US Analysis

July 23, 2026

RBC Economics

July Executive Briefing: Three risks facing the US in the second half of 2026

We've been consistent: It's hard to bet against the US economy. Major non-residential infrastructure buildouts, a powerful top-income consumer, and sizeable government spending are keeping the economy on track to grow by more than 2% this year.

The labor market is structurally tight, driven by the ongoing exodus of retirees and reduced immigration. We expect the structural hiring in health care to continue, but payroll growth doesn't send the same signal it once did. We continue to view the unemployment rate as a better indicator of labor market health.

Data over May and June have largely confirmed that the US economy is in a comfortable place as we head into the second half of the year. Tame core inflation measures and strong retail sales mean the worst fears over energy inflation spreading, and/or consumers faltering under high oil prices have not materialized.

At least not yet. Despite our optimistic base case forecast, we continue to monitor for risks in what is an increasingly rosy outlook. We feel confident our forecast is the right one as we take a mid-year moment to think critically about our outlook. Still, the tails around risks are getting fatter, most notably the uncertainty created by the Iran war.

Top risks for US economy in the second half of 2026

A false sense of safety on inflation

Labor market resilience is a the base case forecast, but not a given

Consumers now vulnerable to additional shocks

Frances Donald | Mike Reid

Risk 1: A false sense of safety on inflation

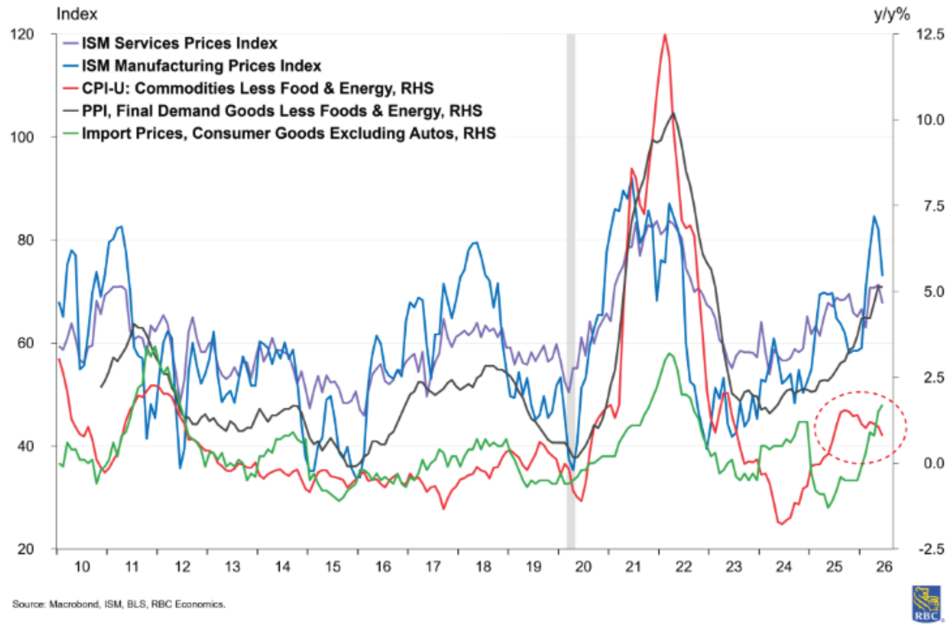
Inflation eased as a concern in June. The core measures of consumer and producer prices dramatically decelerated as energy prices subsided. As a result, both consumer and market-based measures of inflation expectations dropped. But it's increasingly looking as though the June sigh of relief was an anomaly, and July is a reversion to the new trend of sticky inflation with upside risks.

- Most obviously, energy prices have surged higher in the back end of July. At the time of writing, they are fluctuating around $90/barrel. While that is lower than the peak in May, prices are still almost 60% higher since the start of the year and nearly 35% higher than the start of July. Importantly, while inflation data will focus on month-over-month and year-over-year changes, consumers are more likely to focus on price levels. Average gasoline prices back up above the $4 psychological threshold matters, and the temporary improvements in real wage growth in June will likely retrace.

- The threat of tariffs is back in play, which is disappointing because the peak of tariff pressure on inflation could have been behind us (we had previously expected the peak in Q2). While the implementation of Section 301 tariffs on Canada is likely to have limited impact on our outlook for the US, the US administration has indicated it may be applying new tariffs across dozens of countries as temporary global tariffs expire at the end of July. As we've covered, tariffs have real impact on goods prices, but with a fairly substantial lag. Tariff refunds provide one-time support to businesses, but they aren't a permanent fix on an ultimately inflationary policy.

- There are still cost pressures in the pipeline. Producer prices rose 5.5% year-over-year in June, and leading indicator of finished consumer goods inflation is elevated at 3.6% y/y. The gap between core goods CPI and finished consumer goods PPI suggests consumer prices still face pressure in the pipeline. That doesn't sound like a massive gap, but the problem for consumers is there are no signs of outright deflation.

The recent trend in core goods CPI trend is the outlier



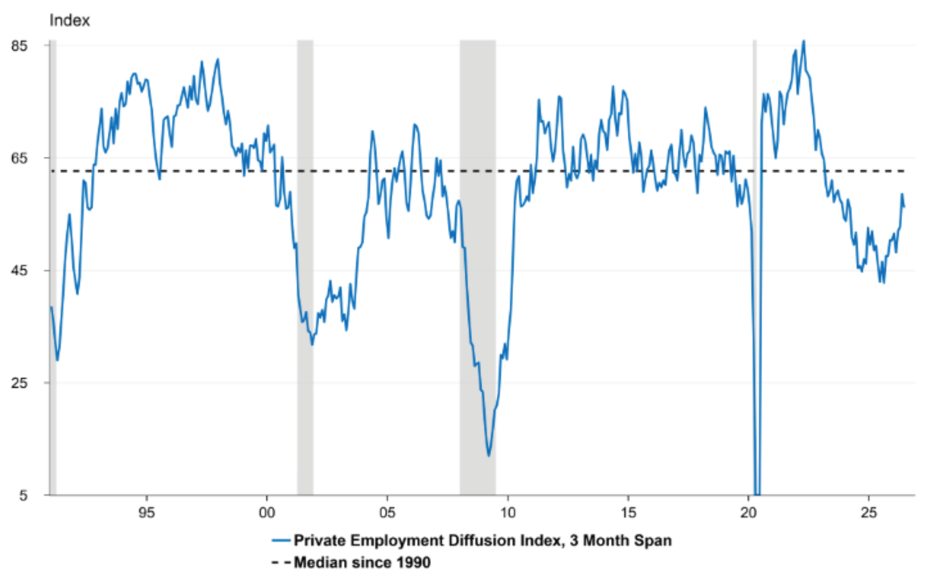
Source: Macrobond, ISM, BLS, RBC Economics.

Risk 2: Labor market resilience is our base case, but not a given

We're long-time believers that structural forces should keep the US labor market tight (see America needs workers, not jobs). A shrinking labor force and structural needs for hiring in health care mean the unemployment rate in our base case should stick close to 4.3% for the remainder of the year. However, there are some yellow flags in some recent employment data that should be monitored, particularly if price pressures re-accelerate and businesses find the need to cut costs.

- The June employment report provided substantial revisions to prior months, which had previously suggested job growth was strong. The three-month average payroll gain collapsed by more than a third. Net revisions to the prior two months subtracted more jobs than were created in June.
- Leisure and hospitality—one of the few bright spots earlier in the year—shed jobs at a pace that reversed the prior month's gains entirely. The BLS explicitly flagged "weaker than usual seasonal hiring," the sector has shown no net employment growth in 2026, and the end of the World Cup risks additional layoffs ahead.
- Outside of the two sectors mentioned above, there is little to be excited about from a growth perspective. There are pockets of growth—nonresidential construction is benefiting from the AI boom—but residential construction is declining, and we expect the housing market will remain in a deep freeze. The manufacturing sector is seeing strong growth in terms of industrial production, but much of the growth is concentrated in capital intensive, advanced manufacturing sectors that are not adding jobs meaningfully. Critically, trade exposed sectors will face cost pressures as new tariffs come into play on top of rising energy prices. The recent rebound in trade-exposed sectors could very well end up being short-lived.

The breadth of payroll gains remains below the median over the past 35 years

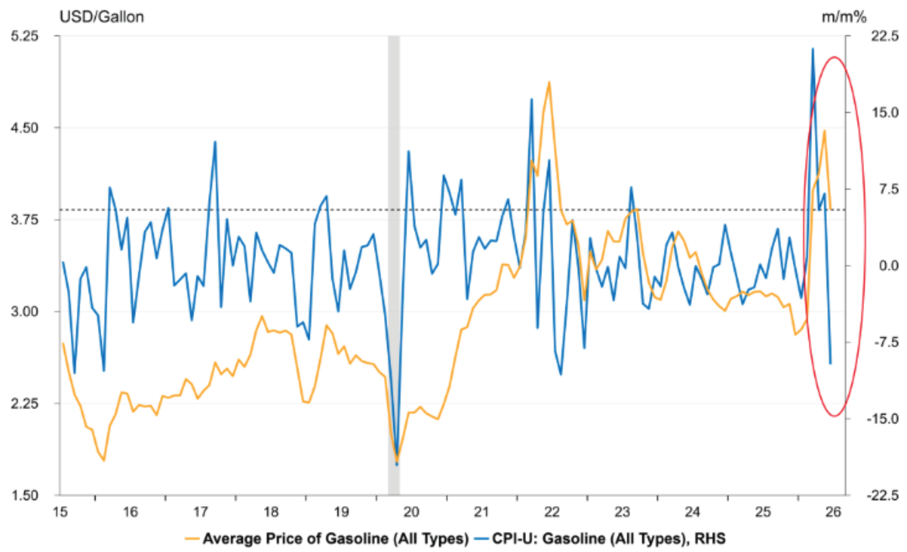


Source: Macrobond, BLS, RBC Economics.

Risk 3: Consumers are now more vulnerable to additional shocks

Inflation spikes and labor market wobbles aren't new, even in the past few years. Consumers have weathered those storms thanks to strong balance sheets, steady employment, strong non-labor income growth, and more recently, tax refunds.

Levels matter and gas prices around $4 per gallon don't help the consumer



Source: Macrobond, BLS, EIA, RBC Economics.

Growth outlook

House view: US economic resilience continues, with underlying growth slightly above the 2% trend, though diverging trends persist beneath it. AI continues to drive the entirety of the business investment story: spending on information processing equipment and data center infrastructure has surged, while CAPEX outside of the AI remains exceptionally weak. On the consumer side, there are signs that consumer buffers in Middle America are developing cracks worth monitoring. With energy prices rising once again, we view risks to the economy as roughly balanced, with downside surprises still possible should another inflationary shock rear its head and upside surprises still possible from productivity and the AI investment boom.

July 2026 forecast:

U.S. GDP QoQ annualized, %

Q2-26	Q3-26	Q4-26	Q1-27
2.4	2.1	2.2	2.2

Downside risks to growth
(lower growth)

- Middle America is showing some signs of cracks as the savings rate declines and real wages have been hurt.
- Housing affordability continues to weigh on residential investment and construction activity.
- Consumer debt and interest expense is weighing on consumers, particularly for younger borrowers, limiting consumption.
- Rising goods imports, primarily for AI related capex, can widen the trade gap.

Upside risks to growth
(stronger growth)

- Spending by the rapidly-growing retired cohort is bolstered by strong asset price appreciation.
- AI capex and plans signal strong growth into 2027.
- Services spending continues to grow as consumer but the upside in goods spending help boost consumption. The overturn of IEEPA helped keep goods prices steady.
- Defense spending acceleration can be technically additive to GDP.

Balance of Risks: Growth

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Inflation outlook

House view: Even as energy prices settle, inflationary pressures remain broad and persistent. Housing inflation is still running hot, strong wage growth continues to put a floor under core services, and tariff passthrough to core goods is still likely coming through the pipeline – as evidenced by the gap between PPI and CPI. We expect core inflation to settle just below 3% by year-end. The new wrinkle in our outlook is incoming Federal Reserve Chair Kevin Warsh who has decidedly positioned the central bank as keen to return inflation back to the 2% target. Should the Fed begin hiking again, the heat under inflation may be more contained.

July 2026 forecast:

CPI QoQ SAAR, %

Q2-26		Q3-26		Q4-26		Q1-27	
headline	core	headline	core	headline	core	headline	core
3.9	2.8	3.0	2.6	2.8	2.8	2.3	2.8

Downside risks to inflation (i.e. cooler inflation)

- A more active Federal Reserve, intent on hiking rates to cool inflation could indeed have the desired effect.
- Consumer demand for discretionary goods and services erodes as a result of higher costs for essentials and high debt servicing costs.
- Trade-exposed layoffs would lead to reduced purchasing power and lower demand. Layoffs are another option for firms looking to preserve margins without fully absorbing higher prices.

Upside risks to inflation (i.e. higher inflation)

- Geopolitical risk backdrop is still elevated. If oil prices trend higher, this could disrupt any expected improvement in inflation in H2.
- Additional tariffs could translate to higher inflation in the goods space.
- AI buildout could lead to demand-driven price pressures for products whose inputs contain semiconductors, along with higher utility costs.

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Balance of Risks: Inflation

Labor market outlook

House view: We continue to expect both structural factors will keep the US labor market very tight even with some cyclical weakness. Monthly hiring in the US labor market has outpaced expectations – especially in the context of exceptionally low breakeven employment. But recent payroll growth has been revised lower, and the breadth of hiring is still well below the 30-year median. Employment in white-collar sectors remains in decline, contributing to a significant skills-matching problem facing new graduates. Real wage growth improved in June, but a reversal means the risk of demand destruction has not fully dissipated.

July 2026 forecast:

Unemployment rate, %

Q2-26	Q3-26	Q4-26	Q1-27
4.3	4.3	4.3	4.3

Downside risks to labor (higher unemployment rate)

- Energy price spikes erode margins and cost cutting measures result in layoffs.
- New tariff announcements risk a slowdown in trade-exposed sectors.

Upside risks to labor (lower unemployment rate)

- Retirements ramp up faster than expected and firms need to backfill positions.
- Consumer demand for services is stronger than expected resulting from strong transfer income to retirees. Firms need to hire to keep up with demand.

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Downside risks to labor
(higher unemployment rate)

- Consumer demand erodes in the face of higher prices, forcing firms to cut jobs.
- The World Cup wrapped up in July, adding to continued layoff risk in the leisure and hospitality sector.

Upside risks to labor
(lower unemployment rate)

- Firms investing in labor-augmenting technologies ramp up hiring to deploy widespread implementation.

Balance of Risks: Labor

Frances Donald is the Chief Economist at RBC and oversees a team of leading professionals, who deliver economic analyses and insights to inform RBC clients around the globe. Frances is a key expert on economic issues and is highly sought after by clients, government leaders, policy makers, and media in the US and Canada.

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