U.S. Economic Comment

- Dissents at the July FOMC meeting: the Committee remains united in a return to price stability, but the 9-3 vote – and subsequent statements by dissenters – illustrate perhaps differing approaches to achieving that aim
- Updated monetary policy forecast: we project that the FOMC will remain on hold through year-end 2026, with policymakers enacting marginal easing in early 2027
- Employment Cost Index: little indication of upside inflation risks from the labor market

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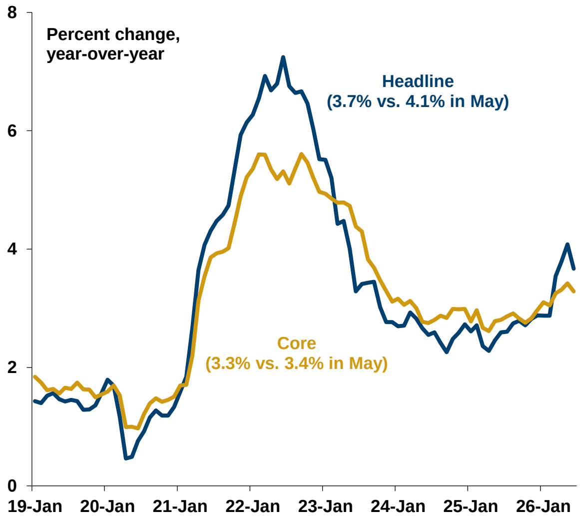
A Period of "Watchful Thinking" at the Warsh Fed

Earlier today all three dissenters from the FOMC's policy action this week released statements outlining reasons for their objections to maintaining the target range for the federal funds rate at 3-1/2 to 3-3/4 percent. Neel Kashkari, President of the Federal Reserve Bank of Minneapolis, noted that monetary policy is best deployed to address demand-driven inflation, although policymakers "face greater trade-offs" when it is deployed to address supply shocks. As such, it is often appropriate to hold fire in response to one-off supply shocks and allow for a transient inflationary impulse to fade on its own. With that standard approach acknowledged, he drew a parallel between the current period of high inflation and the 1970's, noting that price pressure in both instances were "largely the result of a series of successive supply shocks." Further, he recognized that there were distinct differences between then and now, but expressed a preference toward a series of incremental adjustments to the federal funds rate as a hedge "against the risk that high inflation could become entrenched." Beth Hammack of the Cleveland Fed expressed perhaps more pressing concerns, arguing that "Inflation has remained stubbornly above 2 percent for more than five years, and I am not confident it will return to our objective on its own." Moreover, she saw inflation as currently "the more pressing problem" (than possible downside risks facing the labor market) and argued that she "did not see the current policy stance as appropriately restrictive." Lorie Logan, President of the Federal Reserve Bank of Dallas, adopted elements of other critiques. She observed that "Labor, consumption and financial market conditions indicate that monetary policy is not restraining the economy," which was aligned with President Hammack's view, while also suggesting that inflation would not recede sans hikes absent an "unanticipated shock." And, as a remedy, she echoed President Kashkari's view regarding the potential path of interest rates: "Modest action in the near term would reduce the likelihood of needing to take sharper action later."

Chairman Warsh shared his colleagues' concern about the persistent overshoot of inflation (see chart on the PCE price index, next page, left), and early in his press conference summarized salient considerations in addressing the problem. In short, he noted: "the implications of the past five years of high inflation on the current policy "conjuncture"; "the economic shocks of recent years" and their effects on output and employments; "price increases arising" from aforementioned shocks; and available "tools and strategies." What differed, in our view, was his approach to addressing those considerations. Mr. Warsh emphasized as a key development in the intermeeting period the notable increase in real rates (chart, next page, right) and appeared heartened that it not only signaled a market reaction to economic events (versus prior responses wherein he perceived markets reacting to forward guidance) but also acted to constrain aggregate demand. In essence, financial conditions tightened without the Committee needing to hike interest rates. Moreover, he was quick to add that the policy hold was simply an inertial response: "my own judgment is this is a period of watchful thinking, not watchful waiting." Thus, he – and the majority of the Committee – did not dismiss key considerations informing current inflation dynamics but sought to further probe the questions (which likely involves receiving feedback from task forces) and await additional data (two full cycles of inflation and employment releases ahead of the September 15-16 FOMC meeting).

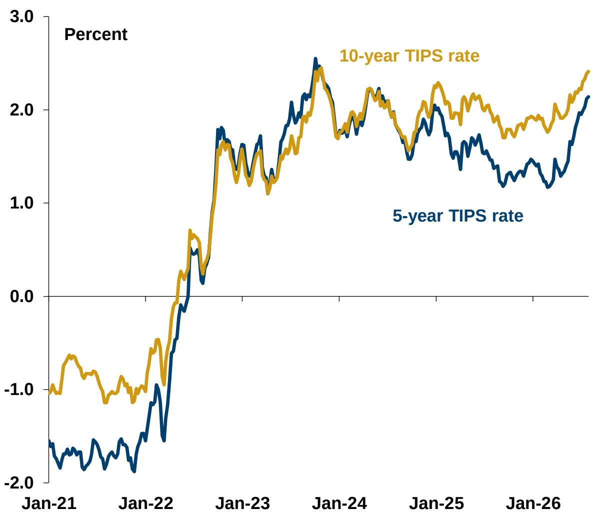
PCE Price Index*



** PCE = personal consumption expenditures*

Source: Bureau of Economic Analysis via Haver Analytics

Real Interest Rates*



** Weekly average data except for the latest observations which are daily quotes from July 30, 2026.*

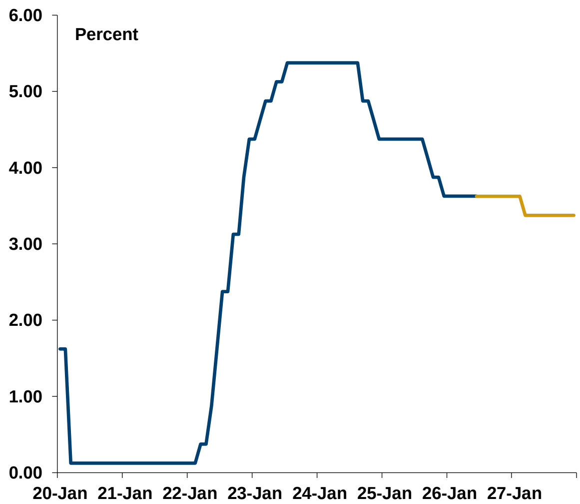
Source: Federal Reserve Board via Haver Analytics

(For the entirety of the cited remarks, please see: Kashkari, Neel, “Statement on My FOMC Dissent,” Federal Reserve Bank of Minneapolis, July 31, 2026. https://www.minneapolisfed.org/article/2026/statement-on-my-fomc-dissent; Hammack, Beth M. “Statement from Federal Reserve Bank of Cleveland president Beth Hammack regarding her vote at the Federal Open Market Committee’s July 28–29 meeting,” July 31, 2026, Federal Reserve Bank of Cleveland. https://www.clevelandfed.org/collections/speeches/2026/sp-20260731-statement-regarding-july-fomc-meeting-vote; Logan, Lorie, “Statement from Dallas Fed President Lorie Logan on FOMC dissent,” July 31, 2026, Federal Reserve Bank of Dallas. https://www.dallasfed.org/news/releases/2026/nr260731dissent; “Transcript of Chairman Warsh’s Press Conference,” July 29, 2026, Federal Reserve Board. https://www.federalreserve.gov/mediacenter/files/FOMCpresconf20260729.pdf)

Daiwa’s Revised Call

In light of the evolution of events surrounding this week’s FOMC meeting, along with ongoing heightened uncertainty generated by the conflict in the Middle East and its implications for energy prices – not to mention a new round of tariffs recently announced by the Trump administration -- we can no longer reasonably expect as a baseline the FOMC to reduce interest rates this year. Thus, while we maintain an easing bias in our forecast, we now look for the Committee to remain on hold over the final three meetings of 2026 (year-end 2026 target range of 3-1/2 to 3-3/4 percent; versus the prior expectation of a cut of 25 basis points in December coupled with a second cut in March 2027). That said, we currently foresee a combination of easing inflation (which we expect to gather force in the second half of the year, barring further escalation with Iran) and additional softening in underlying labor market conditions to pave the way for a modest reduction in early 2027 -- adjusting the policy rate from slightly restrictive to within the range of neutral (-25 basis points in March 2027, with a year-end 2027 target range of 3-1/4 to 3-1/2 percent; chart, right).

Federal Funds Target Rate*

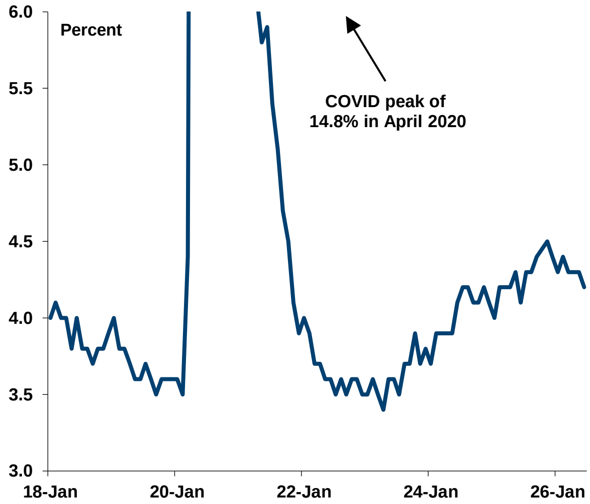


** The gold line shows the projected path of the federal funds rate through year-end 2027.*

Sources: Federal Reserve Board via Haver Analytics; Daiwa Capital Markets America

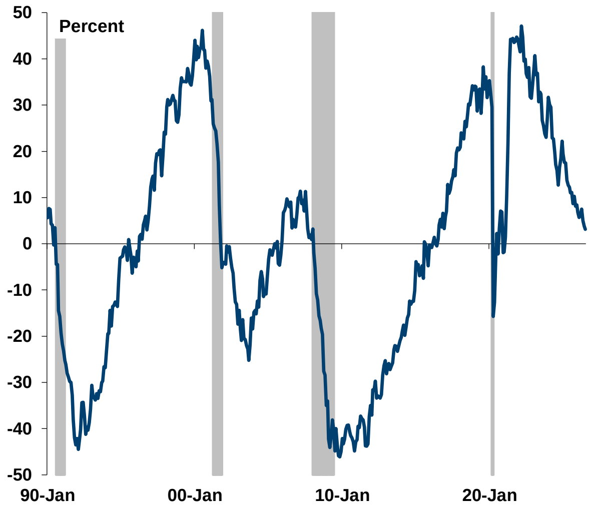
Even amid a revision to our forecast, however, we remain attuned to downside risks to the labor market. The unemployment rate is currently low at 4.2 percent (chart, below left), but we suspect that metric obscures to a degree deterioration in underlying employment conditions. Private-sector job growth is currently narrowly based, and workers perceive hiring conditions to be exceptionally challenging. On the latter point, the labor market differential from the Conference Board's Consumer Confidence Survey (share of survey respondents indicating jobs are plentiful less the share noting that they are hard-to-get) slid to its lowest level since February 2021 – a period when the economy was healing from the effects of the COVID pandemic (chart, below right). In reviewing these developments, we are left to wonder when modest hiring will transition to layoffs – which could develop rapidly in the event of a shock (or even recalibration by businesses in a challenging environment). Therefore, we still see the bar to rate hikes as higher than those for modest cuts at the margin to shift policy into a neutral posture.

Unemployment Rate



Source: Bureau of Labor Statistics via Haver Analytics

Labor Market Differential*



** The share of survey respondents who say jobs are "plentiful" less those who say they are "hard to get." The shaded areas indicate periods of recession in the United States.*

Sources: The Conference Board, National Bureau of Economic Research via Haver Analytics

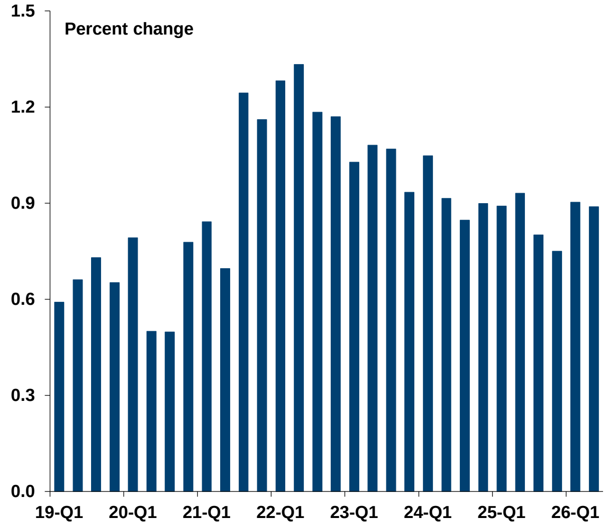
The above said, we readily admit that forecasting the path of monetary policy in the current environment is a fraught exercise. We have little insight into how day-to-day developments related to the Iran conflict will unfold, or whether President Trump will send markets into disarray with some late-night post on social media. Even so, one scenario to which we assign little weight is a "one-and-done" hike that has garnered some discussion in the financial press. We saw some commentary both preceding and following this week's FOMC meeting suggesting that the Committee should raise the target range to perhaps surprise the market or pacify those concerned that the Fed Chairman's hawkish rhetoric will not be backed by decisive action. In listening to the Chairman's remarks, which dismissed a singular semi-favorable PCE read and argued that monetary policy must separate signal from noise and respond to trends in the data, or those of dissenting colleagues (two of which explicitly cited series of modest hikes), a single hike appears unlikely.

Employment Cost Index: Little Indication of Upside Inflation Risks from the Labor Market

While the current inflation situation is highly uncertain, one variable is decidedly no longer a concerning source of potential pressure. With demand for labor having fallen sharply and the market in equilibrium, growth in total compensation has moderated to a level we view as consistent with 2 percent inflation over time (which we view as compensation growth below approximately four percent; the sum of the inflation target and our assessment of trend productivity, which acts as a buffer against higher costs). On the point, the release of the Employment Cost Index for Q2 rose 0.9 percent (not annualized) – one tick faster than the median forecast of +0.8 percent from the Bloomberg economist survey but a favorable reading nonetheless. On a year-over-year basis, the headline ECI rose 3.4 percent, essentially unchanged from the Q1 read but well off the recent high of +5.1 percent in 2022-Q2 – indicative of the unwinding of previously tight labor market conditions.

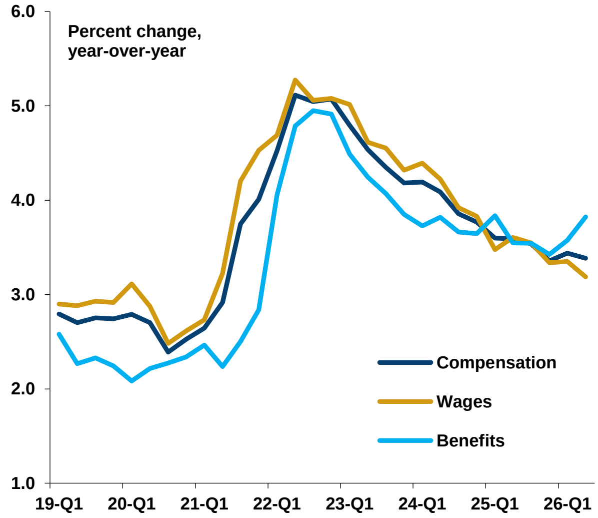
Parsing the data, wages and salaries, one of two key components of the ECI, advanced a similar-sized 0.9 percent in Q2. The year-over-year advance, correspondingly, slowed to 3.2 percent from 3.4 percent in Q1 and the recent high of 5.3 percent in 2022-Q2. Benefits costs, meanwhile, rose 1.0 percent (versus +1.2 percent in Q1 and the 2025 average of +0.8 percent). The year-over-year advance, in turn, accelerated to 3.8 percent – up about 0.2 percentage point from the 3.6 percent observation in the prior quarter but still well off the recent high of 4.9 percent in 2022-Q3 (charts, below).

Employment Cost Index



Source: Bureau of Labor Statistics via Haver Analytics

Employment Cost Index



Source: Bureau of Labor Statistics via Haver Analytics

In context, the ECI, while lagged versus average hourly earnings from the Employment Situation report (quarterly versus monthly release; July data due next Friday), is among the best measures of compensation growth and thus favored by Fed officials in tracking pay trends and implications for inflation. Specifically, the measure is preferable on account of it being fixed-weight, which prevents it from being subject to compositional shifts in hiring that affects metrics like average earnings. With that in mind, the latest reading -- while a bit firmer than expected – provides a reliable (and favorable view) that the labor market is no longer generating undesirable price pressure, a welcome development given the multitude of current risks.

Note to readers:

The next issue of the U.S. Economic Comment will be published on August 14, 2026.

The Week Ahead

ISM Manufacturing (July) (Monday)
Forecast: 53.0% (-0.3 pct. pt.)

Despite uncertainty generated by ongoing tensions in the Middle East and the Trump administration's trade (tariff) agenda, the factory sector has performed well in 2026 – with the Institute for Supply Management's manufacturing PMI indicating expansion for six consecutive months after remaining mired in contraction for much of the past few years. While conditions are expected to ease somewhat in July (led by anticipated cooling in the supplier deliveries and new orders indexes), the projection would still leave the metric in line with the 26-H1 average of 53.0 percent.

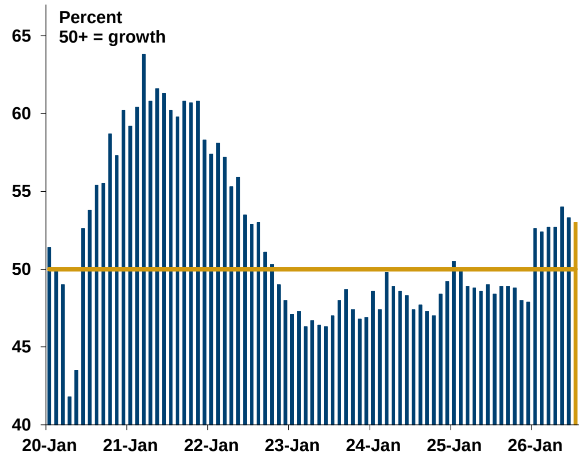
Construction Spending (June) (Monday)
Forecast: +0.1%

Following a 19.0 percent surge in housing starts (influenced entirely by a jump in multi-family units), private residential construction could tilt higher for the fourth consecutive month in June. Concurrently, government-sponsored building has essentially flattened after trending sharply higher earlier in the expansion and business-related activity has cooled steadily since surging to a record high in late 2024 – performances we expect to be maintained in the latest report.

Trade Balance (June) (Tuesday)
Forecast: -$73.5 billion ($4.1 billion narrower deficit)

The goods deficit narrowed by $4.4 billion to $101.5 billion in June (Census basis; published July 28), reflecting a drop in the dollar value of imports (-$8.2 billion or -2.6 percent) that exceeded one for exports (-$3.8 billion or -1.8 percent). This shift implies similar improvement for the total trade shortfall in June, with the expected change, if realized, following net widening of $21.0 billion in the prior two months. Reported trade flows for Q2 thus far equated to a drag of 1.01 percentage points from net exports on GDP growth, reflecting ongoing brisk imports. The contribution of net exports to growth will likely be tweaked after the release of next week's report, although anticipate that the impact on currently reported figures will be relatively modest.

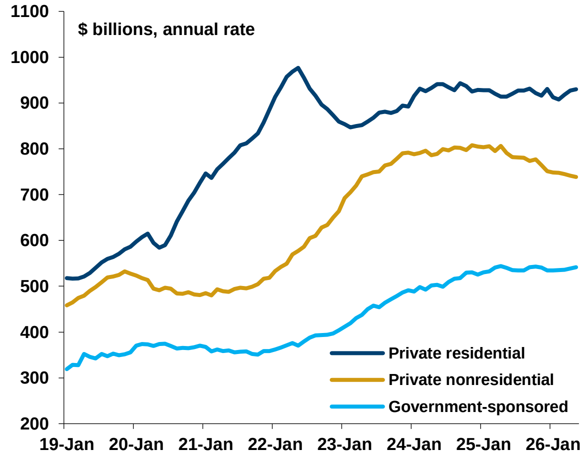
ISM Manufacturing Index*



** The gold bar is a forecast for July 2026.*

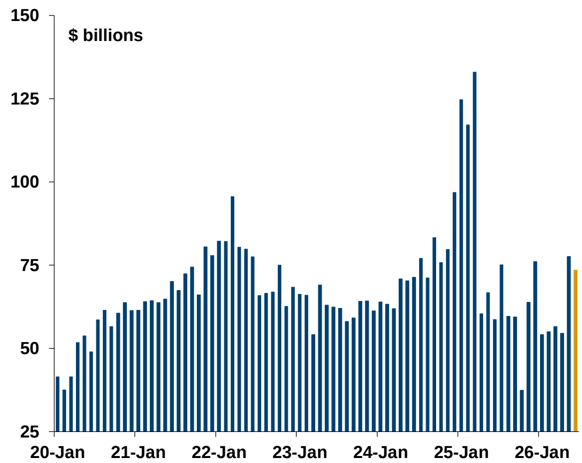
Sources: Institute for Supply Management via Haver Analytics; Daiwa Capital Markets America

Value of Construction Put in Place



Source: U.S. Census Bureau via Haver Analytics

Nominal Trade Deficit in Goods & Services*



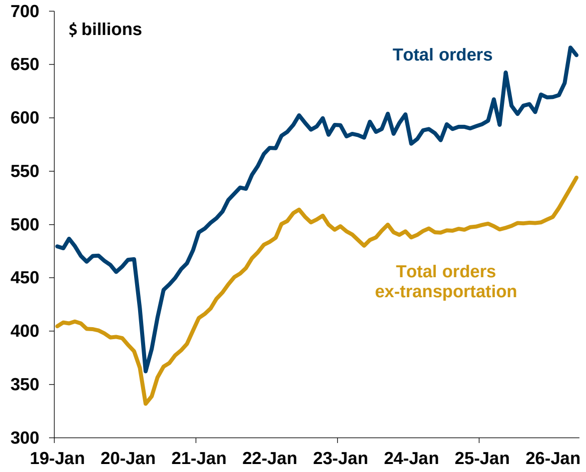
** The gold bar is a forecast for June 2026.*

Sources: Bureau of Economic Analysis via Haver Analytics; Daiwa Capital Markets America

Factory Orders (June) (Tuesday)
Forecast: -0.5%

Shifts in total manufacturers' bookings typically reflect wide swings in the often-volatile transportation category (range of -13.5 to +22.4 percent in the past six months). That trend is likely to take a breather in June, however, with this area easing only 0.2 percent (reflective of an increase in the nondefense aircraft subcategory being offset by declines in defense aircrafts and autos). Excluding transportation, factory orders have tilted higher on balance over the past year (+2.5 percent year-over-year as of May 2026). Preliminary shipments data released with the Advance Report on Durable Goods on July 27 indicate a decrease of 1.3 percent in the nondurable area.

Manufacturers' New Orders

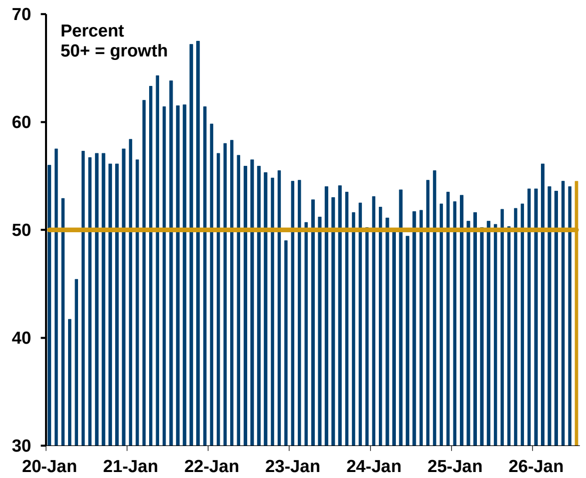


Source: U.S. Census Bureau via Haver Analytics

ISM Services (July) (Wednesday)
Forecast: 54.5% (+0.5 pct. pt.)

Similar to its manufacturing counterpart, the Institute for Supply Management's services PMI is likely to highlight firms' resilience in a challenging business climate, with July's projected increase, if realized, leaving the metric in expansion for the 25th consecutive month. Our estimate would reflect some retracement in the business activity and new orders indexes after declines in June. Conversely, we could envision some reversal for employment after last month's seemingly outsized increased pushed the index back into expansion territory (+3.3 percentage points to 51.2 percent), thus providing a partial offset.

ISM Services Index*



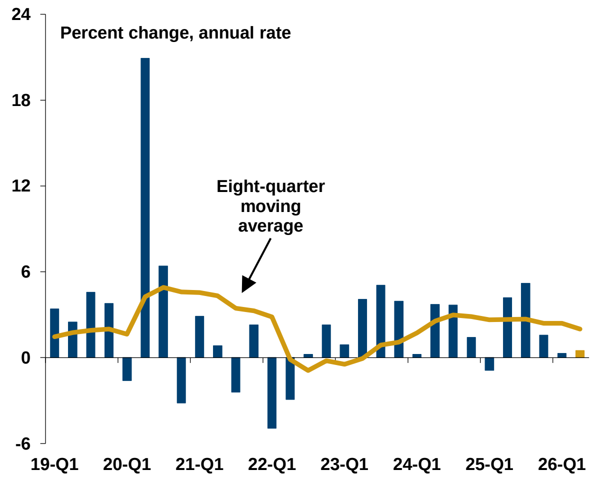
** The gold bar is a forecast for July 2026.*

Sources: Institute for Supply Management via Haver Analytics; Daiwa Capital Markets America

Nonfarm Productivity (2026-Q2) (Thursday)
Forecast: +0.5%

The output measure that feeds into the calculation of nonfarm productivity posted respectable growth in Q2 (nonfarm gross value added; +1.7 percent, annual rate), with available data indicating that hours worked also picked up. Thus, productivity growth appears poised to remain on a growth trajectory in Q2, albeit at a slower pace than the trailing eight-month average of +2.4 percent. (We offer a longer-term view to get a sense of underlying trend, as the measure exhibits significant quarter-to-quarter volatility.) Furthermore, the projected increase in productivity, along with available data on compensation growth, points to unit labor costs firming from the +1.8 percent, annual rate, pace in the prior quarter (projection of +2.0 percent).

Nonfarm Productivity*



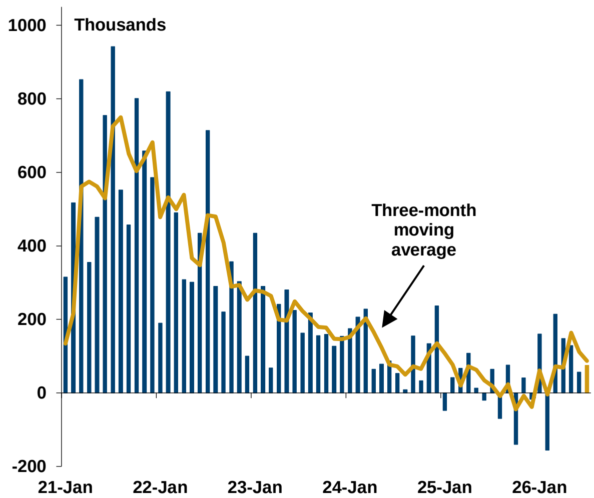
** The gold bar is a forecast for 2026-Q2.*

Sources: Bureau of Labor Statistics via Haver Analytics; Daiwa Capital Markets America

Payroll Employment (July) (Friday)
Forecast: +75,000

After showing signs of firming earlier in the spring (possibly as a short-term recovery after weather-related disruptions in hiring in the winter), topline payroll growth of 57,000 in June 2026 was, in our view, consistent with the prior narrative of a lackluster steady-state. Moreover, results in the prior two months were revised lower by a combined 74,000, with the trailing three-month average of 164,000 favorable but somewhat less so than the previously reported brisk pace of 188,000. Turning to July, while we expect payroll growth to accelerate a bit from the prior month, it would still reflect a subdued pace of hiring. Consequently, that less-than-vigorous pace could facilitate the unemployment rate returning to 4.3 percent after a low side reading in the prior month. With respect to wages, average hourly earnings could register an advance in line with the trailing 12-month average of +0.3 percent (associated with a year-over-year increase of 3.5 percent, essentially unchanged from June).

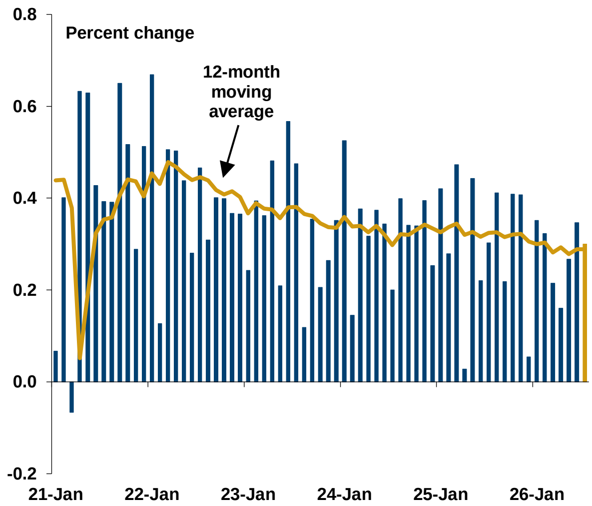
Change in Nonfarm Payrolls*



** The gold bar is a forecast for July 2026.*

Sources: Bureau of Labor Statistics via Haver Analytics; Daiwa Capital Markets America

Average Hourly Earnings*



** The gold bar is a forecast for July 2026.*

Sources: Bureau of Labor Statistics via Haver Analytics; Daiwa Capital Markets America

Economic Indicators

July/August 2026

Monday	Tuesday	Wednesday	Thursday	Friday
27	28	29	30	31
DURABLE GOODS ORDERS Apr 8.5% May -4.0% June 0.3%	**INTERNATIONAL TRADE IN GOODS** Apr -$82.2 billion May -$105.9 billion June -$101.5 billion **ADVANCE INVENTORIES** Wholesale / Retail Apr 0.7% 0.7% May 0.3% 0.5% June 0.3% 0.0% **FHFA HOUSE PRICE INDEX** Mar 0.1% Apr -0.1% May 0.3% **S&P COTALITY CASE-SHILLER 20-CITY HOME PRICE INDEX** Mar -0.1% Apr 0.0% May 0.1% **CONFERENCE BOARD CONSUMER CONFIDENCE** May 90.6 June 92.2 July 90.8 **FOMC MEETING (FIRST DAY)**	**FOMC RATE DECISION**	**UNEMPLOYMENT CLAIMS** Initial / Continuing (millions) July 4 0.217 1.798 July 11 0.209 1.789 July 18 0.188 1.782 July 25 0.197 N/A **GDP** GDP / Chained Price 25-Q4 0.5% 3.7% 26-Q1 2.1% 3.6% 26-Q2(a) 1.5% 6.2% **PERSONAL INCOME, CONSUMPTION, AND CORE PRICE INDEX** Inc. / Cons. / Core Apr 0.1% 0.5% 0.2% May 0.7% 0.9% 0.3% June 0.2% 0.3% 0.1%	**EMPLOYMENT COST INDEX** Comp. / Wages 25-Q4 0.7% 0.7% 26-Q1 0.9% 0.8% 26-Q2 0.9% 0.9% **MNI CHICAGO BUSINESS BAROMETER** May 62.7 June 56.7 July 57.6 **CONSUMER SENTIMENT** June 49.5 July(p) 54.4 July(r) 55.2
3	4	5	6	7
ISM MFG. INDEX (10:00) Index / Prices May 54.0 82.1 June 53.3 73.0 **July 53.0 68.5** **CONSTRUCTION (10:00)** Apr 0.3% May 0.1% **June 0.1%** **VEHICLE SALES** May 16.1 million June 16.6 million **July 16.3 million**	**TRADE BALANCE (8:30)** Apr -$54.6 billion May -$77.6 billion **June -$73.5 billion** **FACTORY ORDERS (10:00)** Apr 5.3% May -1.1% **June -0.5%** **JOLTS DATA (10:00)** Openings (000) / Quit Rate Apr 7,585 1.9% May 7,594 1.9% June -- --	**ISM SERVICES INDEX (10:00)** Index / Prices May 54.5 71.3 June 54.0 67.7 **July 54.5 64.0**	**UNEMP. CLAIMS (8:30)** **PRODUCTIVITY & COSTS (8:30)** Productivity / Unit Labor Costs 25-Q4 1.6% 2.1% 26-Q1 0.3% 1.8% **26-Q2 0.5% 2.0%** **WHOLESALE TRADE (10:00)** Inventories / Sales Apr 0.7% 2.2% May 0.3% 3.4% **June 0.3% 2.9%**	**EMPLOYMENT REPORT (8:30)** Payrolls / Un. Rate May 129,000 4.3% June 57,000 4.2% **July 75,000 4.3%** **CONSUMER CREDIT (3:00)** Apr $20.8 billion May -$0.2 billion June --
10	11	12	13	14
	NFIB SMALL BUSINESS OPTIMISM INDEX **EXISTING HOME SALES**	**CPI** **FEDERAL BUDGET**	**UNEMP. CLAIMS** **PPI**	**RETAIL SALES** **CONSUMER SENTIMENT** **BUSINESS INVENTORIES**
17	18	19	20	21
EMPIRE MFG **NAHB HOUSING INDEX** **TIC FLOWS**	**HOUSING STARTS** **IMPORT/EXPORT PRICES** **IP & CAP-U** **PENDING HOME SALES**	**FOMC MINUTES**	**UNEMP. CLAIMS** **PHILLY FED INDEX** **LEADING INDICATORS**	

(a) = advance (1st estimate of GDP), (p) = preliminary, (r) = revised

Forecasts in bold.

Treasury Financing

July/August 2026

Monday	Tuesday	Wednesday	Thursday	Friday
27	28	29	30	31
AUCTION RESULTS: Rate Cover 13-week bills 3.815% 3.06 26-week bills 3.945% 3.12 2-yr notes 4.315% 2.66 5-yr notes 4.408% 2.28	**AUCTION RESULTS:** Rate Cover 6-week bills 3.700% 2.93 7-yr notes 4.473% 2.49 **ANNOUNCE:** $72 billion 17-week bills for auction on July 29 $110 billion 4-week bills for auction on July 30 $100 billion 8-week bills for auction on July 30 **SETTLE:** $72 billion 17-week bills $110 billion 4-week bills $100 billion 8-week bills	**AUCTION RESULTS:** Rate Cover 17-week bills 3.875% 3.04 Spread Cover 2-yr FRNs 0.050% 3.37	**AUCTION RESULTS:** Rate Cover 4-week bills 3.630% 2.80 8-week bills 3.675% 2.74 **ANNOUNCE:** $171 billion 13-,26-week bills for auction on Aug 3 $95 billion 6-week bills for auction on Aug 4 $52 billion 52-week bills for auction on Aug 4 **SETTLE:** $171 billion 13-,26-week bills $95 billion 6-week bills	**SETTLE:** $21 billion 10-year TIPS $69 billion 2-year notes $70 billion 5-year notes $44 billion 7-year notes $30 billion 2-year FRNs
3	4	5	6	7
AUCTION: $171 billion 13-,26-week bills	**AUCTION:** $95 billion 6-week bills $52 billion 52-week bills **ANNOUNCE:** $72 billion* 17-week bills for auction on Aug 5 $110 billion* 4-week bills for auction on Aug 6 $100 billion* 8-week bills for auction on Aug 6 **SETTLE:** $72 billion 17-week bills $110 billion 4-week bills $100 billion 8-week bills	**AUCTION:** $72 billion* 17-week bills **ANNOUNCE:** $58 billion* 3-year notes for auction on Aug 11 $42 billion* 10-year notes for auction on Aug 12 $25 billion* 30-year bonds for auction on Aug 13	**AUCTION:** $110 billion* 4-week bills $100 billion* 8-week bills **ANNOUNCE:** $171 billion* 13-,26-week bills for auction on Aug 10 $95 billion* 6-week bills for auction on Aug 11 **SETTLE:** $171 billion 13-,26-week bills $95 billion 6-week bills $52 billion 52-week bills	
10	11	12	13	14
AUCTION: $171 billion* 13-,26-week bills	**AUCTION:** $95 billion* 6-week bills $58 billion* 3-year notes **ANNOUNCE:** $72 billion* 17-week bills for auction on Aug 12 $110 billion* 4-week bills for auction on Aug 13 $100 billion* 8-week bills for auction on Aug 13 **SETTLE:** $72 billion* 17-week bills $110 billion* 4-week bills $100 billion* 8-week bills	**AUCTION:** $72 billion* 17-week bills $42 billion* 10-year notes	**AUCTION:** $110 billion* 4-week bills $100 billion* 8-week bills $25 billion* 30-year bonds **ANNOUNCE:** $171 billion* 13-,26-week bills for auction on Aug 17 $95 billion* 6-week bills for auction on Aug 18 $16 billion* 20-year bonds for auction on Aug 19 $8 billion* 30-year TIPS for auction on Aug 20 **SETTLE:** $171 billion* 13-,26-week bills $95 billion* 6-week bills	
17	18	19	20	21
AUCTION: $171 billion* 13-,26-week bills **SETTLE:** $58 billion* 3-year notes $42 billion* 10-year notes $25 billion* 30-year bonds	**AUCTION:** $95 billion* 6-week bills **ANNOUNCE:** $72 billion* 17-week bills for auction on Aug 19 $110 billion* 4-week bills for auction on Aug 20 $100 billion* 8-week bills for auction on Aug 20 **SETTLE:** $72 billion* 17-week bills $110 billion* 4-week bills $100 billion* 8-week bills	**AUCTION:** $72 billion* 17-week bills $16 billion* 20-year bonds	**AUCTION:** $110 billion* 4-week bills $100 billion* 8-week bills $8 billion* 30-year TIPS **ANNOUNCE:** $171 billion* 13-,26-week bills for auction on Aug 24 $95 billion* 6-week bills for auction on Aug 25 $69 billion* 2-year notes for auction on Aug 25 $70 billion* 5-year notes for auction on Aug 26 $44 billion* 7-year notes for auction on Aug 27 $28 billion* 2-year FRNs for auction on Aug 26 **SETTLE:** $171 billion* 13-,26-week bills $95 billion* 6-week bills	

**Estimate*