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Inflation Displaces Growth as Bigger Worry

THE OUTLOOK |

By Matt Grossman and Anthony DeBarros

The good news: War with Iran didn't hurt the U.S. nearly as much as economists feared.

The bad news: It left inflation, already above the Federal Reserve's 2% target, more persistent—and left the Fed with no room to cut interest rates.

That's the upshot of how the views of economists surveyed this month by The Wall Street Journal have evolved since the previous survey in April, roughly a month into the war.

Forecasters expect the economy to grow 2.1% this year, up from 2% estimated in April, based on the change in inflation-adjusted gross domestic product between the fourth quarter of 2025 and 2026. Growth last year was 2%. Economists' average estimated probability of a recession in the next 12 months fell to 25% from 33% in April, the lowest since the start of 2025.

But along with an improved outlook for growth comes greater concern for inflation. Economists expect the consumer-price index to rise 3.4% in the 12 months through December, up from 3.2% in April's survey.

Note

Inflation concerns have spread beyond the war's boost to energy costs. Economists project the price index of personal-consumption expenditures excluding food and energy, which Fed officials track closely, to rise 3.2% in 2026, up from a forecast of 2.9% in April.

In April, economists worried that consumers would be hammered by higher energy prices after the U.S. and Israel attacked Iran at the end of February and Iran closed the Strait of Hormuz, through which roughly 20% of the world's oil supply flowed. Oil, which was $67.02 a barrel on the eve of the war, peaked at $112.95 in April.

Note

Oil prices proved less of an obstacle than many analysts expected. Economic activity relies less on oil than in past decades. And a rising stock market helped keep consumer spending stable.

Some analysts were struck by how well the economy has held up over the past year. "Who would have thought this, with a trade war and an oilprice shock?" said David Berson of Cumberland Advisors.

"We're learning that there's more momentum in the economy: It keeps growing at 2% no matter what you throw at it, and inflation stays elevated," said Robert Fry, a Delaware-based independent economic consultant. "Some of that is that the economy's stronger than we thought, and some of it is that the Fed's stance may not be all that restrictive." Note

Oil fell as low as $68.55 on July 6 after the U.S. and Iran agreed to a ceasefire in June and to reopen the Strait of Hormuz. This past week, hostilities resumed and President Trump said the ceasefire was over, and oil rebounded to close at $71.41 on Friday, still well below wartime peaks.

Looking ahead, economists mostly expect oil to trade sideways, ending December at about $70 a barrel.

Note

Job-market views have turned more positive as well. Economists forecast unemployment of 4.3% in December, compared with 4.5% in the April survey, and employment gains of roughly 65,000 a month over the next year, compared with 45,000.

Stubbornly rising prices are shaping up as the biggest challenge confronting the Federal Reserve under Kevin Warsh, who became chairman in May. Economists expect the Fed to hold rates steady through December at the current range of 3.5% to 3.75%, rather than continue gradual rate reductions that began in 2024. Still, only 15% of those surveyed believe a rate increase is probable.

Since Trump nominated Warsh to lead the Fed in January, economists have felt more confident in the central bank's independence. That is good news for Warsh, who leads an institution that Trump dragged into the political fray under Warsh's predecessor, Jerome Powell.

In the latest survey, 90% of respondents said they think that the Fed is "mostly" or "completely" independent, a rise from the last time the question was posed, in October. A smaller percentage now rates the Fed as "partially" independent.

Warsh has proposed reducing "forward guidance" that hints about where interest rates are headed. Economists, though, indicated they still want some forward guidance. Nearly half of respondents said they wish to see the Fed continue to produce its Summary of Economic Projections, including the "dot plot" of where officials expect the Fed's interest- rate target to go. Another 27% said they would like the Fed to release the projections but without the dot plot, and 15% want the Fed to drop the projections altogether.

The survey of 72 economists was conducted July 2–7. Not every economist answered every question.

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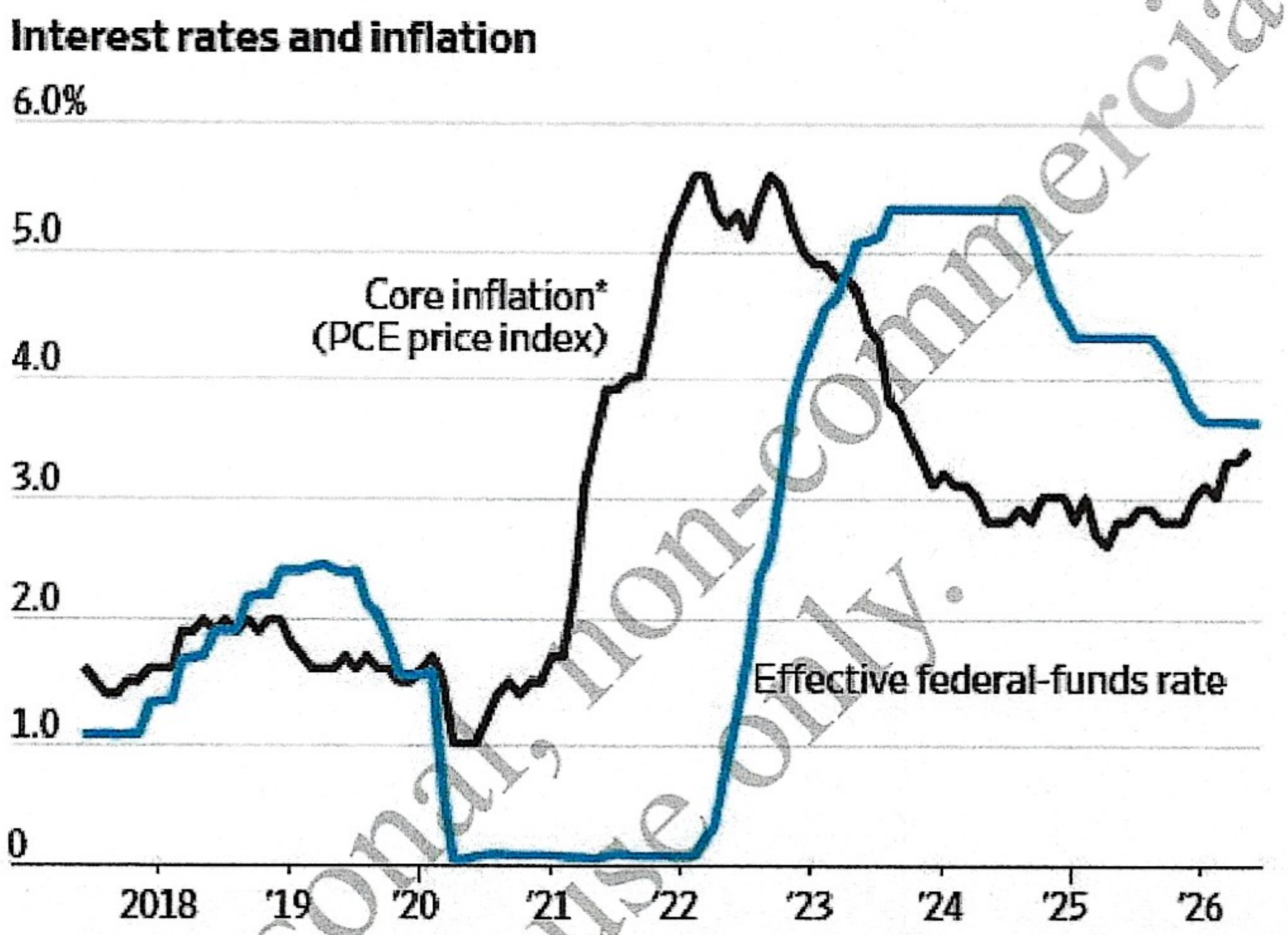

*Core inflation excludes food and energy prices
Sources: Federal Reserve (federal-funds rate), Commerce Department (PCE index)
