

Economic Navigator

Disruption and Division: AI, Inflation, and the Labor Gap

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Executive Summary

- **Q2 and Q3 Economic Growth Assisted by Infrastructure Buildout:** Business spending on transit, information-processing, and defense & space equipment may add roughly 0.5 percentage points to growth.
- **Inflation Set to Improve, but It Depends on Supply Chains:** Federal Reserve (Fed) research shows that trend inflation remained in the 2.5–3.0% range for the 24 months before the Iran war. Once oil shocks fade, inflation will likely return to this range.
- **Job Growth Will Cluster Around Service-Producing Sectors:** During the latter half of this year, we expect the unemployment rate to rise to 4.6%, which is still historically low. Quarterly payroll gains should average 160,000.
- **APPENDIX:** View the supporting charts on rates, oil, trade, and other global macro factors.

Why the Navigator?

The macroeconomic context is a key component of the investment process. Every asset class — whether credit, equities, currencies, commodities, real estate, or infrastructure — responds to the forces shaping the global economy. Inflation trends, interest rate cycles, fiscal and monetary policy shifts, and economic growth trajectories all influence market behavior and risk-adjusted returns. Ignoring these dynamics means missing the bigger picture.

So, what will the drivers of growth be in the remainder of 2026 and what characteristics of growth are worth noting? How will Chairman Warsh lead the Fed and how will it impact policy?

In this edition of the *Economic Navigator*, we provide an update on our expectations for growth, inflation, and unemployment and what it means for businesses and consumers.

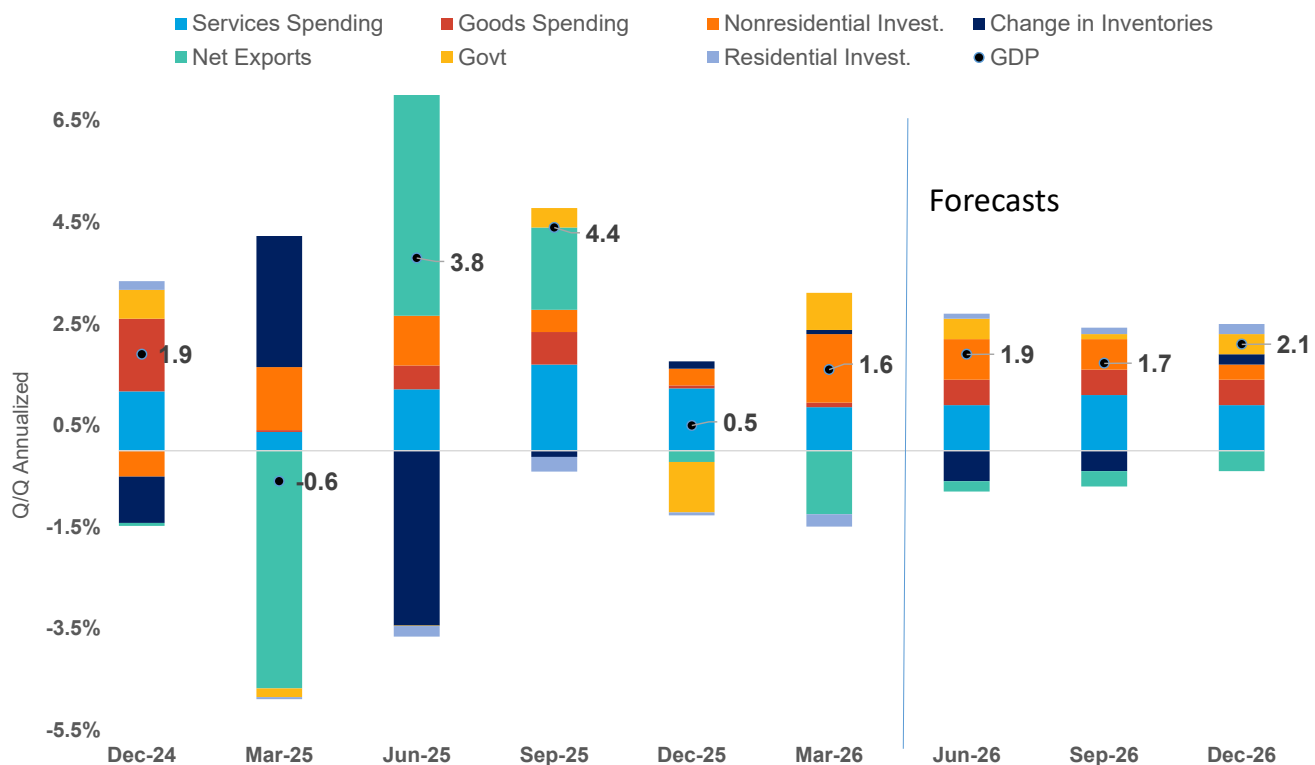
Business Spending on Transit, Information-Processing, and Aerospace Equipment Should Add Roughly 0.8 Percentage Points to Growth

Recession is not in our baseline forecast, but much depends on recent geopolitical events not negatively spilling over into the broader economy. On a positive note, expectations of a coming increase in oil supply are helping offset the current pressures in energy markets. Demand for structural non-residential investment has been a clear pillar of economic growth in recent quarters. This category includes data center construction, oil and gas well drilling, and other non-defense capital goods. These are providing a steady counterbalance to the softer components of gross domestic product (GDP), like the weakness in residential construction. Business spending on equipment related to AI, intellectual property products, and non-residential structures has expanded as firms continue to invest in productivity-enhancing technologies, supply chain resilience, and capacity aligned with longer-term demand trends. This strength has contributed positively to overall output, helping sustain real GDP growth, even as tighter financial conditions have weighed on interest-sensitive sectors.

The latest insights into industrial production illustrate the dispersion within sectors. The strongest areas in the May Industrial Production release were investment- and equipment-related: business equipment, which rose 0.6% in May

and is up 5.7% from a year ago, with transit equipment up 10.4% year over year; information-processing equipment up 8.7%, and defense and space equipment up 7.7%. In contrast, consumer-facing production was weaker: consumer goods fell 0.5% in May and are down 0.6% annually, with durable consumer goods still down 3.0% and automotive products down 5.0%. Automotive products remain a weak underlying category on a year-over-year basis, down 5.0%, despite recent monthly rebounds. The bottom line is industrial activity remains positive but highly uneven, with momentum concentrated in business equipment, high-tech, defense, and mining, while consumer-facing and nondurable categories continue to lag, as highlighted in the “Business Spending May Support Growth” chart.

Business Spending May Support Growth



Source: LPL Research, Bureau of Labor Statistics 06/17/26

Past performance is no guarantee of future results. Economic forecasts may not develop as predicted.

Residential Investment Could Subtract at Least 0.25 Percentage Points From Q2

The month-to-month housing data are immensely volatile, which has drawn a warning from the data collectors. Per Census Bureau FAQs, it may take six months to establish an underlying trend for housing starts. But that said, we normally don't see a plunge like the -15.4% drop that occurred in May housing starts. Other than the sharp decline in early 2024, the last time housing contracted this much was during the onset of the pandemic. What this means for GDP growth projections is residential investment will likely be a drag on growth in Q2. Housing starts for unit structures of five or more fell the most in May as the condo market may be oversupplied after builders were exuberant on the multifamily sector in recent years. Expect to see rent prices decline this year, easing inflationary pressures in housing. Given the slowdown in new housing construction, residential investment will likely drag on GDP

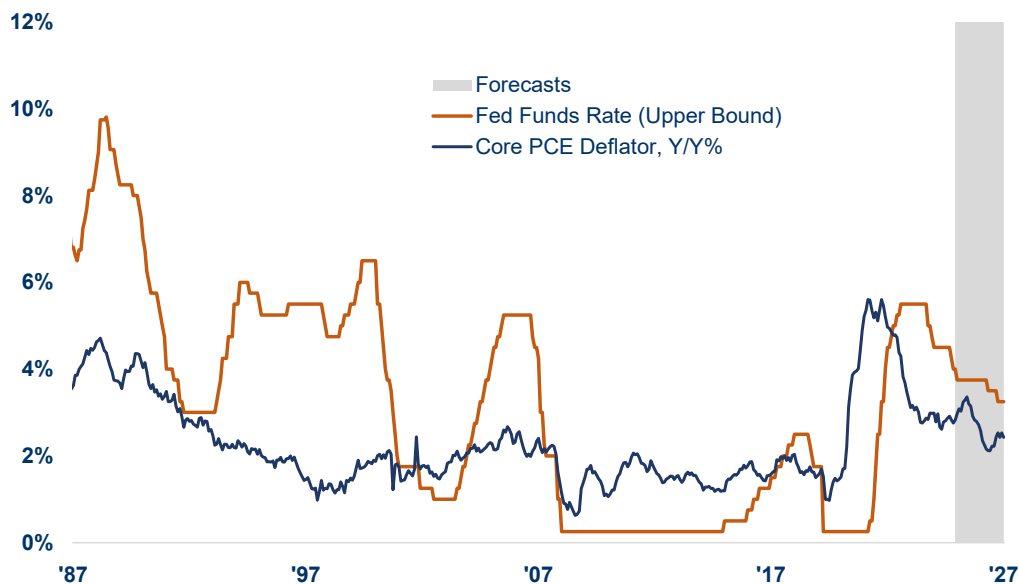
growth this quarter. In Q1, this category subtracted a quarter point from headline GDP, and we could expect something a bit worse for Q2. In sum, we still have a tight housing market. Single-family completions have trended lower each month since October and according to the most recent release, completed projects were the lowest since 2020 and affirm the thesis that policy needs to address the supply side of the housing equation to successfully deal with the affordability crisis in the U.S.

Near-Term Inflation May Stay Above 3%, but Don't Rule Out a December Surprise

Our base case is that inflation pressures should moderate by the end of 2026, if geopolitical tensions ease, because the recent upside pressure has been driven disproportionately by energy and related supply-chain channels rather than by a broad-based reacceleration in underlying inflation. If geopolitical tensions de-escalate meaningfully, energy transit normalizes, and we don't get major amounts of strategic stockpiling, the direct boost to gasoline and utility prices should fade, and the indirect pressure on transportation, freight, and input costs should begin to subside as well. We believe this would take us back to 2.7% core inflation by the end of the year. But that doesn't mean the Fed will be inclined to cut rates, but at least it keeps the Fed from hiking.

Analysis from the Richmond Fed shows that trend inflation has remained in the 2.5–3.0% range since the third quarter of 2023, with housing and food accounting for much of that persistence, while services inflation has continued to fall from its peak.¹ If the geopolitical risk premium embedded in commodity and shipping markets convincingly recedes, the economy should be left dealing mainly with slower-moving domestic categories rather than a fresh, broad-based price shock.

Geopolitical Shocks Keeping Inflation Up, But Expect Improvements By Q4



Source: LPL Research, Bureau of Economic Analysis 06/17/26

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¹ [Are We There Yet? The Road Back to 2 Percent Inflation | Richmond Fed](#)

The Unemployment Rate May Rise to 4.6% but Still Historically Low

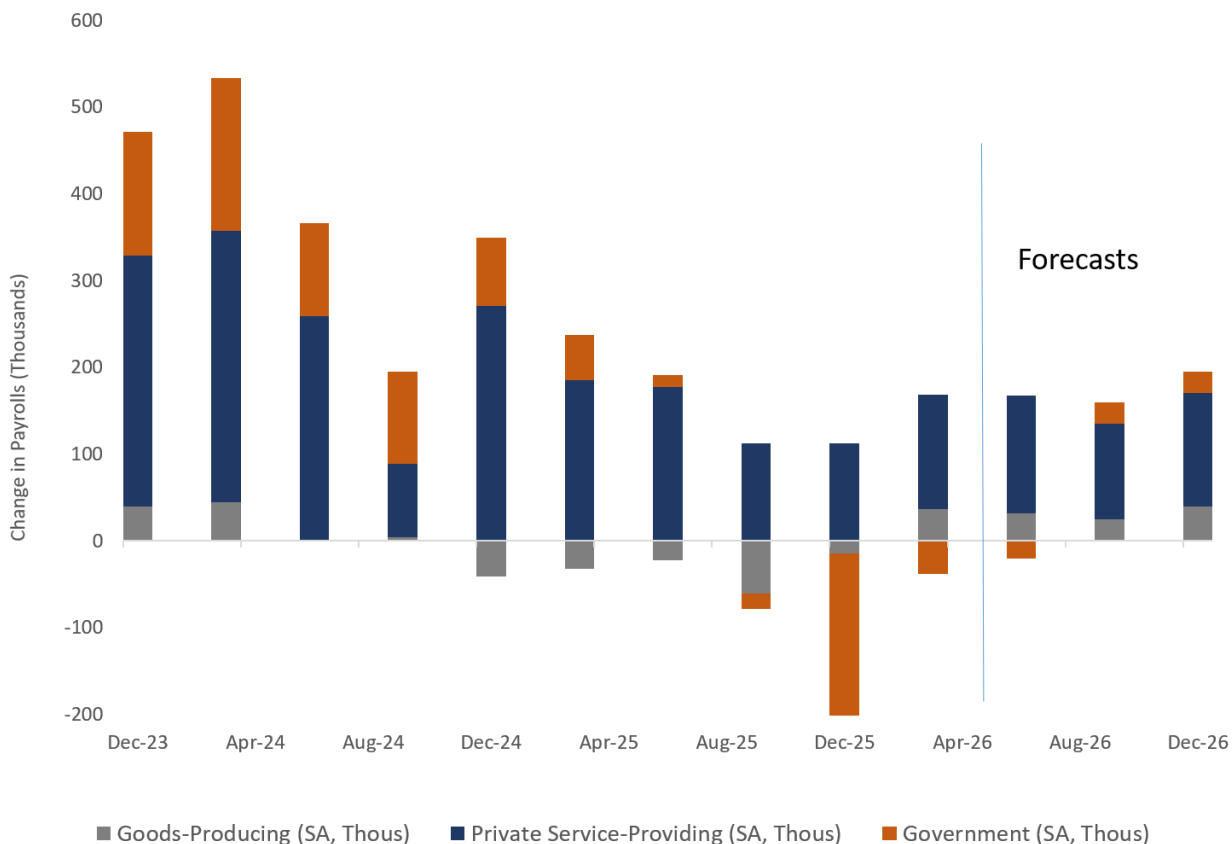
The labor market is still posting a relatively low unemployment rate, mainly because layoffs remain restrained, not because hiring is especially strong. The corporate sector is in a “low-hiring, low-firing, low-quits” equilibrium: firms are hiring more cautiously than in earlier years, but they are also not shedding many workers, which helps keep measured unemployment from rising much. Today’s hiring rate would historically have been associated with a much higher unemployment rate, but the unusually low separation rate is offsetting that pressure.

Another reason unemployment has stayed low is that labor supply growth has slowed sharply. Labor force growth could be near zero because of weaker population growth, lower net immigration, and aging-related declines in participation, meaning the economy needs only modest job growth to keep the unemployment rate steady.

However, if labor force participation starts to edge higher, the unemployment rate can rise mechanically even without a recession. The reason is definitional: the unemployment rate measures the share of the labor force that is jobless but actively looking for work, so people who come off the sidelines and begin searching are added to the labor force and may initially be counted as unemployed until they find a job.

That effect is more important in a labor market like today’s, where hiring is subdued even though firing is also low. In a low-hire environment, an increase in labor supply can temporarily outpace job matching, which would nudge the unemployment rate higher even if overall employment continues to grow.

Job Growth Will Likely Cluster in Service-Providing Sectors



Source: LPL Research, Bureau of Labor Statistics 06/17/26

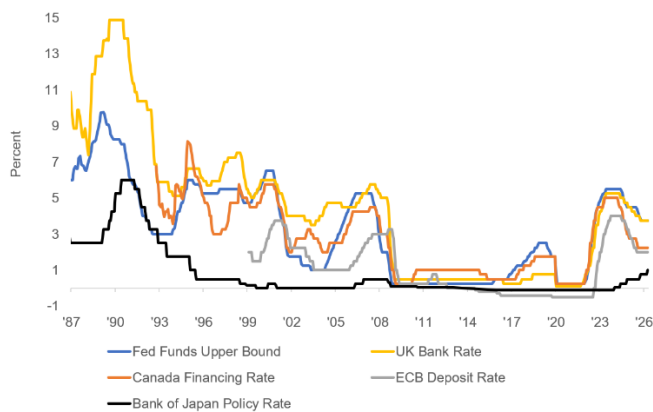
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Key Takeaways

- Growth should moderate but remain positive in the second half, with strong business investment helping offset weakness in housing and other rate-sensitive sectors.
- Spending on AI-related equipment, intellectual property, and nonresidential structures will continue to provide an important cushion for overall activity.
- Elevated household net worth relative to income will continue to provide an important buffer for consumers and help support demand.
- We believe inflation should ease by year-end. We expect inflation to moderate toward 2.9% by the end of 2026 if geopolitical tensions ease meaningfully.
- Unemployment should edge higher but remain historically low, rising to around 4.6% by year-end as hiring stays subdued.

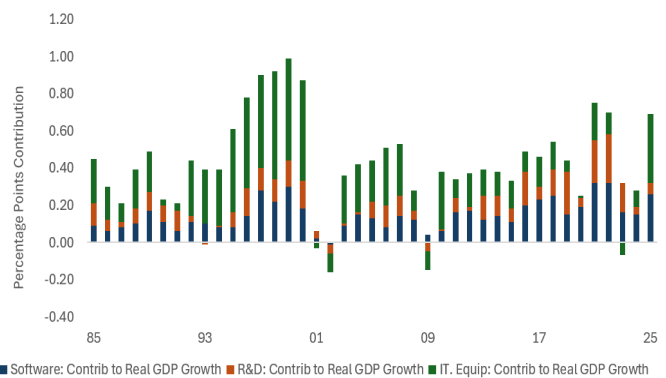
Appendix: Supporting Macro Charts

Bank of Japan Is Playing Catch-Up



Source: LPL Research, BOC, BOE, BOJ, ECB, Federal Reserve Board 06/17/26

There's Room to Go with Infrastructure Buildout



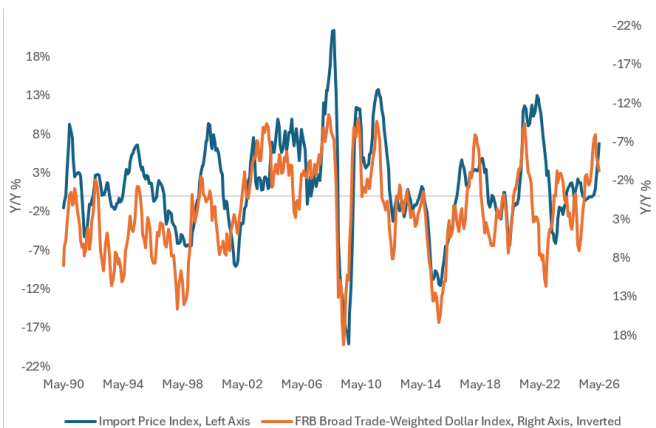
Source: LPL Research, Bureau of Economic Analysis 06/17/26

Net Worth Padding Upper Income People



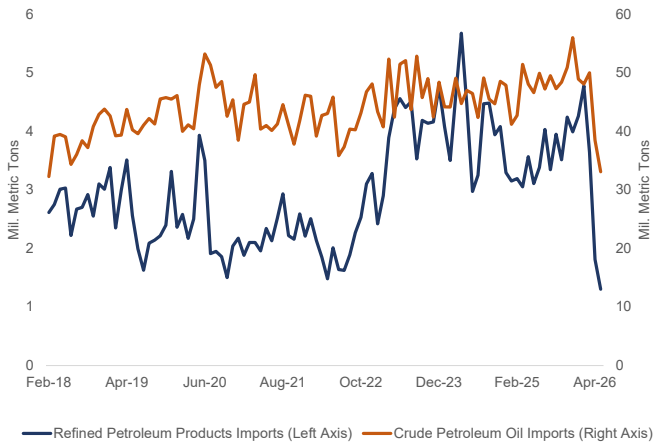
Source: LPL Research, Federal Reserve Board 06/17/26

Stronger Dollar Suppresses Import Prices



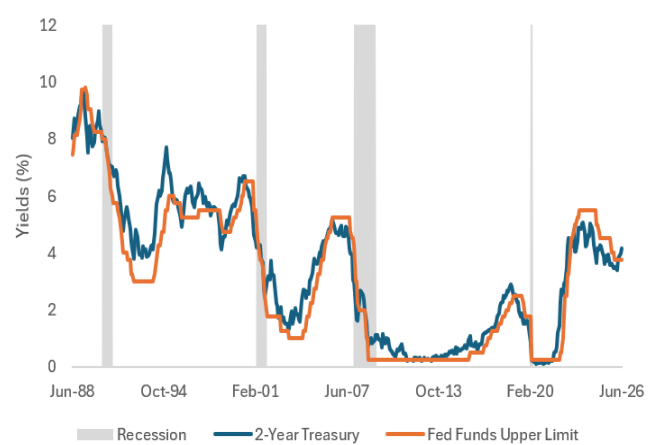
Source: LPL Research, BLS, Federal Reserve Board 06/17/26

Lower Chinese Imports Kept Global Prices At Bay



Source: LPL Research, China General Administration of Customs 06/17/26

Treasuries Rise As Growth Improves



Source: LPL Research, Federal Reserve 06/17/26

Forecasts Imply 2026 May Be a Pivotal Year

	2025				2026				2024	2025	2026
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4			
Growth											
Nominal GDP (Y/Y %)	4.6	4.6	5.4	5.4	5.9	6.4	5.7	5.4	5.3	5.0	5.6
Real GDP (Yr/Yr %)	2.0	2.1	2.3	2.0	2.6	2.1	1.6	2.2	2.8	2.1	2.1
Real GDP (Q/Q Annualized)	-0.7	3.8	4.4	0.5	1.6	1.9	1.7	2.1			
Consumer Spending	0.6	2.5	3.5	1.9	1.4	1.5	1.8	1.8	2.9	2.6	1.7
Government Spending	-1.0	-0.1	2.2	-5.6	4.4	1.0	1.2	1.3	3.8	1.1	2.1
Private Investment	23.3	-13.8	0	2.3	7.0	6.3	7.1	7.8	3.0	1.9	7.2
Exports	0.2	-1.8	9.6	-3.3	13.1	2.5	4.2	5.5	3.6	1.6	11.5
Imports	38	-29.3	-4.4	-1.0	21.4	2.9	6.5	6.2	5.8	2.7	13.6
Real Final Sales to Domestic Purchasers (Q/Q Ann.)	1.4	2.4	2.8	0.6	2.8	2.1	1.9	2.0	3.1	2.4	2.4
Business Sector											
Nonfarm Productivity (Q/Q Annualized)	-0.9	4.2	5.2	1.6	0.3	2.5	4.7	3.1	2.9	2.2	2.0
Corporate Profits After Taxes (Yr/Yr %)	7.5	4.8	10.8	10.2	10.4	7.9	4.2	3.9	3.9	8.4	6.7
Industrial Production (Yr/Yr %)	0.7	0.5	1.7	1.5	0.8	1.2	1.1	1.1	-0.6	1.1	1.1
Consumer											
Real disposable income (Yr/Yr %)	2.0	1.8	1.8	1.0	0.7	1.1	1.4	1.8	2.9	1.7	1.3
Retail Sales (Yr/Yr %)	4.5	4.3	4.4	3.0	3.9	4.0	3.5	4.1	2.6	4.0	3.9
Retail Sales Ex-Autos (Yr/Yr %)	4.3	3.9	4.2	3.7	4.6	3.9	3.4	3.7	2.8	4.0	3.9
Consumer Confidence	99.8	93.1	97.4	94.2	90.7	92.0	95.0	97.0	104.5	96.1	93.7
Light Vehicle Sales (Mil. Units, SAAR)	16.4	16.2	16.5	15.7	15.4	15.1	15.1	15.8	15.9	16.2	15.4
Jobs & Housing											
Unemployment rate (%)	4.1	4.2	4.3	4.5	4.3	4.5	4.6	4.6	4.0	4.3	4.5
Nonfarm Payroll (Change in Thousands)	61	101	70	-116	218	180	150	170	1459	29	180
Housing Starts (Mil. Units)	1.40	1.35	1.35	1.32	1.42	1.25	1.30	1.35	1.37	1.36	1.3
Existing Home Sales (Annualized, Millions)	4.08	4.01	4.04	4.16	4.05	3.24	3.55	4.00	4.06	4.07	3.71
Inflation, Annual											
Consumer Price Index (CPI)	2.7	2.5	2.9	2.7	2.7	3.9	3.4	3.5	3	2.7	3.1
Core CPI	3.1	2.8	3.1	2.7	2.5	3.5	3.2	2.8	3.3	2.9	2.7
PCE Inflation	2.6	2.4	2.7	2.8	3.1	3.7	3.3	2.9	2.6	2.6	3.0
Core PCE Inflation	2.8	2.7	2.9	2.9	3.1	3.5	3.1	2.5	2.9	2.8	3.0
Brent Crude Spot Price (Average, \$)	75.81	68.01	68.97	63.63	80.21	91.00	79.00	75.00	79.86	68.19	81.30
Rates											
Fed Funds (% Upper Bound, Period End)	4.50	4.50	4.25	3.75	3.75	3.75	3.75	3.75	4.50	4.25	3.75
Mortgage Rates (30-year Fixed, Period End)	6.79	6.77	6.39	6.27	6.56	6.50	6.45	6.35	6.49	6.60	6.465

Source: LPL Research, Federal Reserve Bank of Philadelphia, Bloomberg 06/17/26

Disclosures: Past performance is no guarantee of future results. Forecasts may not materialize as predicted and are subject to change. Shaded areas are forecasts and are subject to change as additional data is published.

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All index data from FactSet.

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