

WEEKLY ANALYSIS

A SURPRISING START TO THE KEVIN WARSH ERA

Economic downturn in Q2. Stagflation remains the base case. Growing concerns about the services sector. Consumers are worried. Negative surprises on the jobs front. Fed on hold. Strong demand for the dollar. Attractive bond yields.

Key points



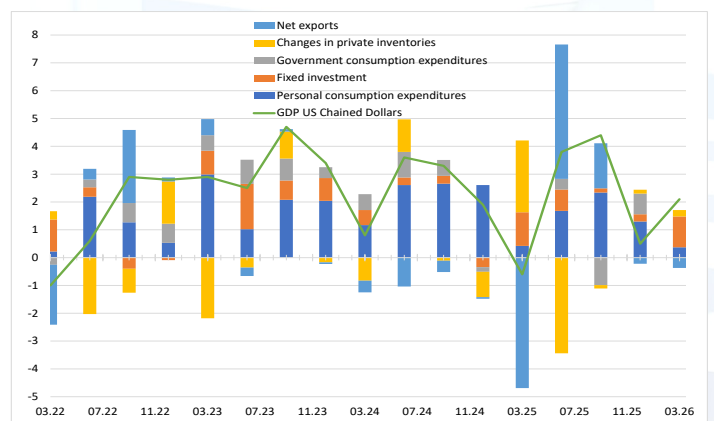
- Economic resilience will fade in Q2
- The stagflation anticipated for Q2 is materializing
- The trend in services PMIs is a cause for concern
- The job market is weakening and returning to a downward trend
- The Fed in a new era by Kevin Warsh
- Inflation stabilizes at high levels over the summer
- Increased volatility and rising bond yields
- Investors' sustained enthusiasm for the dollar
- The surprising paradox of the stock market

Economic resilience will fade in Q2

In Q1 2026, the trajectory of the U.S. economy could have taken a complex and more negative turn in light of the potential implications of the external shock on February 28 caused by the war in the Middle East. After Q4 2025 was dragged down to +0.7% by the historic government shutdown, the expected technical rebound was logically set to run into a sharp resurgence of inflationary pressures. However, the initial GDP figure of +1.6% was ultimately revised upward to +2.1%, demonstrating greater resilience than fears of a sharp slowdown had suggested. Supply chain disruptions and soaring commodity prices did not affect the quarter's momentum until later in the period. That said, the effects of the oil shock will take time to materialize and pose a tangible risk for Q2. The external inflation shock compounds existing fiscal vulnerabilities and will lead to a decline in economic activity. The revision of preliminary Q1 GDP data primarily concerned consumption, with spending on services revised down to just +0.5% from +1.8% previously. But this situation also affected long-term investment intentions. The already fragile growth mix will continue to suffer the repercussions of rising energy prices. While Q4 had exposed the vulnerability of public utilities, Q1 highlights a supply crisis in which the accumulation of involuntary inventories by businesses masks

an underlying weakness in real demand. During the first few months of the year, personal consumption, a long-standing pillar of the economy, slowed and contributed only +0.3% to GDP, losing momentum under the combined effect of persistent tariffs and the latest surge in gas prices. The Consumer Price Index (CPI), which rebounded to +3.3% year-over-year at the end of Q1, eroded real purchasing power much more aggressively than expected. Geopolitical uncertainty has broadly affected capital spending by medium-sized companies, with the lack of visibility on the path of interest rates suggesting a cautious stance. Job creation, while appearing resilient on the surface with a strong rebound of +178,000 jobs in March following weakness in previous months, is concentrated primarily in low-wage sectors, which are insufficient to drive retail sales. Even as investment in AI-related technology infrastructure continued on an upward trajectory, it was no longer enough to mask the fragility of other parts of the economy. This technology sector continued to drive the overall productivity index, while the ISM Services Employment Index fell below the 50-point mark, confirming the sector's slowdown. The residential real estate market was also hurt by long-term mortgage rates. Q1 performance was nevertheless better than expected, but it is highly likely to slow as the effects of the oil shock spread to the broader economy in Q2.

Quarterly GDP growth - United States



Sources: Bloomberg, BBGI Group SA