

Growth Moderates as Price Pressures Ease

An initial batch of June economic data showed the U.S. economy entering the third quarter on solid ground, although momentum has eased from earlier in the spring. The Institute for Supply Management’s (ISM) monthly surveys of manufacturing and service-sector managers showed composite PMI readings that remained in expansion territory. These surveys are closely watched because they measure whether business activity is expanding or contracting across key sectors of the economy. A reading above 50 indicates expansion, while a reading below 50 indicates contraction. In June, both the manufacturing and services PMIs remained above 50, signaling continued growth, but each expanded at a slower pace than in May.

The manufacturing sector grew for a sixth consecutive month in June, with the ISM Manufacturing PMI registering 53.3, down from 54.0 in May. After several years of uneven performance, the sector appears to have stabilized, with activity continuing to expand, but at a more moderate pace.

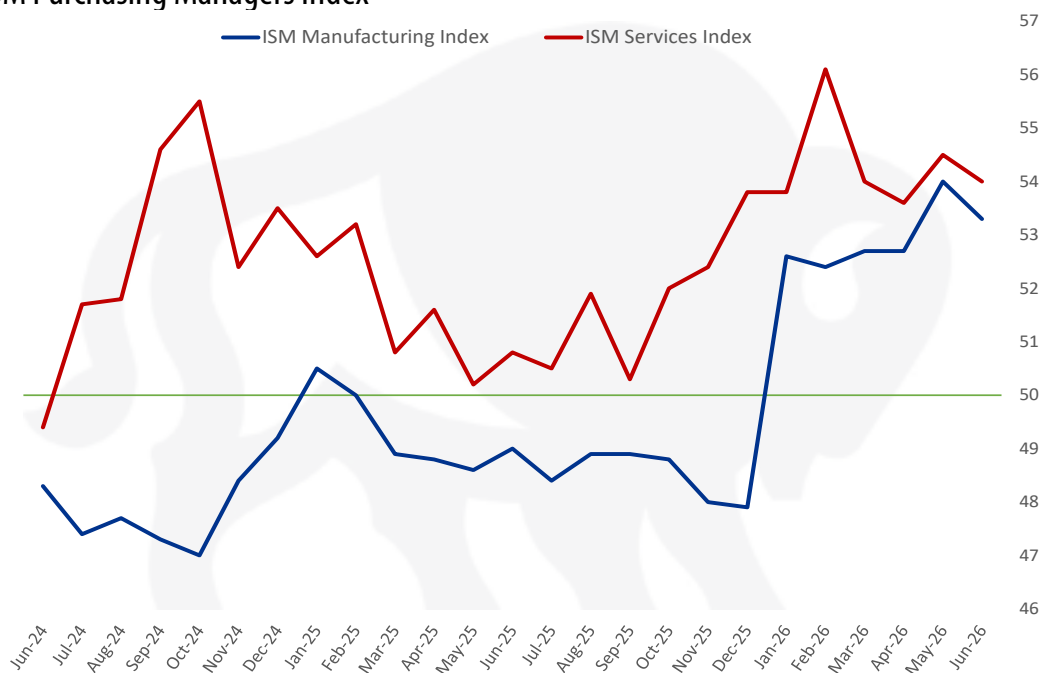
One of the more encouraging parts of the manufacturing report was the decline in price pressures. The ISM Prices Index fell sharply from 82.1 in May to 73.0 in June, the largest monthly drop since 2022. Manufacturers had been dealing with cost pressures tied to energy volatility, transportation, supply chain uncertainty, and tariffs. Employment also improved, rising to 49.7 from 48.6, barely missing expansion territory and suggesting manufacturers are moving closer to adding workers again.

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ISM Purchasing Managers Index



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Source: Institute for Supply Management

The much larger services sector told a similar story. The ISM Services PMI declined to 54.0 from 54.5 in May, still comfortably above the 50 level that separates expansion from contraction. New orders eased to 55.1 but remained solid, while business activity continued to indicate broad growth across the service economy. The employment component improved to 51.2 from 47.9, returning to expansion territory.

Inflation pressures in the services sector also showed improvement, with the prices-paid index declining from 71.3 to 67.7. This is the type of data markets and Fed officials want to see: growth, improved hiring, and less price pressure. However, the level of the prices-paid indexes remains elevated, which means the inflation problem has not yet disappeared.

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While both ISM reports were positive on balance, the Atlanta Fed's GDPNow model offered a note of caution. The model estimate for real GDP growth in the second quarter fell to 1.2% on July 1st, down from 2.5% on June 25th. The decline was driven in part by a lower estimate for real gross private domestic investment growth and a larger drag from net exports.

A 1.2% GDP growth rate would represent slower headline growth, but it does not necessarily point to a weak economy. Domestic demand remains more resilient than the headline figure suggests, with underlying demand reportedly closer to 2.8%. That means part of the slowdown appears tied to GDP categories such as trade and investment rather than a decline in consumer or business activity. That is consistent with the ISM surveys, which continue to show expansion across both major sectors of the economy.

Oil prices have moved back toward pre-crisis levels as the U.S. and Iran continue to work toward a resolution. Ship traffic through the Strait of Hormuz has recovered to roughly 30 to 40 ships per day, well above the worst levels seen during the conflict, though still below the pre-war average of approximately 130 ships per day. OPEC has also begun restoring production that was curtailed during the conflict, and additional supply could come back next month. With oil near \$70, lower oil prices should eventually help reduce gasoline prices and broader inflation pressures.

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Gas prices have fallen for six consecutive weeks as oil prices have retreated and supply concerns in the Middle East have eased. However, pump prices remain elevated because crude oil is only one component of the price consumers pay. Refining margins, transportation costs, taxes, and other distribution expenses have prevented gasoline prices from falling as quickly as oil prices. Despite those headwinds, lower energy costs should help ease inflation pressures in the months ahead.

For the Fed, the outlook remains complicated. Growth is slowing but not stalling. Employment is growing more slowly. Oil and gasoline prices are moving lower, but inflation remains too high and continues to be the deciding factor for monetary policy. Until policymakers have greater confidence that inflation is moving sustainably lower, the Fed is likely to remain on hold.

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The importance of Fed independence was reinforced last week when the Supreme Court ruled that President Trump could not immediately remove Federal Reserve Governor Lisa Cook, allowing her to remain in her position while her legal challenge continues. The Court reached a different conclusion in a companion FTC case, signaling that the Fed occupies a distinct constitutional status among independent agencies. For markets, the Cook ruling is important

because it reinforces the Fed's structural independence at a time when monetary policy is being closely scrutinized.

This week's FOMC minutes from Kevin Warsh's first meeting as Chair will offer an early look at how the new Fed leadership is thinking about the path forward. Next week's June CPI report will be even more important, as a cooler inflation reading could reintroduce the case for eventual policy easing. Meanwhile, President Trump heads to Turkey this week for the NATO summit, where continued progress on Ukraine and allied defense spending could further support stability, lower energy prices, and *reduced* inflation pressures in the second half of the year.

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Market Indications as of 1:17 P.M. Central Time

DOW	Up 51 to 52,952 (NEW HIGH)
NASDAQ	Up 297 to 26,130 (HIGH: 27,094)
S&P 500	Up 51 to 7,534 (HIGH: 7,610)
1-Yr T-bill	current yield 3.93%; opening yield 3.92%
2-Yr T-note	current yield 4.12%; opening yield 4.13%
3-Yr T-note	current yield 4.15%; opening yield 4.15%
5-Yr T-note	current yield 4.21%; opening yield 4.22%
10-Yr T-note	current yield 4.48%; opening yield 4.48%
30-Yr T-bond	current yield 4.99%; opening yield 4.98%

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