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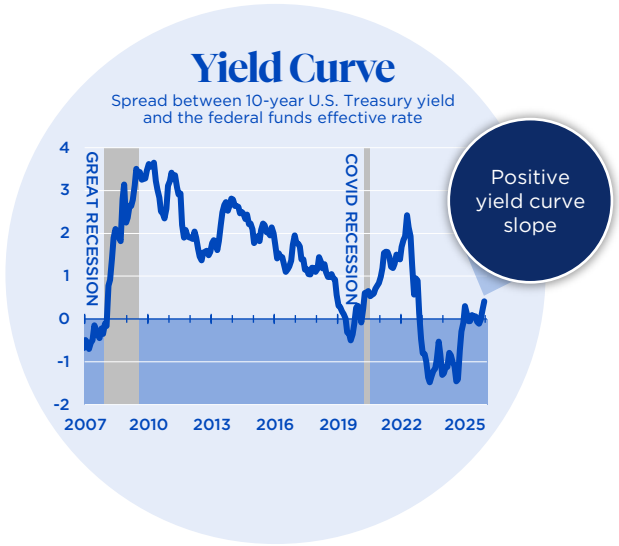
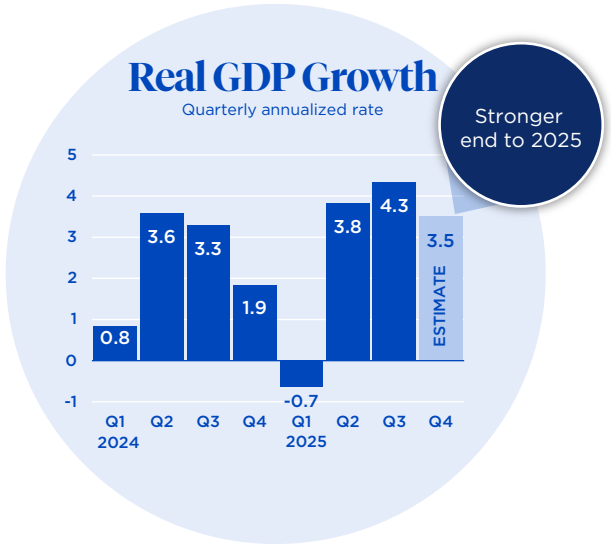
Economic & Financial Markets Monthly Review | January 2026

The economy shows consistent growth

Where is the economy now?

The U.S. economy opens 2026 with firm momentum from 2025. The labor market has softened but appears to be in balance while many businesses are ramping up investment plans for 2026, fed by stimulative tax incentives and anticipated reduction in uncertainty despite the recent spike in geopolitical tensions. After lowering rates several times over the second half of 2025, the Fed is prepared to pause in early 2026 before resuming rate cuts around mid-year.





Where we are this month

Optimism building for 2026 growth

Real GDP growth appears to be stronger than expected at the end of 2025, underpinned by consumer spending and net exports. With fiscal stimulus and looser monetary policy in 2026, estimates for growth this year are rising.

What does this mean

- While policy uncertainty remains high, we believe peak uncertainty is in the rearview mirror, supporting more consistent economic activity in 2026. Larger individual tax refunds and enhanced business incentives will support growth despite lagging hiring conditions.
- Against this backdrop, we expect the Fed to pause interest rate declines over the first half of 2026. But there is likely to be a few cuts later in the second half of 2026.

Yield curve steady as Fed signals pause

Long-term interest rates have edged up in recent weeks, reflecting spillover impact from a jump in Japanese bond yields and a modest reduction in market expectations for rate cuts this year.

- Yields on 10-year Treasury notes climbed above 4.2 percent on the heels of higher Japanese bond yields and a more normalized yield curve. We expect 10-year yields to remain above 4.0 percent, allowing the yield curve to steepen further over the course of 2026.
- Credit spreads entered 2026 historically tight as markets price in upbeat earnings growth expectations. Tight spreads also reflect the market's view of lower risks to the economic outlook.

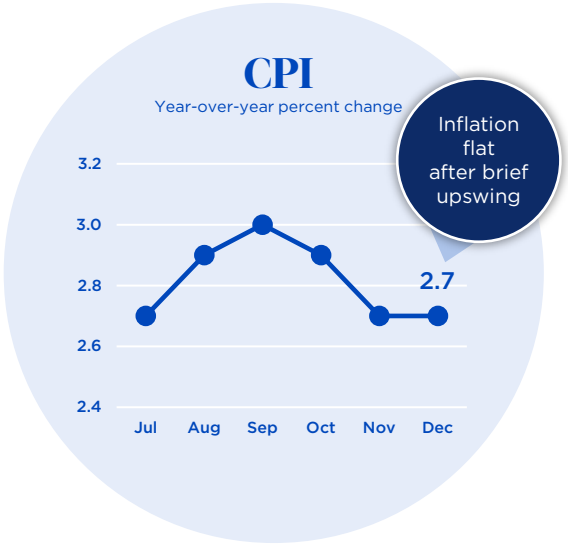
Growth surges past expectations

Economic growth beat expectations over the second half of 2025, increasing at an annualized rate of 4.3 percent in the third quarter with an estimated 3.5 percent growth rate in Q4 to round out the year.

- The second half's growth was led by strong consumer spending, rising productivity, and a large contribution from net exports as trade policies settled down. But core activity also remained solid with final sales to private domestic purchasers up a robust 3.0 percent in the third quarter.
- The strong handoff to 2026 adds confidence that the economy can uphold its momentum even as job gains remain sluggish.

Cooling price pressures amid slow-but-steady job gains

Recent data point to cooler inflation as 2025 came to a close. Inflation readings were encouraging, with core CPI rising only slightly and goods prices flat, reinforcing expectations for disinflation in 2026. Payroll growth remained moderate in December, keeping labor supply and demand largely in balance. At the same time, existing home sales surged on lower mortgage rates, although tight supply may limit affordability gains going forward.



Where we are this month

What does this mean

Core inflation was modest in December

Headline CPI rose 0.3 percent in December, while the core rate posted a modest 0.2 percent increase. Tariff-driven goods price pressures appear to be fading, supporting a cooler inflation outlook for 2026.

- Core goods prices were flat — the lowest reading since March — with used car and truck prices falling by 1.1 percent. Cooler trends on the goods side reinforce expectations that tariff impacts will diminish this year.
- Core services inflation rose 0.3 percent, a firmer pace than goods, but we continue to anticipate gradual disinflation in services through 2026. Headline CPI was boosted by a 4.4 percent spike in utility gas prices, but lower gasoline prices offer an offset.

Labor market holds balanced tone

The labor market ended the year with supply and demand largely in balance. December's payroll gain of 50,000 was close to expectations, and the unemployment rate ticked down to 4.4 percent.

- Modest job growth and a slight dip in unemployment show labor demand slowing in step with softer supply. This balance supports our view that the Fed holds rates steady before resuming rate cuts later in 2026.
- Hiring remains concentrated in healthcare and social assistance, while cyclical sectors show little improvement. We expect broader gains as looser fiscal and monetary policy take hold, aided by increased investment by businesses over the year.

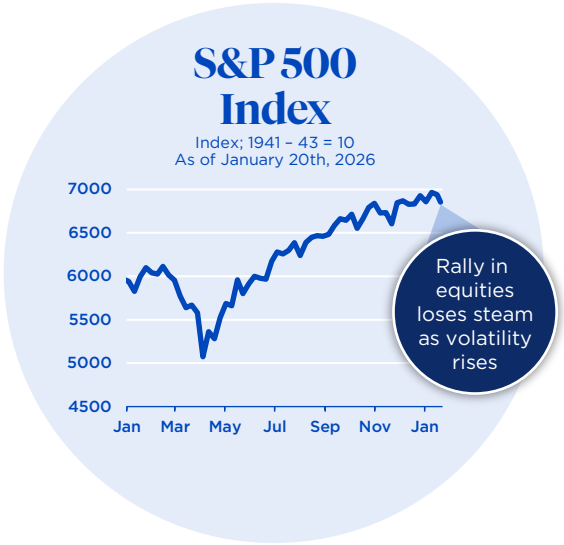
Existing home sales spike on lower rates

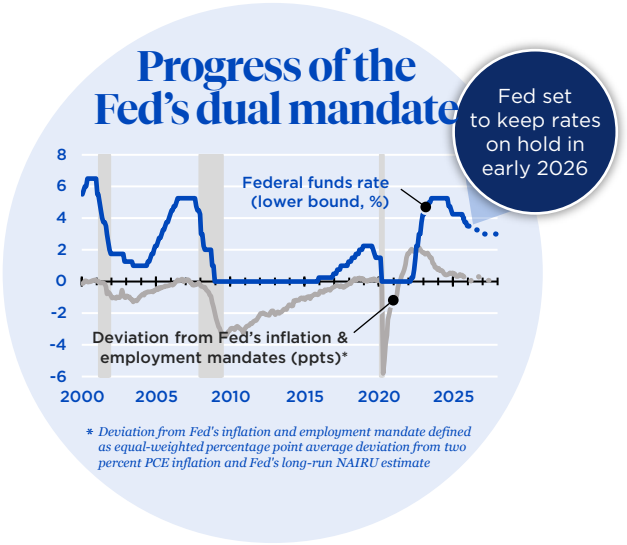
Existing home sales surged in December as buyers returned to the market with mortgage rates falling to their lowest levels of the year.

- December's annualized pace of existing home sales was the fastest since 2022, with buyers locking in lower financing costs. Median prices softened, rising just 0.4 percent year-over-year as more sellers need to cut asking prices to attract selective buyers.
- We expect stronger purchase activity early in 2026 as mortgage rates hover just above 6.0 percent, but tight supply — just 3.3 months of inventory — could push prices higher and limit improvement in affordability.

Rising geopolitical tensions and Japanese bond yields

U.S. equities and bonds were off to a promising start to 2026 but heightened geopolitical tensions with Europe and a jump in Japanese bond yields have injected increased volatility into the financial markets. However, from a fundamental basis, healthy corporate earnings and a constructive economic environment provide firm underpinnings. The Treasury yield curve should continue to steepen as the Fed cuts rates while longer-term interest rates remain above four percent.





Where we are this month

What does this mean

Equity rally stalls for now

Enthusiasm for equities that carried over into early 2026 has faded with threats of a renewed trade war with Europe. However, encouraging economic data and corporate financial performance provide strong support.

- The S&P 500 Index ended 2025 on a bright note as it recorded a very healthy 14.5 percent advance for the year. Favorable fundamentals, including easier monetary and fiscal policy mix provide support.
- Earnings expectations for 2026 are very upbeat, setting the stage for a solid performance. Further, prior recent equity gains are not out of step with past rallies, suggesting additional room to run.

Steady long-term yields

Treasury yields were mostly rangebound until a spike in Japanese bond yields spilled over to the U.S. Prior to the jump, the pull lower from a weakening job market was offset by upward pressure from solid activity,

- The Fed has signaled it is unlikely to implement another rate cut when policymakers meet again this month. We continue to anticipate the Fed will resume its cutting cycle in June 2026 as inflation peaks and after a new Fed Chair takes the helm.
- We expect a buoyant economy and normalized term premium to keep the benchmark 10-year U.S. Treasury yield elevated. Rising Japanese government bond yields will also place upward pressure on U.S. yields.

Fed on pause for now

The latest forward guidance suggests Fed policymakers are unlikely to reduce interest rates at the upcoming January policy meeting. The policy rate is currently around neutral — neither restrictive or stimulative.

- The economy isn't significantly under or overshooting the Fed's dual mandate, so the economy doesn't demand an immediate change in Fed policy.
- We expect 50 basis points worth of Fed rate cuts this year. The balance of risks should push the FOMC to favor looser policy in the early summer. Recent headlines surrounding Fed independence and upcoming Supreme Court rulings present some risks to our forecast.

Outlook

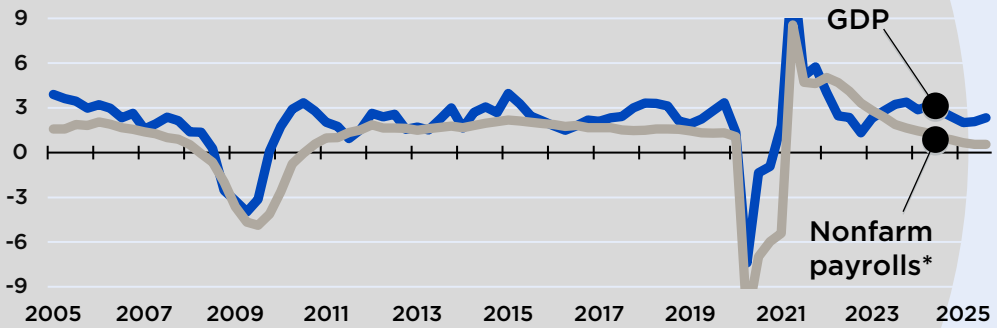
Can the economy continue to expand without job growth?

After a stronger than expected second half, real GDP growth for 2025 is now expected to come in around 2.7 percent — surpassing expectations. Strong AI investment by businesses and improved worker productivity were significant factors in the upside shown in 2025. But consumer spending also remained robust despite elevated uncertainty from policy changes and softness within the labor market. In fact, payrolls rose less than 50,000 per month over 2025 (with downward revisions likely when benchmarked to tax filings), creating an unusual divergence between the growth trends for the economy and hiring.

History suggests that the economy needs a solid pace of job gains to spur consumer activity and to sustain growth. AI spending and faster productivity trends should continue in 2026, but further weak job growth could threaten to undermine these upside factors. Fortunately, job gains improved at the end of 2025, and we expect firms to accelerate hiring over the year in response to reduced policy uncertainty and enhanced tax incentives.

GDP and nonfarm payroll growth

Q3 2025; Percent, year-over-year



Note: Nonfarm payrolls data account for impact of preliminary benchmark revisions.

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Forecast

Data as of January 2026

	2024 ACTUAL	2025 ESTIMATE	2026 FORECAST	2027 FORECAST	2028 FORECAST
REAL GDP [1]	2.4%	2.7%	2.2%	2.3%	2.3%
UNEMPLOYMENT RATE [3]	4.1%	4.5%[a]	4.2%	4.2%	4.2%
INFLATION [1] (CPI)	2.7%	**2.8%[a]**	**2.5%**	2.0%	2.0%
TOTAL HOME SALES	4.75	4.75	5.09	5.52	5.85
S&P/COTALITY HOME PRICE INDEX	3.7%	1.4%	2.7%	3.1%	3.0%
LIGHT VEHICLE SALES	15.8	16.2[a]	16.1	16.5	16.5
FEDERAL FUNDS RATE [2]	4.25%	3.50%[a]	3.00%	3.00%	3.00%
5-YEAR TREASURY NOTE [2]	4.38%	3.73%[a]	3.55%	3.55%	3.55%
10-YEAR TREASURY NOTE [2]	4.58%	4.18%[a]	4.10%	4.00%	4.00%
30-YEAR FIXED-RATE MORTGAGE [2]	6.91%	6.18%[a]	**5.80%**	**5.30%**	5.25%
MONEY MARKET FUNDS	4.96%	4.03%[a]	3.22%	3.03%	3.03%

[1] *Percent change Q4-to-Q4*
[2] *Year end*
[3] *Q4 average*
[a] *Actual*

Tariff price impacts appear to be fading

Inflation ended 2025 softer than expected as tariff impacts continued to be minimal. The CPI is expected to peak just above 3.0 percent in early 2026 before easing over the rest of 2025 with any lingering tariff price increases for goods waning.

Mortgage rates likely to drop further

Significant purchases of MBS assets by Fannie Mae and Freddie Mac could lower mortgages rates by at least 15-20 bps in early 2026. This should provide a shot in the arm for home sales, although affordability concerns are likely to linger for many potential buyers.

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