*Bruin Reserve Bank*

# Monthly Economic Outlook: February 2026

*The Post-Global World*

# CONTENTS

# At a Glance: The U.S. Macro Pulse

| | Q3 2024 | Q3 2025 | YOY |
|---|---|---|---|
| GDP | $29,511.664B | $31,098.027B | +5.36% |
| CPI | -- | -- | +3.39% |
| PPI | -- | -- | +2.75% |
| PCE INDEX | -- | -- | +2.76% |
| UNEMPLOYMENT | 4.2% | 4.3% | +0.1%PTS |
| S&P 500 INDEX | -- | -- | +15.95% |
| UMICH CONSUMER SENTIMENT INDEX (BASE=100) | -- | -- | -14.38% |
| AVERAGE EFFECTIVE TARIFF RATE | 2.3% | 10.9% | +8.6%PTS |

**Figure 1:** Snapshot of selected U.S. macroeconomic, financial, and policy indicators comparing Q3 2024 and Q3 2025, with year-over-year changes where applicable. Dashes indicate indicators reported primarily as indices or growth rates for which level comparisons are not economically meaningful in isolation, as well as series affected by data publication disruptions during the October 2025 federal government shutdown.

**Sources:** Federal Reserve Economic Data, Penn Wharton Budget Model.

# Key Insights:

- US-led disruption of the global market has led to a sharp deceleration of global trade volume growth. Trade policy uncertainty has become a persistent variable in global trade, not a transitory or one-time shock.

- PCE inflation remains elevated at 2.8% and could face more inflationary pressure as firms begin to revise pricing strategies to pass the cost of tariffs onto the consumer. Mass deportations could also impact the labor market in a way that would drive up labor costs in the near term.

- The Federal Reserve implemented three consecutive 25-basis-point rate cuts in 2025 and projected an additional cut in 2026, eyeing an end-of-year target range of 3.25-3.50%. The way forward for the Fed is murky as a federal investigation has been opened into Chair of the Federal Reserve Jerome Powell.

- In 2025, the unemployment rate rose from 4.0% in January to 4.4%. Labor markets are experiencing an unusual period of stagnation, settling into a low-fire, low-hire market with young jobseekers being impacted most of all.

- The United States struck Venezuela in an operation that captured President Nicolas Maduro and his wife. This unilateral action and aggressive rhetoric on acquiring other territories, such as Greenland, has shaken U.S. relations withEurope and gives new urgency to developing the means for their own security. In the near future, Europe threatens to become a more hostile economic bloc to the U.S.

- In financial markets, developments in Venezuela had an immediate but reserved impact on oil-related securities as the long term effects are still unclear. Cryptocurrency markets faced volatility and scrutiny from cybersecurity entities as tech stocks diverged in a new show-me phase of the market.

- As AI data centers rapidly expand, so does their energy use. Policymakers have struggled to keep pace with the rate of development as data centers begin to strain power grids across the country.

*Sources for data and references in this section are cited in full within the corresponding sections of the report. The Bruin Reserve Bank Macro-Analysis Team strives to provide the proprietors of any external information cited in this report with proper attribution.*

# MEO Spotlight: The Post-Global World

January 20th, 2026, marked one year since the beginning of the second Trump administration. Rather than delivering clarity on the future trajectory of global macroeconomic policy and the United States' position in today's world order, the previous year has ostensibly shown that policy is no longer a predictable outcome of economic conditions. What has become increasingly clear is that the global economy has entered a regime in which policy can no longer be well approximated by stable reaction functions; instead, it operates as a state-contingent process that alters incentives, prices, and expectations in nonlinear ways.

## *Framing the Regime Shift: Policy as a Shock Process*

State-contingent international macroeconomic policy is not merely a more intense version of uncertainty; it represents a change in the nature of the uncertainty faced by governments, central banks, institutions, investors, and consumers. In a rules-based environment, economic agents can plan around gradual parameter adjustments, such as interest rates, tax schedules, and regulatory thresholds. In a state-contingent configuration, the relevant variable becomes the probability of policy discontinuities: tariff spikes/rollbacks, sanction restrictions, export controls, and industrial policy interventions that are explicitly conditioned on geopolitics and strategic dependence. Over the past year, largely through U.S.-led upheavals, such features have become a central feature of the global policy environment, reshaping expectations well before policy enactment.

Institutional surveillance has characterised this shift with increasing precision. In its January 2026 *World Economic Outlook Update*, the International Monetary Fund (IMF) revised global growth for 2026 upwards to 3.3%, 0.2 percentage points upward relative to its October baseline, reflecting stronger-than-expected, yet fragile tariff safeguarding. At the same time, the Fund explicitly warned that "risks to the outlook for the global economy remain tilted to the downside," noting that recent resilience has been "driven largely by a few sectors and often supported by monetary and fiscal accommodation," leaving expansion vulnerable to sector-specific disruptions, long-standing structural risks, and AI over-optimism.

Consistent with this diagnosis, global trade volume growth is projected to sharply decelerate–from 4.1% in 2025 to 2.6% in 2026. Earlier IMF assessments in October 2025 similarly underscored that global adjustment is taking place amid a reordering of policy priorities and heightened sensitivity to trade actions, rather than through smooth cyclical convergence. Parallel evaluations from UNCTAD's January 2026 Global Trade Update, as well as the WTO's October 2025 Global Trade Outlook and Statistics, both opine towards subdued trade momentum and spiking fragmentation-induced trade slowdowns across regions.

Viewed through this lens, one year into Trump II is best interpreted not as a partisan scorecard, but as a repricing of policy variance. In a state-contingent regime, macroeconomic outcomes increasingly depend more on how rapidly constraints bind once policy wedges shift, rather the size of shocks themselves, and how and how effectively economies can re-engineer ex-ante.

## *The Mechanics: How State-Contingent Policy Enters Macro Pricing*

Throughout the recently-concluded 2026 World Economic Forum Annual Meeting, one motif was abundantly clear: in the current global macroeconomic environment, policy can no longer be approximated as a smooth reaction function responding predictably to inflation, output gaps, or financial conditions (Kempe, 2026). Policy instead operates as a discrete state variable in which trade access, tariff schedules, sanctions exposure, regulatory permissions and industrial policy instruments are explicitly contingent on geopolitical alignment, supply chain positioning, and strategic dependence. Economic agents therefore price not a single baseline policy path, but a distribution over policy states, each associated with sharply different constraints on trade, financing, and legal certainty (Mavroidis, 2025).

What distinguishes the present episode is that the United States has shifted from being a stabilizing institutional anchor to the primary generator of global policy states. By virtue of its central role in trade settlement, dollar funding markets, and alliance-linked market access, discretionary U.S. policy choices now propagate globally even when they are not yet codified in law. As a result, global firms and governments increasingly price U.S. policy discretion itself as a macroeconomic risk factor, rather than as a stable boundary condition. Unlike conventional uncertainty shocks, where variance rises around a stable rule, state-contingent policy introduces non-linear discontinuities. Once agents assign material probability to abrupt regime shifts, expectations, pricing, and real decisions adjust *ex ante*, well before policies are enacted or formally implemented (Bank of International Settlements, 2025).

### *Wedge I: The Trade-Cost / Policy-State Variance*

In a standard open-economy setting, it is textbook knowledge that tariffs and non-tariff barriers act like a tax on cross-border marginal costs. Under state-contingent policy, the binding constraint on trade is no longer the level of applied tariffs alone, but the variance of expected future trade costs. This is precisely why “trade policy uncertainty” is analytically distinct from generic volatility: when tariffs, export controls, sanctions, or licensing requirements can jump discretely across policy states, firms must evaluate profitability under downside realisations rather

than average conditions. Consequently, the mean tariff rate becomes less informative than the probability-weighted distribution of potential trade regimes.

Formally, this mechanism corresponds to open-economy models with stochastic trade wedges, in which policy enters as a random variable affecting marginal costs and market access. In such models, increases in policy-state variance depress trade primarily through the extensive margin—firm entry, exit, partner choice, and product scope—rather than through marginal price adjustments. Even highly productive firms rationally delay or forgo market entry when expected profitability is dominated by downside policy risk, despite unchanged current tariffs.

The Trump II era has materially amplified this wedge. Since mid-2025, U.S. trade actions have been characterised by conditional escalation, selective exemptions, and enforcement discretion tied to bilateral behaviour and strategic considerations rather than multilateral rules. This has replaced a rules-based trade environment with a bargaining-based one, in which access is endogenous to political alignment and negotiation status (Siriopoulos, Spyridou, Polyzos, 2025).

This channel is now explicitly recognised in multilateral surveillance: recent IMF assessments treat trade policy uncertainty not as a transitory disturbance but as a persistent conditioning variable in baseline projections, reflecting its impact on export participation and investment decisions even in the absence of realised tariff changes. The IMF's October 2025 WEO also treats trade policy uncertainty as a persistent assumption through 2025–26—an institutional acknowledgement that the relevant object is not "one-off tariff news" but a durable elevation in policy-state risk. Empirically, this shift is visible not in a dramatic rise in average most-favoured nation (MFN) tariffs, but in the widening dispersion of effective tariff and non-tariff barriers across partners within the same product categories—a pattern increasingly documented in the WTO's October 2025 Global Trade Outlook and Statistics.

Academic work formalises this channel. Hayakawa (2024) shows that increases in trade policy uncertainty operate primarily through the extensive margin, reducing export participation and partner scope even when applied tariff rates remain unchanged—precisely the mechanism implied by a state-contingent trade-cost distribution.

### *Wedge II: The Discount-Rate / Risk-Premium Wedge*

State-contingent policy also enters macro pricing through discount rates, the return investors require to hold an asset, incorporating risk premia in addition to expected policy rates. This typically happens by increasing the compensation investors demand for holding assets exposed to adverse policy states. Even when near-term growth remains resilient, the possibility of abrupt trade restrictions, sanctions, or regulatory reversals raises long-term risks, tightening financial conditions without any mechanical change in policy rates. In asset-pricing terms, this maps to

models in which policy risk raises the covariance between macroeconomic cash flows and adverse states (risk premia rise when asset payoffs covary more strongly with adverse states of the world), increasing required returns even if expected growth is unchanged.

The consequence is an endogenous tightening of financial conditions (risk premia raise borrowing costs and depress valuations even in the absence of policy-rate changes): higher term premia (component of long-term interest rates that compensates investors for bearing duration and uncertainty risk beyond expected short-term rates), wider credit and sovereign spreads, and lower equity valuations—channels through which policy-state risk propagates into investment and consumption decisions.

The critical change under Trump II is that long-duration assets—particularly those exposed to cross-border supply chains or dollar funding, such as U.S. Treasury Bonds—now embed compensation for policy tail risk (low probability but high-impact policy outcomes that materially affect expected returns, such as tariffs) that was largely absent under the prior Trump administration (IMF, 2025). Markets are no longer pricing gradual policy drift, but the possibility of abrupt, discretionary shifts in trade access, sanctions enforcement, and regulatory scope. This repricing is visible in the persistence of elevated U.S. term premia through 2025 despite disinflation and stable growth, as well as in cross-currency basis spreads (deviations from covered interest parity, reflecting stress in global dollar funding markets) that widened in response to policy announcements rather than macro data (New York Fed, 2025).

Recent macro-financial research (Mavrodis, 2025) formalises this mechanism, demonstrating that policy fragmentation increases required risk compensation by heightening exposure to adverse geopolitical and regulatory states rather than by weakening contemporaneous fundamentals. Moreover, this channel is now explicitly monitored by institutions. Both the BIS and the IMF have emphasised that elevated term premia increasingly reflect compensation for long-horizon policy and fragmentation risk rather than near-term inflation uncertainty. As documented in the IMF's October 2025 Global Financial Stability Report The incidence of this wedge is regionally asymmetric. Economies with large external financing needs, concentrated export baskets, or high exposure to U.S.- or China-linked trade have experienced sharper increases in required risk compensation than diversified surplus economies—amplifying cross-country divergence even under similar global financial conditions, evidenced by China's Terrific 10 (Alibaba Group, Tencent, Meituan, Xiaomi, BYD, JD.com, NetEase, Baidu, Geely Automobile, SMIC) (China's equivalent of the United States' Magnificent 7 (M7), which consists of Alphabet, Amazon, Apple, Meta, Microsoft, Nvidia and Tesla), exhibiting more subdued and varied valuations driven by higher risk premia surrounding tariff policies with the U.S. despite a steady rise in deep-tech integration (Bank of International Settlements, 2025).

### *Wedge III: The Real-Options/Timing Wedge:*

A third mechanism operates through irreversibility–the state in which an investment's sunk costs cannot be recovered, making the timing of commitment economically meaningful under uncertainty. When policy outcomes are discontinuous, firms face a real-options problem: committing capital or labour today risks being stranded under an adverse policy state tomorrow. In other words, uncertainty raises the value of waiting relative to committing immediately. In response, firms rationally delay investment and hiring until policy uncertainty resolves, even if demand and financing conditions appear supportive. Formally, this aligns with irreversible-investment models featuring stochastic policy thresholds, where increases in uncertainty shift decision boundaries nonlinearly (Federal Reserve, 2025). Small changes in perceived policy-state risk can trigger substantial delays in real activity, generating sharp slowdowns without commensurate declines in expected fundamentals.

Trump II has shortened the perceived policy-commitment horizon, reducing the value of forward guidance and negotiated trade assurances. When firms believe that access conditions can be renegotiated or reversed at short notice, the option value of waiting dominates even under favorable demand and financing conditions. Institutional evidence corroborates this mechanism. Central bank business surveys throughout 2025 document firms postponing capital expenditure and hiring in response to trade and regulatory uncertainty, despite stable revenues and easing monetary conditions. This helps explain the divergence observed in 2025 between resilient aggregate growth and persistently weak private fixed investment, particularly in trade-intensive manufacturing and cross-border services (Federal Reserve, 2025), despite resilient consumption and easing monetary conditions (International Monetary Fund, 2026).

A concrete manifestation of this shortened policy-commitment horizon is the increasingly fragmentary nature of recent U.S. trade arrangements. Unlike comprehensive, legally binding free trade agreements, several Trump II–era deals have taken the form of partial frameworks, executive arrangements, or politically contingent understandings whose durability is explicitly uncertain. For firms, this alters the real-options calculus: when preferential access is provisional rather than treaty-bound, the expected payoff to committing capital falls sharply relative to the option value of waiting.

The U.S.–Japan and U.S.–Korea trade understandings reached in 2025 expanded market access in select sectors but relied heavily on executive commitments (United States Trade Representative, 2025) rather than ratified, enforceable agreements, leaving firms exposed to renegotiation risk. Amidst the recently-concluded World Economic Forum 2026 Annual Meeting in Davos, Switzerland, the European Parliament's decision to suspend approval of the proposed EU–US trade framework following Greenland-centric tariff escalations underscored the fragility of

transatlantic commitments (Blenkinsop, 2026), as detailed further in *Donald Trump's Backyard* section of this edition of the MEO (Page 38). By a similar token, in Southeast Asia, U.S. arrangements with Thailand and Vietnam have remained narrow, sector-specific, and conditional (United States Trade Representative, 2025). Such fragmentation does not merely reduce expected trade flows; it shortens the perceived policy commitment horizon, raises the option value of delay and suppresses irreversible investment even when headline demand conditions are supportive.

# *The Price of Uncertainty*

## *Indicator 1: Trade Policy Uncertainty vs Trade Participation*

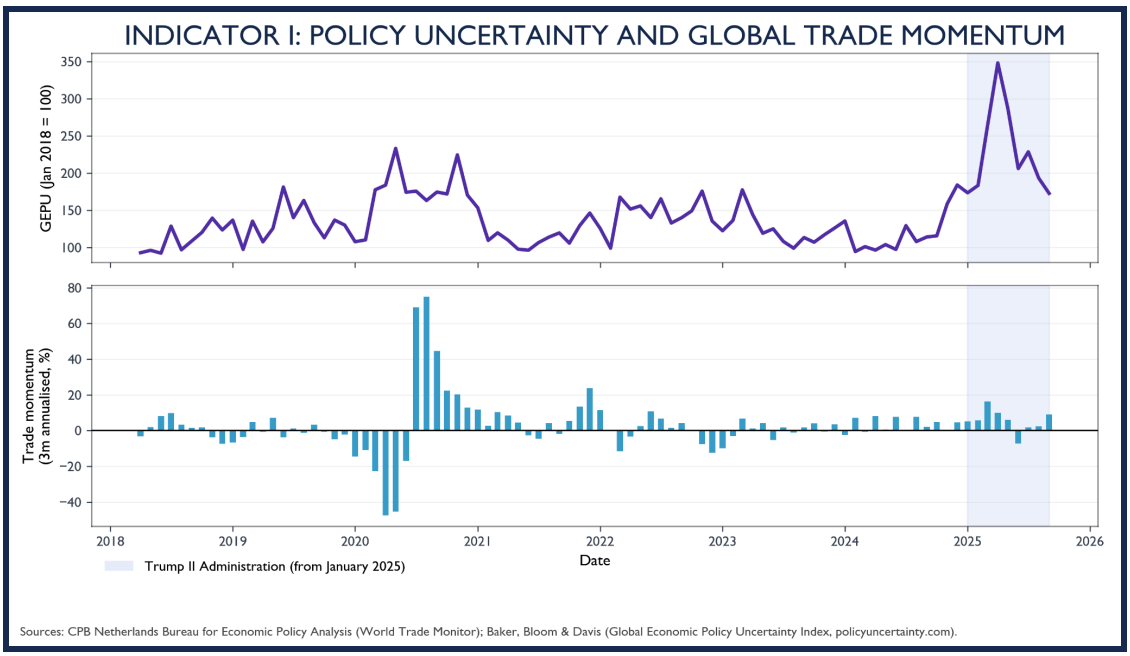


**Figure 2:** The top panel plots the Global Economic Policy Uncertainty (GEPU) index (January 2018 = 100). The bottom panel shows the three-month annualised growth rate of the CPB world merchandise trade volume index. Periods of elevated policy uncertainty are associated with weaker and more volatile trade momentum rather than a mechanical collapse in trade volumes, consistent with a trade-cost variance channel in which firms adjust participation and timing in response to policy-state risk.

**Sources:** Baker, Bloom & Davis (Global Policy Uncertainty Index); CPB World Trade Monitor.

Figure 2 illustrates a central claim of this report: under a state-contingent policy regime, the binding constraint on global trade increasingly operates through the distribution of expected trade conditions, as opposed to the level of tariffs or aggregate trade volumes per se. While global trade volumes continue to adjust gradually, trade momentum—a proxy for marginal shipping, sourcing, and inventory decisions—is subject to more volatile dynamics during episodes

of elevated policy uncertainty. Importantly, this co-movement should not be interpreted as a monocausal relationship; trade outcomes are jointly shaped by macroeconomic demand, financial conditions, supply chain adjustments, and geopolitical shocks. Nevertheless, the post-2024 period is characterised by a sharp rise in policy uncertainty without a commensurate collapse in trade levels, alongside smaller, more erratic, and increasingly negatively skewed trade growth figures. In this sense, trade deceleration manifests through timing and composition effects rather than abrupt volume contractions—aligning with the trade-cost variance wedge.

Readers are directed to Appendix A.I for further details concerning data procurement, construction, and the transformations for Indicator I.

## *Indicator II: Policy Risk and the Global Cost of Capital*

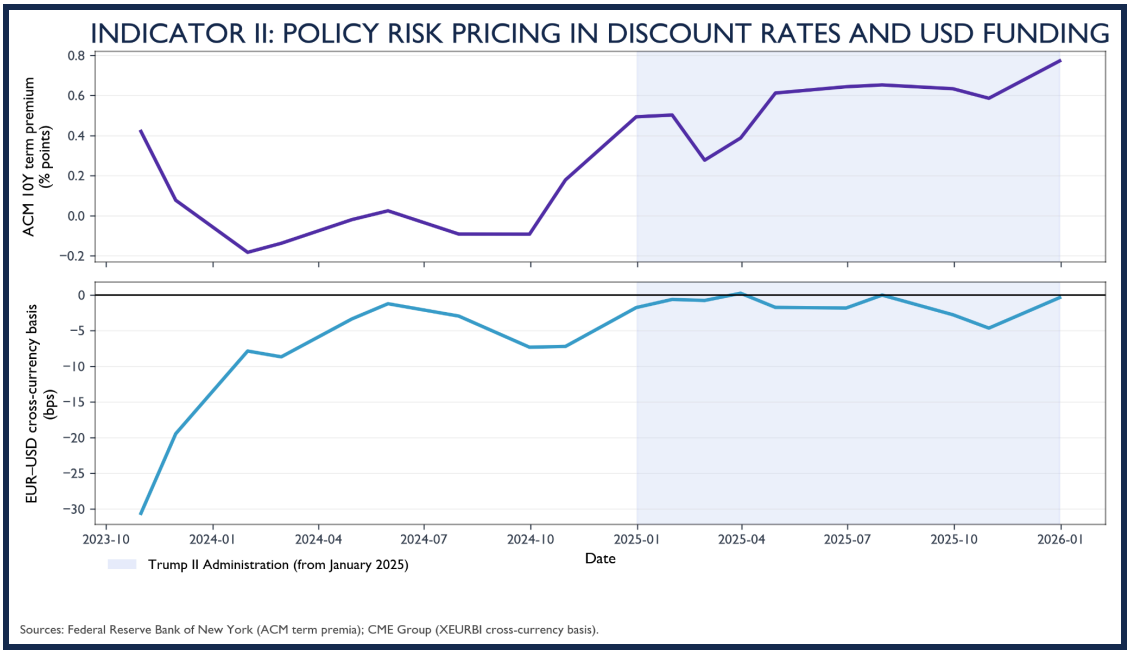


**Figure 3:** U.S. term premia and cross-currency funding spreads have repriced upward since 2024, indicating that policy uncertainty is increasingly capitalized through discount rates and global dollar funding conditions, rather than through contemporaneous macro data.

**Sources:** Federal Reserve Bank of New York (ACM term premium); CME Group (EUR/USD cross-currency basis).

Figure 3 illustrates a second core transmission channel of a state-contingent policy regime: the repricing of macroeconomic risk through discount rates rather than through realised growth or inflation outcomes. While policy rates themselves have followed relatively predictable disinflation paths across advanced economies, longer-horizon asset prices have increasingly embedded compensation for policy tail risk—the probability of abrupt, discretionary shifts in trade, sanctions, regulation, or market access.

The first panel shows the ACM term premium on U.S. Treasury securities, estimated by the Federal Reserve Bank of New York. Unlike nominal yields, which reflect expected future short rates plus term premia, the ACM measure isolates the compensation investors demand for bearing duration risk. The post-2024 rise in term premia is notable because it occurs alongside moderating inflation and stable near-term growth expectations. This divergence suggests that markets are not pricing macro overheating or monetary tightening, but instead heightened uncertainty over the policy environment governing long-horizon cash flows.

The second panel plots the EUR/USD cross-currency basis, a measure of stress in offshore dollar funding markets. A more negative basis indicates that non-US borrowers must pay a premium to access dollar liquidity via swaps, reflecting either balance sheet constraints or perceived funding risk. Since 2024, the persistence of a negative basis—despite abundant global liquidity—signals that dollar funding conditions have become increasingly sensitive to policy announcements, geopolitical developments, and regulatory discretion, rather than to cyclical fundamentals alone.

Taken together, these indicators corroborate the discount-rate wedge underlined earlier. In a state-contingent regime, policy does not simply shift expected growth paths; it increases the covariance between asset payoffs and adverse states of the world. Investors, therefore, require higher compensation even in the absence of near-term macro deterioration.

Readers are directed to Appendix A.II for further details concerning data procurement, construction, and the transformations for Indicator I.

## *Synthesis: Toward a State-Contingent Global Economic Order*

The developments analysed in this Spotlight suggest that the global economy is entering a decisively new regime—one defined less by cyclical synchronisation and more by state-contingent economic governance, anchored within a U.S.-led but increasingly fragmented international order. The post-Cold War architecture—characterised by rules-based multilateralism, predictable policy reaction functions, and relatively stable geopolitical priors—has been progressively displaced by an environment in which national security, fiscal capacity, domestic political constraints, and strategic competition increasingly condition economic outcomes. The United States remains the central node of this system, not merely through its monetary dominance or financial depth, but through its role as the principal setter of global policy narratives, risk pricing, and institutional tolerance for disruption.

Looking forward, the central analytical challenge is not whether the global economy avoids recession or achieves a soft landing, but whether policymakers and markets alike can adapt to a world in which economic outcomes are explicitly conditional on state behaviour.

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# Inflation in 2026: Moderation or Resurgence?

## *Key Indicators*

Leading inflation indicators suggest a mixed macroeconomic state as headline pressures persist above the Federal Reserve's 2% target. In December, the Consumer Price Index increased by 2.7% year-over-year, while core CPI—which excludes food and energy costs—increased by 2.6% (Bureau of Labor Statistics, 2026). Additionally, the Personal Consumption Expenditures (PCE) index, the Fed's preferred inflation gauge, signals sticky price momentum as the year begins, with January nowcasting data indicating core PCE as 2.8% (Federal Reserve Bank of Cleveland). With respect to labor costs, the Employment Cost Index reported a 3.5% yearly increase in the third quarter of FY2025, suggesting persistent wage pressures (Bureau of Labor Statistics. These readings collectively indicate that while inflation has cooled from earlier peaks, core measures remain elevated and stubborn.

## *Major Drivers*

Inflation is primarily anchored by high housing and food costs, and each reflects distinct structural dynamics. Housing costs represent over one-third of the CPI basket, and they have moderated substantially from their March 2023 peak of 8.2% to 3.2% year-over-year in December, with further gradual declines projected through 2026 as existing leases roll over (Cox, 2026). Food price pressures remain more acute, with supply-driven increases in beef and coffee offset partially by stabilizing egg prices.

More significant near-term inflation risks stem from the Trump administration's tariff policies, which have raised the effective U.S. tariff rate to 17.5%, which is the highest level since 1932 (Iacurci, 2026). Through 2025, importers absorbed most tariff costs through inventory management and delayed price adjustments, but economists project substantial consumer price pass-through beginning in mid-2026 as firms revise pricing; this tariff transmission is projected to add an estimated $1,300 to $1,700 to annual household spending. The administration's mass deportation operations are also expected to exacerbate cost pressures, particularly in the agricultural and services sectors, and they are estimated to add $2,150 per year in household expenditures (FWD.us).

## *Monetary Policy Outlook*

The Fed concluded 2025 with three consecutive 25-basis-point interest rate cuts, lowering the target range to 3.50-3.75%, though decision to lower rates in December drew three dissents from

Open Market Committee (FOMC) members, signaling strong internal contention and disagreement (Schneider, 2025). Market pricing assigns high probability to a rate hold at the next FOMC meeting in late January, with the next cut unlikely before mid-2026. In fact, the Fed projects only one additional cut for 2026, implying an end-of-year target range of 3.25-3.50% and median inflation expectations of 2.4%—well above its 2% target (RSM US). Analyst forecasts diverge sharply: Oxford Economics projects core PCE cooling to 2.2% by year-end under benign tariff assumptions, while Bank of America warns core PCE could persist near 2.8% through late 2026 (Hyatt, 2026).

Additionally, federal prosecutors recently initiated a criminal investigation into Fed Chair Jerome Powell, exacerbating policy uncertainty. The investigation concerns statements made during Powell's June 2025 Congressional testimony, where he described "threats and ongoing pressure" from the current administration to compromise the Fed's political independence (Mena, 2026). In conjunction with the administration's pending removal of Lisa Cook from the Fed and the announcement of Kevin Warsh, who has aligned himself with Trump's calls for lower interest rates, to replace Chair Powell at the end of his term, this investigation creates uncertainty over the Fed's leadership, policy stance, and political independence, adding institutional risk at a critical juncture in monetary policy.

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# A Labor Market in Stasis: Structural Transformation Amid Uncertainty

The labor market is experiencing a period of acute stagnation as a result of long-standing economic uncertainty. This uncertainty reflects rising global trade tensions, AI adoption, and domestic policy shifts. In December, the unemployment rate decreased by 10 basis points to 4.4% (BLS, 2025a; Torry, 2026), although it has increased from 4.0% since last January (BLS, 2025a; Torry, 2026). Total nonfarm payrolls increased by 50,000 in December, lower than November's 56,000 gain (BLS, 2025a). Overall, employers added 584,000 total jobs in 2025, a marked decline from 2024 when 2 million jobs were created (BLS, 2025a; Torry 2026). Following the Federal Reserve's policy tightening in 2022, the labor market continued to cool to its current sluggish state. Understanding whether this shift reflects short-run adjustment or deeper structural change is central to assessing recent employer hiring and retention behavior and the broader U.S. economic outlook.

## *The Low-Hire, Low-Fire Conundrum: Evidence of Labor Market Stagnation*

Labor market dynamism started weakening in 2022 as the Federal Reserve began raising interest rates and firms corrected its post-pandemic overhiring. Labor demand exhibited signs of significant decline, as measured through the job openings, quits rate, and continuing claims (Pickert & Saraiva, 2023). In 2025, these metrics appear frozen at historically low levels as employers grapple with external uncertainties. Job openings have declined from a peak of 12 million in March 2022 to a low 7.1-7.7 million range in 2025 (BLS, 2022a; BLS, 2025b; Grossman 2026) . Declining labor market demand discouraged workers from leaving their jobs, resulting in the quits rate consistently declining from a past high of 3% in March 2022 (BLS, 2022a). Over the past year, the quits rate has stabilized around a low 2% level as workers remain resistant to leaving their jobs amid external headwinds, further constraining the growth of new job openings (BLSa, 2025). Early 2025 saw claims hover between 1.83-1.85 million until April, increasing to around 1.93-1.97 million before declining again to 1.83-1.9 million towards the end of the year (U.S. Employment and Training Administration, 2026). This freeze in labor demand and turnover rates in 2025 has made it increasingly difficult for the existing unemployed to find employment, as continuing claims on unemployment insurance remain persistently high with minor fluctuations.

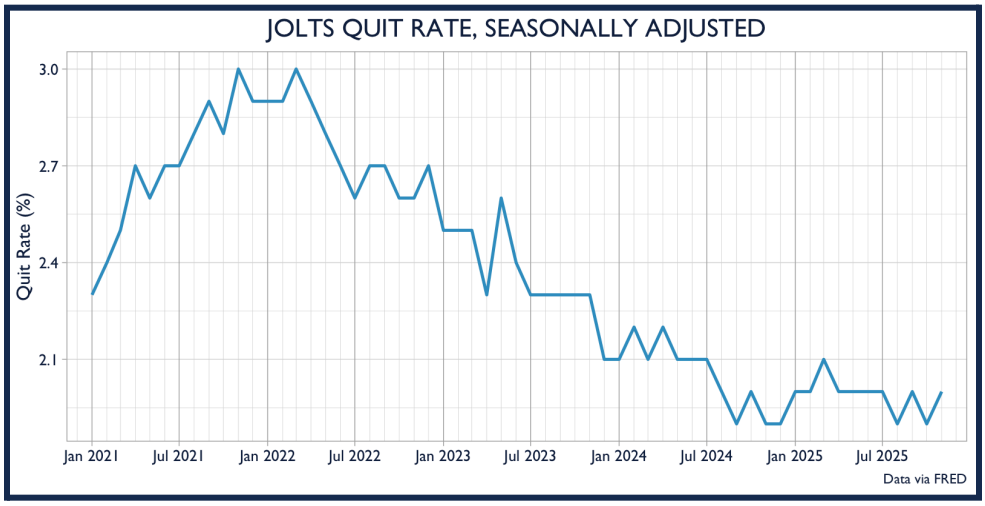


**Figure 4:** JOLTS reported quits rate has fallen 100 basis points since its peak of 3.0% in April 2022 and stabilized around a low 2.0% in 2025. Workers remain wary of leaving their jobs amidst a downturn in labor demand, further constraining new job openings.

Historically, an increase in layoffs has coincided with downturns in the labor market as firms tighten operations and avoid expansion. Interestingly, the current layoffs and unemployment trends circumvent this relationship.

Initial unemployment insurance claims provide insight into labor market conditions by capturing the flow of workers experiencing job loss. Initial claims primarily reflect recent layoffs and often rise alongside the unemployment rate during periods of market weakness. Currently, we are seeing a divergence in this trend, in which layoffs are unlikely to be the primary driver in December's unemployment rate. Using historical data, we modeled two estimates of the relationship between initial claims and the unemployment rate. Model I compares monthly unemployment rates to the average flow of initial claims for a given month. To reduce high-frequency noise and capture short-run adjustments, Model II uses a rolling 4-week average of initial claims compared to the 4th week's unemployment rate. The models span from January 1994 to November 2025, excluding data from March 2020 through June 2021 to avoid distortions associated with pandemic-related shutdowns and temporary unemployment insurance expansions from the federal government. Each model forecast December's unemployment rate to observe any potential abnormality in this relationship.

Both models showed a substantial level of correlation between initial claims averages and unemployment. When applying December's data, Model I and Model II undermeasure the current unemployment rate by 3.5 and 4.1, respectively. The claims to unemployment relationship observed in December is highly unusual relative to historical norms, suggesting that elevated unemployment is not driven by layoffs.

## *The Disappearing On-Ramp: Graduates in a Low-Hire, AI-Exposed Economy*

Recent college graduates are particularly impacted by the current labor market softening. The unemployment rate for recent graduates between the ages of 22 and 27 has risen to 5.8% in September, substantially higher than the 4.0% rate in 2019 (Federal Reserve Bank of New York, 2025). A 1.8% increase is substantial and underscores growing concerns around technological disruptions to white-collar jobs that are contributing to market stagnation. Currently, the evidence of AI's impact on entry-level hiring remains mixed. A recent study from the Stanford Digital Economy Lab observes a 6% employment decline for early career workers (ages 22-25) in AI-exposed occupations. This stands in stark contrast to the rest of the market – employment of older workers in the same professions grew by 6-9% while occupations with low AI exposure grew by 5-13% (Brynjolfsson et al., 2025). On the other hand, the Yale Budget Lab observes an increase in the occupational mix of recent college graduates that typically occurs during periods of technological disruption, but argues that this shift predates the rise of generative AI (Gimbel et al., 2025).

Nevertheless, AI's impact on employment could assume two paths: either employers in AI-exposed sectors observing the effects of AI before committing to entry-level hires or the direct automation of entry-level roles, both of which increase unemployment rates for recent college graduates by slowing entry-level hiring. Taken together, the recent graduate labor market provides an early signal that AI may be emerging as a structural headwind that could shape labor market dynamics in 2026 by slowing the absorption of new workers.

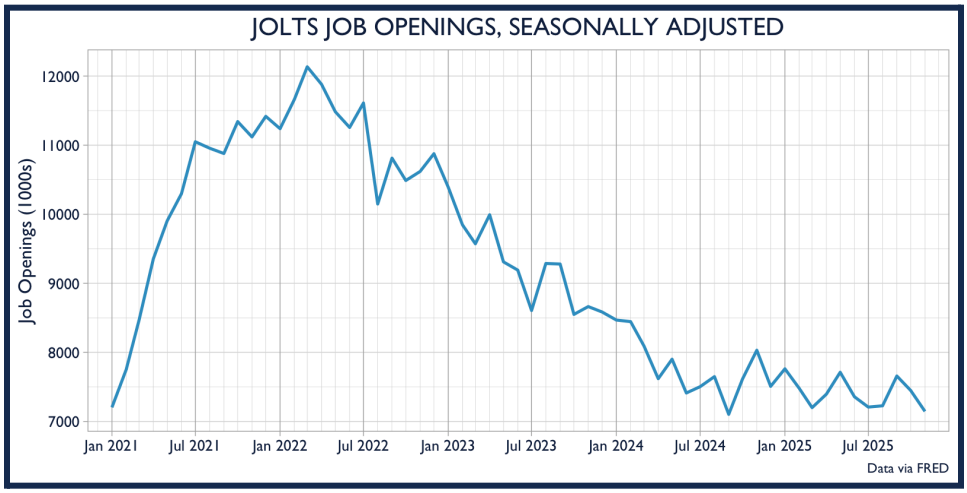

**Figure 5:** Job openings have stabilized around a low 7.1-7.7 million range in 2025 amidst uncertainty about future economic conditions after a continuous fall since 2022, meant to correct overhiring practices in the years following the COVID-19 pandemic.

## *An Unconventional Drift towards Long-Term Unemployment: A Structural Warning Signal*

The labor market freeze has culminated in a sustained uptick in long-term unemployment (unemployment for >27 weeks) over the past year. The number of long-term unemployed has increased by 397,000 over the past year to 1.9 million and makes up 26% of all current unemployment (BLS 2025a). A Federal Reserve Bank of Minneapolis report notes that the current rise in long-term unemployment several years after a recession is unusual. Typically, long-term unemployment rises during recessions and falls sharply during recoveries for a sustained period of time (Goodman-Bacon & Wozniak, 2025). This indicates that the current bout of long-term unemployment is more structural than cyclical. This shift reflects layoffs of almost 277,000 federal workers, postponed hiring owing to uncertain tariffs, frozen entry-level hiring for new graduates, and loss of workers due to intensified immigration enforcement. Therefore, the recovery of the labor market will hinge on the improvement of labor demand and a gradual reduction of long term unemployment.

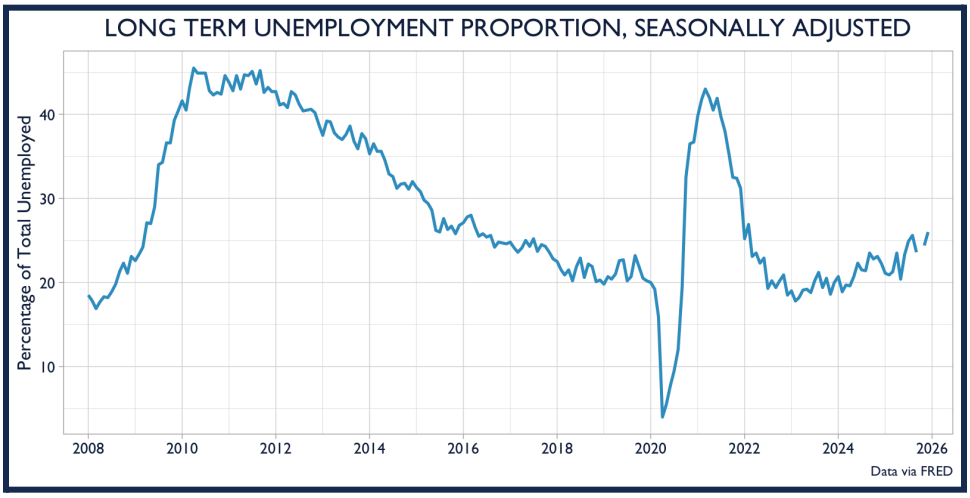


**Figure 6:** The current post-pandemic market shows a sustained increase in workers unemployed for >27 weeks since 2023, unlike the post-2008 era of declining long term unemployment. This trend suggests a structural shift in the labor market rather than a cyclical recovery.

Ultimately, whether the labor market regains dynamism will depend on the persistence of the low-hire, low-fire environment. Although federal funds rates stay stable for now, tax cuts enacted in 2025 could support aggregate demand and encourage firms to increase hiring. Hiring incentives would strengthen if firms observe that AI adoption complements labor rather than substituting for it, expanding opportunities for recent graduates and the long-term unemployed.

Greater clarity around the legality of tariffs would reduce uncertainty and encourage business expansion (LaRocco, 2026). Overall, sustained developments in 2026 addressing demand and structural headwinds could lay the groundwork for renewed labor market momentum; conversely, continued stagnation would signal deeper weakness in the U.S. economy.

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# Financial Frenzy: Navigating the Great Divergence in Geopolitics and AI

In January 2026, financial markets began picking clear winners and losers. A U.S. intervention in Venezuela sent stocks of specific American energy firms soaring while leaving global oil prices flat. In technology, a great AI divergence is underway: software companies with vague AI promises are seeing their stocks plummet, while the hardware makers powering the revolution are booming. Meanwhile, the crypto market is feeling the chill from new regulatory battles and a risk-off mood. The message from investors is clear: broad trends are out, and specific, provable value is in.

## *Oil Markets Price in a New Geopolitical Reality*

The U.S. intervention in Venezuela at the start of January triggered a sharp, yet nuanced, reaction in energy markets. While the action was framed as a move to stabilize the region and secure energy assets, its immediate impact was felt more in equity valuations than in global commodity prices.

**Sector-Specific Equity Surge:** U.S. oil companies with historical or potential interests in Venezuela saw their stocks jump in premarket trading following the news. Investors anticipated a more favorable operating environment and enhanced asset security for American firms. Key movers included Chevron (CVX), which rose 7.82%, oilfield services giant Halliburton (HAL), up 8.45%, and ConocoPhillips (COP), which gained 7.54%. The market's positive response was predicated on the expectation that U.S. companies could now operate without the political and operational constraints imposed by the former Maduro regime (Nasdaq, 2026).

**Muted Impact on Global Crude Prices:** Despite the significant geopolitical development, the immediate impact on global oil prices was minimal. Brent crude futures traded flat or only marginally higher (approximately 0.4%), as the market focused on the potential for long-term supply increases rather than any immediate shortage. Venezuela's current oil output, crippled by years of underinvestment and mismanagement, accounts for only about 1% of the global supply, meaning its immediate disruption or restoration has a limited effect on the global balance (US Energy Information Administration, 2026).

**Long-Term Outlook and Infrastructure Challenges:** While the intervention aims to bring investments to Venezuela's oil industry, analysts remain cautious. The country's oil infrastructure is widely described as being in a "total bust" state. A significant ramp-up in production to levels that would meaningfully impact global supply would require years of sustained investment and political stability. Consequently, U.S. refiners equipped to process heavy Venezuelan crude, such as Valero (VLO), Phillips 66 (PSX), and Marathon Petroleum (MPC), are seen as potential long-term

beneficiaries, but the immediate financial upside is viewed more through the lens of geopolitical positioning than a large-scale supply event (Morgan Lewis, 2026).

## *Crypto Markets Navigate Volatility and Regulatory Headwinds*

The digital asset space experienced significant volatility in January, reflecting both macroeconomic pressures and sector-specific regulatory battles. After a strong start to the year, a spike in Treasury yields and renewed fears of a trade war prompted a severe "risk-off" sentiment. This triggered a sharp market downturn, with Bitcoin plunging from highs above $95,000 to around $78,000, while other major cryptocurrencies experienced even steeper declines (Binance, 2026).

**Key developments shaping the crypto landscape this month include:**

**Regulatory Pushback:** The industry is girding for a protracted battle with regulators. A coalition of DeFi groups has begun actively opposing stringent SEC and FTC oversight, arguing that rules designed for centralized financial intermediaries are ill-suited for non-custodial, decentralized systems. Similarly, major exchange Coinbase publicly flagged what it termed "fatal flaws" in new Senate bills, signaling a more confrontational stance from industry players (Finance Magnates, 2026).

**Institutional Integration and M&A:** In a notable move, Capital One announced its acquisition of Brex's crypto-friendly credit card and stablecoin units. This demonstrates that traditional financial giants are still strategically entering the space. Further bridging the gap between traditional and decentralized finance, Ondo Finance began the process of moving its tokenized U.S. Treasury assets onto the NYSE, a key step in the maturation of real-world asset (RWA) tokenization (Seeking Alpha, 2026).

**Security and Global Enforcement:** The risks inherent in the ecosystem remain a focus. Citi issued a warning to clients about the rise of "address poisoning" scams on the Ethereum network, highlighting ongoing security vulnerabilities. Simultaneously, international enforcement actions are ramping up, with Brazilian authorities successfully disrupting a $126 million crypto-based money laundering operation. While analysts note that the "institutional era" of crypto continues with new ETF filings, the market remains susceptible to macroeconomic shocks and an increasingly complex global regulatory patchwork (investing.com, 2026).

## *A Tale of Two AIs: The Great Divergence in Tech Valuations*

As of late January, the technology sector is characterized by a stark performance divergence. While the macro trend of AI-driven infrastructure growth continues unabated, investors have initiated a sharp sell-off in software stocks that have struggled to translate AI hype into tangible revenue growth. This marks a new "show me" phase for the market, where valuations are being re-assessed based on clear monetization strategies (Shukla 2026).

**The "Software Sell-off":** A broad rotation out of high-valuation software stocks defined the start of the year. Companies such as HubSpot, Atlassian, and Braze saw their shares fall more than 20% in January. Even enterprise software leader ServiceNow experienced a six-day losing streak. This pullback reflects growing investor impatience with companies that have yet to demonstrate a clear, profitable AI angle. In response, firms like Workday, despite a 15% drop, are actively working to reassure investors that AI will be a net positive tailwind for their business models (Nasdaq, 2026).

**AI Infrastructure and Hardware Boom:** In stark contrast, companies providing the foundational "picks and shovels" for the AI revolution are thriving. Capital has rotated into these "pipes & power" plays. Applied Digital (APLD), which provides data center infrastructure, saw its shares surge over 40% year-to-date. Hardware providers like Nvidia, Broadcom, AMD, and Taiwan Semiconductor Manufacturing (TSM) continue to report robust demand for AI computing power. In a notable turnaround, legacy tech firm Nokia has surged roughly 40% over the past year, driven by its successful pivot to deploying AI in edge computing networks (Reuters, 2026).

**Market Drivers and Volatility:** The "Magnificent Seven" experienced a brief dip early in the month, making them valuation-wise the cheapest they had been in months and prompting a "buy the dip" response from some investors (Saxo Bank, 2026). However, individual company performance remains volatile; Intel's stock fell in late January after a weak Q1 outlook, erasing some of its 40% gain from the prior month and underscoring the fierce competition in the chip market. Looking ahead, investors are closely monitoring the development of AI agents, which have the potential to automate software development cycles and pose an existential threat to slower-moving software incumbents (PR Newswire, 2026).

## *Conclusion: A Granular Re-pricing of Risk and Opportunity*

Our analysis of financial market dynamics in January 2026 indicates a pivotal departure from broad-based sentiment toward a more discerning, granular re-pricing of assets. We found that investors are no longer responding to macro themes with uniform capital allocation; instead, they are actively engaging in a sophisticated differentiation process, demanding tangible evidence of value creation. This has resulted in stark performance divergences across and within key sectors, which our research has identified in three primary narratives.

**1. Energy Markets: A Targeted Bet on Corporate Futures Over Commodity Speculation**

Our examination of the energy sector following the U.S. intervention in Venezuela reveals a nuanced and calculated market response. Contrary to what might be expected from a significant geopolitical event in an oil-producing state, global crude prices remained largely inert. Our research shows the market astutely priced in the reality that Venezuela's current output is insufficient to materially impact near-term global supply.

Consequently, investor activity bypassed broad commodity speculation and instead manifested as a targeted equity surge. Capital flowed precisely to U.S. firms, such as Chevron and Halliburton, which possess the historical footprint and operational capacity to capitalize on a potential long-term stabilization in Venezuela. This demonstrates a market making a sophisticated, forward-looking wager on specific corporate earnings potential rather than a reactive trade on headline risk.

**2. Cryptocurrency Markets: Contested Legitimacy Amid Regulatory Headwinds**

We found the digital asset space to be caught in a pronounced tug-of-war between advancing institutional integration and escalating regulatory pressures. On one hand, the trend toward mainstream adoption continues to provide a foundational layer of legitimacy, evidenced by Capital One's strategic acquisition of a crypto-native business unit. This signals that traditional finance continues to strategically carve out a role for digital assets.

On the other hand, this progress is being directly challenged by significant policy shocks. The specter of stringent new frameworks from regulatory bodies like the SEC, combined with broader macroeconomic anxieties, precipitated a distinct risk-off sentiment. Consequently, the immediate market impact has been a distinct downturn, as the tangible pressures of regulatory uncertainty and macroeconomic tightening have, for now, outweighed the long-term promise of institutional integration, leading to the recent decline in digital asset valuations.

**3. Technology Sector: The Great Divergence in AI Monetization**

Our analysis of the technology sector uncovered a profound bifurcation driven by the maturation of the Artificial Intelligence theme. The market has unequivocally entered a "show-me-the-money" phase, initiating a sharp rotation of capital.

- **The Winners: The "Picks and Shovels" of the AI Revolution.** Our findings show an aggressive allocation of capital towards companies providing the foundational infrastructure for AI. Hardware and infrastructure providers—including semiconductor firms like Nvidia and AMD, data center operators like Applied Digital, and network specialists like Nokia—experienced significant valuation increases. The market has identified these firms as the tangible and immediate beneficiaries of the AI build-out, akin to selling the essential tools during a gold rush.

- **The "Prove It" Cohort: The Software Incumbents.** Conversely, a broad cross-section of high-valuation software companies faced a significant sell-off. We conclude that investor patience has worn thin for firms that have promoted an AI narrative without demonstrating a clear and profitable monetization strategy. The market is now demanding tangible evidence of AI-driven revenue growth, punishing those whose AI integration remains purely theoretical.

**Overall Assessment**

In summary, our analysis of January 2026 points to a definitive maturation of investor behavior, shifting from thematic momentum to rigorous scrutiny. Hype and high-level narratives are now being systematically stress-tested against on-the-ground realities. Whether in response to geopolitical events, technological disruption, or emerging asset classes, capital is decisively flowing not to the most compelling stories, but to the specific entities with the clearest and most defensible pathways to generating tangible value in an increasingly complex global economy.

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# Perplexing Perceptions: Changing Winds in Economic Sentiment Amid Underlying Patterns

Over the past several months, U.S. economic sentiment has been shaped less by headline macroeconomic outcomes and more by the interaction of uncertainty, distributional pressures, and perceptions of economic durability. While inflation has moderated from its post-pandemic peaks and financial markets have remained resilient, confidence measures deteriorated steadily through late 2025 as households grappled with persistently high price levels, a cooling labor market, and heightened policy uncertainty. Entering January, sentiment showed tentative signs of stabilization, with select indicators rebounding modestly from recent lows. However, this improvement has been uneven and fragile, reflecting conflicting signals across consumer surveys rather than a decisive shift in underlying economic confidence.

The divergence across sentiment measures underscores a broader tension defining the current environment. Households increasingly distinguish between disinflation and affordability, between resilient aggregate growth and deteriorating job prospects, and between market strength and everyday economic security. Labor market perceptions have weakened alongside slowing hiring and rising long-term unemployment, while concerns around tariffs, prices, and political uncertainty continue to weigh on expectations. At the same time, equity market gains and easing inflation expectations have provided partial support to confidence among certain income groups, complicating the interpretation of headline sentiment rebounds. Against this backdrop, January's readings suggest not a restoration of confidence; rather, they represent a recalibration, one in which optimism remains constrained by structural headwinds and asymmetric economic experiences across households.

## *Why the Recent Optimism Doesn't Mean Problem Solved*

University of Michigan's preliminary consumer sentiment readings increased from December into January, reaching the highest level since September 2025, after months of consecutive declines. After reaching a low of 51.0 in November, the index rose to 52.9 in December and further to 54.0 in January, marking a 2.1% month-over-month increase and a 24.7% year-over-year decrease (Surveys of Consumers, n.d.). On average, consumers perceived a modest improvement in the economy over the past two months, but the readings remain well below the January 2025 level of 70.7 (Surveys of Consumers, n.d.). Year-ahead inflation expectations were steady at 4.2%, the lowest since January 2025, but above the 3.3% expected in that period. Long-run inflation

expectations, meanwhile, increased from 3.2% in December to 3.4% this month (Surveys of Consumers, n.d.).

The Conference Board's readings declined, however. The Consumer Confidence Index fell from 94.2 in December to 84.5 in January, with 1985 as the baseline (The Conference Board, 2026). The Present Situations Index, which is based on consumers' assessment of current business and market conditions, decreased by 9.9 points to 113.7 in January (The Conference Board, 2026). The Expectations Index, based on consumers' short-term outlook for income, business, and labor market conditions, fell to 65.1 (The Conference Board, 2026). Notably, the Board's Expectations Index has been under 80 for 12 consecutive months, a typical sign of an impending recession (The Conference Board, 2026). Perceptions of employment conditions declined, and the labor market differential continued to decline from previous months. Expectations for business conditions improved from December to January, by nearly 0.1%(The Conference Board, 2026). Expectations for labor market conditions were worse, a trend that has continued into this month. The outlook for household incomes was less positive as well, despite strong wage growth of 3.6% in November and 3.8% year-over-year last month (The Conference Board, 2025; Mutikani, 2026).

Regarding the issues foremost on consumers' minds, references to tariffs, prices, trade, inflation, and politics remained prominent themes, though consumers' worries about tariffs gradually receded. However, consumers have consistently distinguished between inflation and price levels. Inflation expectations spiked last year but abated quickly whereas high-price mentions remained elevated throughout, according to the University of Michigan's 2025 survey results. Moreover, comments on high prices have remained elevated for the past three years, in contrast to the significant fluctuations in the 1960s and 1970s, possibly suggesting that consumers have yet to internalize post-pandemic price levels as normal, which may affect their perception of the economy.

## *The K-Shaped Divergence Persists– but With a Twist*

One surprising result of this month's preliminary survey of consumer sentiment was the decline in sentiment among higher-income groups, while lower-income groups improved. Both groups have faced very different economic realities since last year: higher-income households have been supported by equity market gains and accumulated wealth, benefiting from stock market gains in both 2025 and 2026. Last year, the S&P 500 maintained its 7-month rally, gaining 16% in November (The Great Divergence, 2025). This year on January 21 , Wall Street posted its largest one-day percentage gain in two months after a slump on January 20, following a framework agreement on Greenland, with the Dow Jones Industrial Average and the Nasdaq Composite posting milestone gains since January 5 and December 19, respectively *(French, 2026)*. Supported by equity market gains, high-income households have accounted for a disproportionate share of overall spending, which, in turn, is the biggest driver of U.S. economic growth. Moreover, as of fiscal year 2024, nearly 50% of government revenue came from

individual income taxes, further underscoring the role of the market in driving consumer behavior (particularly consumer confidence and discretionary spending) and government revenue (1919 Investment Counsel, 2026).

On the other hand, lower-income households have been marred by rising debt balances, higher delinquency rates, and declining real wages overall, leaving limited room for further deterioration in an already worsening labor market. Employment growth slowed more than expected amid job losses in construction, retail, and manufacturing, which have been struggling with weak consumer demand, rising input costs, a volatile global trade environment, weaker earnings, and less optimistic outlooks for their performance. Businesses have been holding back on hiring and shedding jobs at an alarming rate, particularly in sectors dependent on consumer discretionary spending, owing to decreases in consumer disposable income, lack of clarity about staffing needs, and the role of artificial intelligence in their operations. This, in turn, has increased pressure on household budgets. These patterns increase the risk of strains in economic growth and tax receipts to fund government spending without relying on debt issuance in the event of a significant market decline.

In this regard, a decline in sentiment among high-income households does not bode well for the economy. Consumer sentiment among high-income consumers steeply declined throughout 2025, with the country's highest tercile of earners suffering a 32.1% decline in December, in contrast to the 29.8% and 27.6% declines among the lowest and middle terciles, in the same period (DiPalma, 2026). Declining faith in labor markets has been a particularly sensitive issue for high-income consumers, with pessimism creeping into the upper-income bracket. High earners, as stock owners, have been relatively insulated against inflation and rising prices for housing, food, and electricity over the past year. However, the fact that nonfarm payrolls increased by only 50,000 in December while the economy added only 584,000 jobs last year, down from 2 million in 2024, is weighing on the third tercile (Mutikani, 2026). A weakening labor market spells trouble for white-collar workers, as hiring has been frozen for the past year and anxiety over job loss is widespread among these employees. Fears of joblessness over the next year were most pronounced among the highest-income households last summer, with Morning Consult reporting a 10.5-point decline in sentiment among consumers earning more than $100,000 a year (DiPalma, 2026).

Executive sentiment has similarly deteriorated. Across the U.S., 43% of CEOs have marked economic uncertainty as their top concern, compared with 29% among their global counterparts (The Conference Board, 2026). Although measuring AI ROI is a top priority for nearly half of U.S. CEOs, many executives are struggling to translate this into measurable business value because organizational obstacles, such as unclear use-cases, siloed data, and challenges integrating AI into core operations, continue to hinder meaningful returns on investment(The Conference Board, 2026; Congruity360, 2025). Moreover, businesses in general have entered a new period of uncertainty, with multiple indicators showing a loss of momentum despite ongoing productivity improvements. While firms continue to invest in AI-related infrastructure to avoid being left behind, concerns about sustainability, the concentration of spending, and the market's heavy

reliance on a narrow set of firms have intensified. As of November 2025, just 10 companies accounted for 41% of gains in the S&P 500, while their equal-weighted counterparts posted a 0% price return over the prior 12 months (The Great Divergence, 2025). These dynamics raise questions about the durability of aggregate capital expenditure, particularly if firms reassess the pace of AI investment or if investors rotate away from the small group of companies driving the bulk of market returns.

## *The Effect of Politics on the Vicious Feedback Loop*

Geopolitics adds another dimension to the uncertainty businesses face as trade policy volatility, shifting tariff proposals, and renewed restrictions on strategic minerals affect inventory planning and input costs, particularly for manufacturers. Geopolitical shocks can disrupt supply chains, reprice energy and commodity markets, and alter inflation and interest rate expectations. Moreover, the U.S. dollar has weakened over the past year amid a lack of confidence in U.S. fiscal discipline, raising import costs and inflation because the U.S. is a net importer of goods. A weakened dollar also reduces foreign demand for U.S. assets and increases long-term debt financing pressures, as was seen last year when global investors shifted assets out of Treasury bills and into portfolio managers with a wider mandate to own assets, including international bonds. The latest agreement on Greenland, which has been framed as a non-binding "framework for future cooperation", while avoiding an escalation of trade hostilities, is far from resolved. Should EU leaders perceive a renewed aggressive U.S. push to acquire Greenland, the bloc can suspend ratification of a draft EU-US trade agreement formulated last summer, impose tariffs on $109 billion worth of goods from the U.S., unload $8 trillion worth of U.S. debt to raise borrowing costs and the cost of living in the U.S., or use the anti-coercion instrument to shut off 450 million consumers in the EU single market from American investments and goods completely, further raising uncertainty for businesses that are postponing investment and hiring decisions due to a lack of clear economic signals (Cooban, 2026).

Domestic politics and supply-and-demand dynamics are further exacerbating uncertainty. The political gridlock and fiscal uncertainty stemming from the government shutdown also weighed on consumer confidence and market liquidity, while weak demand from credit-squeezed consumers dampened business activity, leading to higher unemployment and further erosion of consumer confidence last year. The U.S. administration is considering limiting credit card interest rates, prohibiting institutional investors from buying homes, banning stock buybacks, and limiting executive pay for defense contractors, resulting in significant changes and adjustment costs for businesses as they adapt their operations to rapidly changing policies (Peck & Brown, 2026). The Supreme Court's pending ruling on the legality of tariffs imposed under IEEPA complicates investors' assessments of corporate costs, profits, and market-wide uncertainty: experts do not expect a decision revoking IEEPA to have a material impact on the effective tariff rate, since several alternative pathways exist to impose tariffs (J.P. Morgan, 2025). However, implementing these legal pathways could create short-term volatility and affect expected returns by raising company costs, contributing to inflationary pressures, and influencing asset prices across

portfolios, including 401(k)s and IRAs now exposed to diversified funds tracking broad market performance (Bolton, 2026). The question of refunds looms large and adds a layer of complexity: $135 billion in revenue could become eligible for refunds across 30,000 companies, complicating refund filings and straining government finances in the absence of alternative tariffs (Bolton, 2026).

## *How This All Is Affecting Consumer Spending, and What Businesses Can Do*

Amid persistent price increases, consumers have imposed spending limits, even as total retail spending held steady. In the five weeks ending January 3, 2026, U.S. retail sales revenue was flat across food, consumer packaged goods, and discretionary product segments, with demand down 1% compared with the same period in 2024 (Cohen, 2026). Discretionary general merchandise retail dollar sales declined 2%, and unit demand fell 5% compared with the same period a year ago (Cohen, 2026). Interestingly, price increases in retail food and beverage supported the segment's 3%-dollar growth, but consumption remained flat for the year, while general merchandise reported 0.5%-dollar growth and 1.3%-declining sales (Cohen, 2026). This points to a continued willingness to spend, as evidenced by the 4.1% growth in retail sales in December, but price increases are curtailing purchases (National Retail Federation [NRF], 2026).

For businesses, this implies a potential shift in priorities toward agile inventory management, cost control, and adaptable market strategies tailored to a cautious consumer base. Over the long term, firms may need to diversify supply chains, strengthen their digital presence, and build more resilient business models to weather future economic shocks and political uncertainties. As we noted in our previous edition, sectors dependent on discretionary spending or significant capital investment, such as big-ticket items, non-essential goods and services, hospitality, and automobile manufacturing, face prolonged challenges due to delays in major purchases amid job insecurity. On the other hand, opportunities may emerge in defensive sectors, value-oriented products, and technologies designed to enhance service efficiency. Businesses in discretionary segments will need to brace for increased frugality among consumers and adjust their pricing strategies, product offerings, and market priorities to align with evolving demand as consumers seek more affordable alternatives, while also targeting strategies to boost impulse spending.

Markets face double risks from declining consumer sentiment among the upper-income tercile and from systemic risks posed by potential failure or slowdown among the dominant players driving the current jobless boom. Prioritizing efficiency and A.I integration risks further strategic layoffs, while firms that fail to optimize costs and scale up technological adoption risk losing out in the dynamic evolution of global tech markets. Strategic pivots for businesses, including reskilling their workforces to remain competitive and making operations leaner, will be essential to maintaining investor confidence. For investors, diversification across asset classes, including large-cap quality stocks, longer-duration bonds, international equities, real assets, and real

estate, is becoming critical to mitigate risks associated with concentrated market exposure. Additionally, monitoring regulatory developments concerning tech giants and global trade policy will provide further clarity on market direction, but investors should expect increased volatility in the short term and shifts in market leadership, likely to concentrate among defensive sectors and companies with strong balance sheets and consistent cash flows.

Nevertheless, the nature of business and market environments facing consumers and investors ultimately depends on consistent trade and monetary policy choices. Whether the One Big Beautiful Bill Act tax cuts and refunds, favorable financial conditions, and the advancement of AI result in higher GDP growth in 2026, as Goldman Sachs predicts, also matters (Revell, 2025). The overall landscape also depends on how long the AI boom continues and on whether and when the U.S. economy undergoes a market correction, aligning labor market trends and consumer spending with elevated valuations.

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# New Year, Renewed Precedents: The Western Hemisphere Remade

A year of mounting tensions came to a head on January 3 when the U.S. military carried out a raid on Caracas, Venezuela, capturing President Nicolas Maduro (Reuters, 2026a). The deposed president later pleaded not guilty to drug and weapon charges in a Manhattan Federal court (del Valle, 2026). The strike was met with mixed reactions by the international community. While Maduro's Venezuela had few international allies, many heads of state were disquieted that the U.S. would engage in unilateral use of force (Reuters, 2026b). Events in Venezuela reflect the emergence of a new geopolitical epoch in the Western Hemisphere.

## *The Road to Caracas*

From the first day of Donald Trump's second term as president, his administration has been constructing the legal framework for action against Venezuela. Nicolas Maduro was charged with narco-terrorism conspiracy for his alleged involvement with Venezuelan drug trafficking groups Tren de Aragua and the Sinaloa Cartel (Wolfe, 2026). In previous years, these drug cartels were not defined as foreign terrorist organizations by the U.S., but an executive order signed January 20, 2025 designated them as such (Finley, Toropin, & Garcia Cano, 2026).

On September 2, tensions between the U.S. and Venezuela spiked after the U.S. struck down what it claimed was a drug-carrying vessel in the Caribbean (Madhani & Garcia Cano, 2025). Deadly boat strikes continued intermittently for the remainder of the year (Finley, Toropin, & Garcia Cano, 2026).

On December 10, 2025, the U.S. seized an oil tanker off the coast of Venezuela on the grounds that it was allegedly involved in an illicit shipping network (Madhani, Toropin, Goodman, & Garcia Cano, 2025). From this point onward, seizures of Venezuelan oil tankers and their cargo became routine for U.S. forces as they implemented a full blockade of Venezuelan oil (Maher & Liptak, 2025). This is considered the first direct act of trade interdiction against Venezuela. The seizure of oil contributes to Trump's narrative justifying military intervention.

## *Venezuela is a High-Risk Investment Environment*

The Trump administration has justified its actions in Venezuela with a doctrine of energy dominance in the absence of an appeal to international law.. The strategy is deceptively simple: American companies will extract crude oil from Venezuela to sell in the U.S. market (Reuters 2026a). A more considered analysis reveals that this strategy would be risky, expensive, and unprofitable in the near term. The chief driver of risk in the country is the cadre of Maduro loyalists that still leads its government. The continuity of socialist leadership stretches back to the

ascendance of Hugo Chavez to the presidency in 1999. The Chavistas are deeply entrenched in the Venezuelan state and will seek to obstruct market reforms in the country. However, the Venezuelan National Assembly passed legislative reforms that suggest this power bloc has been severely weakened.

Venezuela's oil reserves would contribute to U.S. energy dominance assuming a high degree of mobility between Venezuelan and U.S. oil markets. There is reason to expect access to the Venezuelan market will not hold. The decapitation strike on Caracas left Maduro's inner circle virtually untouched. His vice president, Delcy Rodriguez, was sworn in as interim president immediately (Reuters, 2026a). If Venezuela's low oil output was caused by corruption, ideology, or mismanagement, the responsible parties are still in power. The U.S. does not have any troops in Venezuela nor does it maintain an embassy there. Without a military or diplomatic presence in the country, it will be difficult to impose the wishes of the U.S. government onto the Venezuelan state. Trump threatened that noncompliance would be met with further military interventions, but deepening the conflict would also be fiscally and politically expensive (Lewis & Zengerle, 2026). However, it appears that the threat of further military action induced significant policy reform at the end of January. On January 29, Venezuela's National Assembly approved an overhaul of oil industry regulations. The new laws grant oil companies greater control over operations and allow them to resolve disputes in international venues rather than Venezuelan courts (Romero & Romero, 2026). Though this legislation shows that they are susceptible to U.S. pressure, the capabilities of Maduro loyalists should not be understated. Until direct intervention from the U.S., they successfully held power throughout a tumultuous Maduro presidency against fiercer domestic and international opposition than his predecessor, Hugo Chavez.

In a more dramatic scenario, it is possible that Maduro loyalists may adopt a strategy similar to one used by Iran in 2024. Facing a confrontation with Israel and the United States, Iran threatened to close the Strait of Hormuz and strike oil refineries across the region if it sustained critical damage to its nuclear facilities (Cohen, 2024). Although executing these plans would maim the Iranian economy and provoke retaliations that could destroy the country, the strategy plays off a U.S. desire to prevent a global conflagration and disruption of the energy economy. Similarly, if the leaders of Venezuela feel that their regime is under existential threat from the U.S., they may threaten to destroy parts of their own oil industry or use whatever means available to sabotage oil fields and refineries in the region.

## *Trump Faces Skepticism from the Oil Industry*

Trump is seeking $100 billion to develop the oil infrastructure in Venezuela, but the oil industry has not committed capital on the scale he would like. There is a strong sense that the operation that captured Maduro did not sufficiently address drivers of risk in the country. ExxonMobil's chief executive Darren Woods said "We have had our assets seized there twice and so you can imagine to re-enter a third time would require some pretty significant changes" and added "Today it's uninvestable" (Sherman, 2026). Chevron, the only remaining American firm in the country that

accounts for a fifth of Venezuela's oil production, was optimistic about raising output. Other oil firms expressed enthusiasm at entering the market, but did not make firm commitments to invest (Sherman, 2026). The hesitation from industry reflects a difficult political situation in Venezuela, but the new legislation signals that it may be stabilizing. The National Assembly significantly weakened Petróleos de Venezuela, the national oil company, though they stopped short of privatizing it. The new laws also allow oil companies to circumvent the heavily politicized Venezuelan courts. These reforms are likely to induce new investments from Chevron and risk-tolerant oil companies interested in entering Venezuela. However, players like ExxonMobil are likely to remain skeptical about investing due to the country's record of political instability and asset seizure (Romero & Romero, 2026). Reform in Venezuela opens a pathway to massive capital inflow only if the country develops a new reputation for consistent and fair application of commercial law. This will require time and cooperation with the state's existing corporate partners.

## *Petroleum Pipe Dreams*

Although Venezuela has the largest proven oil reserves in the world according to the Organization of Petroleum Exporting Countries (OPEC), the country produces less than a million barrels of crude oil per day which is less than most other OPEC countries (Organization of Petroleum Exporting Countries, 2025). The U.S. is the number one crude oil producer in the world, producing over 13 million barrels a day (U.S. Energy Information Administration, 2025). In order to fully exploit Venezuela's natural wealth, the extraction infrastructure will need to be heavily updated, a project which would take years. Reportedly, the Venezuelan government agreed to turn over up to 50 million barrels of oil after the Caracas raid, a volume that the U.S. produces in roughly four days (Epstein & Chia, 2026). The government would see a revenue of a few billion dollars for selling off these spoils of war.

Additionally, Venezuela's crude oil is extremely dense, so refining it requires specialized facilities (Simon, 2026). As such, Rystad Energy estimates that $8-9 billion dollars are required to increase production to about 3 million barrels a day by 2040 (Sherman, 2026). The additional costs of refining the crude oil are another factor discouraging firms from mining in Venezuela.

If the Trump administration were principally concerned about extracting Venezuela's crude oil, it would have been prudent to secure the willingness of U.S. oil companies to invest. Since oil firms have expressed little interest in entering Venezuela after the fact, it makes little sense to frame this intervention as a resource war.

## *Donald Trump's Backyard*

Instead of engaging in resource wars, it is more plausible that the Trump administration seeks to establish stronger control over the Western hemisphere. The capture and prosecution of Nicolas Maduro was intended to punish him for aligning Venezuela with China and Russia, and to

discourage other countries in the Americas from doing the same. This is consistent with comments that the president and other officials have made about Cuba.

Cuba received most of its oil from Venezuela, making the blockade a devastating blow to the country already in the midst of an energy crisis. President Trump commented that Cuba was "ready to fall and it is well known that Secretary Rubio has long wanted regime change on the island (Sherwood & Parraga, 2026). Cowing Cuba's leaders into obedience or at least punishing them for cooperating with adversaries is likely a significant motivator for the Trump administration.

Even with regards to allies, Trump has made it clear that multilateral allies in the hemisphere are not secure enough by his standards. He has not relented on his territorial ambitions for Greenland, threatening a new round of tariffs on 8 North Atlantic Treaty Organization (NATO) countries who participated in military exercises on the island (Brennan, 2026). This threat was swiftly reversed as Trump announced a "framework" of a deal with NATO Secretary General Mark Rutte (Davies, Zakrzewski, & Birnbaum, 2026). However, it is plausible that Trump will again reverse course on this issue and push for U.S. sovereignty over some or all of Greenland. Though Greenland is rich in rare earth minerals, the environmental conditions there are so hostile that it would take several years just to build the roads necessary for a mining operation at scale. Comments from Trump indicate that he is more interested in challenging Russia and China in the arctic circle (Peters, 2026). In response to the Greenland crisis, the European Parliament suspended work on a trade deal between the European Union (EU) and the U.S. (Blenkinsop, 2026). As of time of writing, the European Parliament has not resumed the work on this deal. The EU also agreed to an economic partnership with South American bloc Mercosur and signed a major trade deal with India at the end of January. These rapid trade developments signal the EU's willingness to wield economic clout independent of the U.S. (Acharya, Kumar, & Blenkinsop, 2026).

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# Institutions Under Strain: Money, Budgets, and Megawatts

Many economic institutions across the U.S. are entering a period of unusual stress, as monetary, fiscal, and energy systems confront mounting pressures. The Federal Reserve's independence is under strain as investigations, removal attempts, and expanded presidential oversight push monetary policy closer to day-to-day politics. Congress, meanwhile, is struggling to pass timely appropriations amid recurring shutdown risks and rising defense ambitions layered on top of already large structural deficits.

At the same time, a rapid AI-driven data center boom is fundamentally reshaping electricity demand and allocation of costs for the grid that supports it. This expansion is intensifying environmental externalities and compelling regulators to make difficult decisions about how investment costs and risks should be shared between Big Tech firms and households.

## *Testing Independence: Fed Decisions in a Political Era*

At the January 28th Federal Open Market Committee (FOMC) meeting, policymakers voted to maintain the target range for the federal funds rate at 3.50-3.75%, unchanged from December. This decision follows a series of three 25-basis-point reductions over calendar year 2025 as the Fed signaled a gradual shift toward a more neutral policy stance. Labor market conditions have continued to soften, with jobs gains moderating and the unemployment rate rising to 4.4% as of December. Inflation remains somewhat elevated above the Fed's 2 percent long-run goal, but has shown signs of stabilization, while longer-term inflation expectations remain well anchored. The decision to hold rates steady reflects the Fed's effort to balance the risks of persistent inflation against those of further weakening in the labor market (*January 27-28, 2026 FOMC Meeting*, 2026).

The recent January decision unfolded against a backdrop of growing political and legal scrutiny of the Federal Reserve itself. Investigations targeting both Federal Reserve Chair Jerome Powell, over testimony related to cost overruns on the Federal Reserve renovation project, and Governor Lisa Cook, over alleged misstatements on a mortgage application, have raised questions about executive authority over the Fed. By putting individual policymakers under investigation, the executive branch can create pressure that may influence how Fed officials vote or communicate about interest rates and inflation (Liesman & Mangan, 2026).

Moreover, Executive Order 14215, signed in February 2025, expands White House oversight of so-called independent agencies such as the FCC, SEC, and FTC by strengthening presidential review of agency actions and narrowing "for cause" removal protections (Executive Author of the President, 2025). This signals a broader shift towards reducing the legal distance between the executive branch and institutions traditionally protected from political influence. Recent Supreme

Court rulings reinforce this shift, granting presidents greater power to replace leaders of certain independent agencies, especially those led by a single director, while leaving others protected, leaving the limits of institutional autonomy very unclear.

Political pressure on the Federal Reserve risks shifting monetary policy toward short-term objectives at the expense of long-term stability. A key consequence would be a loss of inflation-fighting credibility. If households and markets doubt the Fed's independence, inflation expectations could become unanchored, which would make inflation more persistent and difficult to rectify (NPR, 2026; Rocha, 2026). This would likely translate into higher borrowing costs across the economy, directly affecting consumers, taxpayers, and businesses. Beyond the immediate economic effects, it would also establish a precedent for greater political influence over regulatory bodies, making economic policy incredibly vulnerable to political cycles, and creating uncertainty for long-term investment decisions.

## *The Politics of Delay*

At the end of January, the continuing resolution (CR) that ended November's government shutdown expires, putting the U.S. up against yet another looming fiscal deadline. The impasse stemmed from partisan disputes over the extension of Affordable Care Act (ACA) tax-credits set to expire at the end of the year. Democrats pushed to include an extension in the funding bill, while Republicans demanded a "clean" CR to temporarily maintain spending at the previous year's levels, as negotiations continued.

After nearly a month and a half of being shut down, mounting disruptions - including SNAP shortfalls, flight delays and cancellations, and unpaid government workers - collectively affected tens of millions of Americans (Breen & Sundry, 2025; Rascoe, 2025). These pressures led moderate Senate Democrats to break from their party's unified stance, helping Congress to reach a "bipartisan" deal, leading to the passage of a spending package (H.R. 5371) to reopen the government. The resulting package included three full-year appropriations bills for agriculture, the Legislative Branch, military construction and Veteran Affairs lasting through the end of FY 2026. It also contained the CR that has since funded the remaining sectors of government not covered by the limited appropriations already passed for the current fiscal year. This could, however, become an issue if Congress is unable to pass the remaining appropriations or another CR by the end of this month (U.S. Government Accountability Office, n.d.)

At present, Congress is racing to pass the remaining appropriations before the impending fiscal deadline, having made it to the half-way mark 1/23 when the last spending package that passed was signed by the president (H.R. 6938 - Commerce, Justice, Science; Energy and Water Development; and Interior and Environmental Act, 2026). Legislation packages containing the remaining six appropriations have passed the House, but have yet to pass the Senate. The package covering financial services, Department of State and National Security (H.R. 7006 - Financial Services and General Government and National Security, Department of State and

Related Programs Appropriations Act, 2026) passed the House on 1/14, while those covering Homeland Security (H.R. 7147) and separately Defense, Labor, HHS, Education, and Transportation, HUD (H.R. 7148 - Consolidated Appropriations Act, 2026) were passed 1/22 by the House (*Appropriations Status Table: FY2025*, 2025; Brass et al., 2026; Continuing Appropriations, Agriculture, Legislative Branch, Military Construction and Veterans Affairs, and Extensions Act, 2026, 2025; Commerce, Justice, Science; Energy and Water Development; and Interior and Environment Appropriations Act, 2026, 2026; Consolidated Appropriations Act, 2026, 2026; Financial Services and General Government and National Security, Department of State, and Related Programs Appropriations Act, 2026, 2026). The Homeland Security bill in particular was a closer vote (220-207) compared to the other two (341-79 and 341-88) due to ongoing ICE controversies, with some Democrats wanting to defund it entirely or to use this as an opportunity to instead impose more controls on the agency, which continue to face some Republican pushback (U.S. Senate Committee on Appropriations, 2026).

It currently seems likely that Congress is unable to fully pass all 12 appropriations bills by the deadline and have them signed by the president by the time the current CR runs out, in which case there will probably be a partial shutdown of the federal government, but would only represent the sectors without enacted appropriations passed, lessening the impact compared to the prior 43-day full shutdown this last year. Budget deadline challenges are not new to Congress, especially in recent years with three of the five longest shutdowns having occurred in the past 15 years (2025 - 43 days, 2018-2019 - 35 days, 2013 - 16 days), the longest one by far being the most recent occurrence (Moseley, 2025). Given that it's already January without full annual appropriations being passed, that there are only eight months until the next fiscal deadline at the end of the fiscal year, and that budget conflicts become more prevalent as the national debt is growing at an alarming pace, Congress may again face difficulties passing next year's appropriations, which could create a situation similar to this past year – a far from ideal outcome. In combination with the president's recent proposal to increase military spending from about $901-billion to $1.5-trillion in 2027, these dynamics could place additional strain on an already divided Congress. This pressure may bring fiscal issues back to the forefront of national politics, both now with the upcoming deadline, and later this year when appropriations for FY 2027 are required.

## Powering Progress? Regulating the Data Center Boom

AI use has, unsurprisingly, skyrocketed since November 2022, when ChatGPT launched as the first mass-market large language model (LLM). Prior to that, AI was already embedded in technologies such as search engines and spam detection, however, its use was largely confined to technical circles, making recent adoption rates comparatively astronomical. In the three years since ChatGPT's release, by July 2025 ChatGPT reported 700 million weekly active users, up from 500 million in March 2025 and four times higher than the previous year, with more than 2.5 billion messages sent per day (Chatterji et al., 2025). Generative AI adoption among U.S. adults has similarly risen sharply, increasing from 44.6% in August to 54.6% one year later. Over the

same three-year window, this rate far exceeds adoption of the first mass-market personal computer (30.1% adoption of the IBM PC in 1984) and the internet (30.1% in 1998) (Bick et al., 2025). Firms have been quick to follow the adoption trend, with widespread reports of AI integration into products and services (Alikhani et al., 2025). As AI use has surged, however, so too have concerns about its high resource consumption and environmental costs.

## The Power Growing Power Demand of Data Centers

AI models are trained and run on specialized hardware such as GPUs (Graphics Processing Units, which deliver high performance for deep learning but consume relatively high amounts of power), TPUs (Tensor Processing Units, which orchestrate workloads), all densely packed racks in data centers. In contrast to more conventional data center functions such as web hosting, cloud computing, and standard database operations, AI workloads rely increasingly on these energy-intensive chips, sharply raising rack-level energy demand and resulting heat output, which in turn requires intensive cooling alongside the direct power consumption (Kandemir, 2025).

New AI-focused data center buildouts can consume electricity equivalent to that used by 100,000 households, with the largest data centers under construction projected to require 20 times that level, and the largest announced expected to draw up to 50 times more (D'Ambrosio, et al., 2025). In 2023, data centers accounted for 4.4% of U.S. total energy consumption (using 176 TWh), up from 1.9% in 2018 (76 TWh), and predicted to be in the range of 6.7–12.0% by 2028 (Holecek, et al., 2024). While AI applications are estimated to have contributed to only about 14% of the data center electricity use in 2025, this could rise to about 27% by 2027 amid rapid server growth and adoption rates (Goldman Sachs, 2025).

Although the resulting rapidly increasing demand for power could be a significant problem on its own if energy supply does not sufficiently scale to match, the problem becomes exacerbated as data centers are heavily concentrated in certain regions. These include Northern Virginia (26% of state electricity consumption), Oregon (11.4%), North Dakota (15.4%), and Texas (4.6%), which the Electric Power Research Institute (EPRI) predicts will rise to 14%, 19.3%, and 5.9% respectively by 2030 under moderate growth conditions (Aljbour, Patel & Wilson, 2024; Leppert, 2025). These regions, which contain clusters of data centers, especially those in areas with smaller overall grid sizes, have and will likely continue to face sizable challenges with managing infrastructure buildout and accommodating changes in demand for electricity, while also not passing those same costs to residential consumers due to regulational structuring around price increases as a result of infrastructure additions by energy companies.

## US Energy Markets: Mechanics

Energy is costly to store at scale, so most electricity is produced in real time, with system operators attempting to match supply to demand as closely as possible so as to neither waste production nor undercut demand and avoid blackouts. The energy market is divided into three levels: generation, transmission, and distribution. Power plants *generate* electricity from primary energy sources (coal, natural gas, nuclear, wind, etc.) at lower voltages, increase the voltage at a switchyard for cheaper, more efficient long-distance *transmission* along high-voltage lines, then reduce it through transformers and *distribute* it over medium-voltage lines before a final voltage decrease for general consumer use (U.S. Energy Information Administration, 2016a).

At the level of the continental U.S., the grid is organized into three major interconnections: the Eastern Interconnection, the Western Interconnection (both linked with Canada), and the Electric Reliability Council of Texas (ERCOT), which operates independently to avoid certain federal interstate regulations (U.S. Energy Information Administration, 2016b). The Federal Energy Regulatory Commission (FERC) regulates the sale of electricity and transmission across state lines under the Federal Power Act (1920). The connection between generation, transmission, and distribution is managed under two broad institutional models: regulated (vertically integrated) and competitive (restructured) regions.

In regulated or vertically integrated regions, utility companies own some combination of the relevant capital (generation, high-voltage transmission lines, local lower voltage wires) creating a monopoly, which is then (heavily) regulated at the state level to ensure reliability and lower costs to consumers. This system predominantly dominates much of the Southeastern, interior West and Northeastern United States (U.S. Energy Information Administration, n.d.). In contrast, much of the rest of the country and parts of southern Canada are structured as competitive regions, where generation firms are separated from transmission or distribution-centered firms. ISOs (Independent System Operators: typically single state/smaller area) and RTOs (Regional Transmission Organizations: typically covering multi-state regions) manage these regions by forecasting energy usage and managing energy supply and demand within those regions to improve reliability within a more competitive market. The ISOs create three individual markets for energy: a day-ahead market, a real-time market, and a capacity market (Federal Energy Regulatory Commission, n.d; National Governors Association, 2021).

In the day-ahead market, energy producers bid to meet predicted energy demands for the next day. The ISOs take these bids, starting with the lowest bid to supply to consumers at the lowest cost, working their way up to higher cost bids as energy demand exceeds prior low bid supply maximums. On any given day, energy use is likely to vary somewhat from predicted levels, which is where additional and needed electricity is calculated on a regular basis throughout the day (typically every five minutes) to meet current demand levels in the real time market. The third market, the capacity market, is where ISOs pay energy producers to have the capacity to meet predicted energy needs three years into the future, which is intended to incentivize firms to invest to meet future energy demand. This is to say that they are paid not only for what they produce, but for their *ability* to produce at some output level to meet higher demand levels (e.g. times with unusually high demand and future output needs) (Federal Energy Regulatory

Commission, n.d; National Governors Association, 2021). Even within ISO regions, retail market structure and utility obligations vary by state, reflecting additional layers of complexity due to regional regulation and policy differences.

## *Capital Costs, the Capacity Market and Consumers*

Data center growth will require substantial new investment in every part of the grid, including additional dispatchable generation, expanded high-voltage transmission, and upgraded distribution to serve new data center developments. Under prevailing utility regulation, much of this capital cost is recovered from the broader customer base, while large technology firms often secure more favorable (high volume, lower cost) electricity contracts, shifting a disproportionate share of the infrastructure costs onto residential consumers, especially in regions with dense data center clusters, such as Northern Virginia (Green & Nguyen, 2025). In addition to these capital costs, higher forecasted power demand from data centers raises capacity market clearing prices, which get passed onto consumers through retail bills via higher per-killowatt-hour charges, with customers in ISO/RTO regions that rely on organized capacity market are generally more exposed than those served by vertically integrated utilities. Notably, PJM – an ISO spanning Pennsylvania, New Jersey, Virginia, Maryland, among other states, had an auction for the 2025/2026 delivery year cleared at $269.92/megawatt-day (MW-day), about ten times greater than the average clearing price than the auctions for the year prior ($28.92 MW-day), contributing, alongside other cost drivers, to some states in the PJM managed region to experience residential electricity rate increases up to 20% higher than the year prior. Overall, some estimate that 70% ($9.3 billion) of last year's increases in the cost of electricity was due data center driven demand increases (Lawson, 2025; Monitoring Analytics, 2025).

## *The Externalities of Expansion*

Beyond their electricity needs, data centers consume substantial volumes of water for cooling; large facilities can use up to five million gallons per day, comparable to the daily consumption of a town of 10,000-to-50,000 residents (Yañez-Barnuevo, 2025). Direct water use by U.S. data centers rose from 21.2 billion liters in 2014 to 66 billion liters in 2023 and is projected to reach roughly 150-275 billion liters by 2028, creating significant pressure in already water scarce regions such as Arizona, California, Virginia, and Texas (Holecek et al., 2024). Because so much of this load is met by fossil fuel generation, through new plants or delayed retirements of existing units, data center-driven demand growth risks slowing or reversing progress on emissions reductions, and while nuclear and other low carbon sources are being pursued, they are unlikely to fully cover the projected increase in demand (Wells, 2025). At the same time, states and counties frequently offer sizable tax breaks to attract data centers on the promise of job creation, yet most of the employment gains are temporary and concentrated in construction, with relatively few long-term operational jobs once facilities are running (Stevens, Tolockaite & Tortorelli, 2025). Data center construction and resource costs are effectively subsidized at every stage, from state

tax breaks to utility buildout costs spread across ratepayers and discounted bulk power and water deals, so that forgone tax revenue, higher regional utility prices, and increased water stress leave host communities with net fiscal and environmental burdens that are not fully offset by modest gains in economic activity or jobs.

## Regulatory Responses

At present, the situation is far from ideal, but still manageable, especially where policymakers are beginning to shield residential consumers from data center related grid costs. However, because current build out is tightly tied to AI demand, and many AI firms still lack sustainable business models, any sharp downturn in AI investment could stall projects, leaving utilities on the hook with overbuilt infrastructure and a sudden gap between expected and realized demand. Without stronger cost allocation rules, utilities could then seek to recover stranded costs through higher energy rates on households.

In response to these risks and existing issues, many states have been tightening oversight of data centers, which in many cases face pushback from Big Tech. One approach has been to allow energy utility companies to charge data centers for electricity in such a way as to avoid cost shifting to residential consumers. For example, in January 2025, Georgia Public Service Commission (GPSC) approved a rule that allowed the state's utility company, Georgia Power, to differentiate against customers with greater than 100 MW of demand (this would include data centers) and those less than that demand (residential consumers), being permitted to offer different billing terms and conditions for the two classes of consumers (*PSC Approves Rule to Allow New Power Usage Terms for Data Centers*, 2025). Similar specialized rate laws have also gone into effect in Texas (SB 6; 2025), Maryland (SB 937; 2025), and Oregon (HB 3546, 2025) (Leppert, 2025). A second approach focuses on the environmental side, imposing efficiency or clean energy requirements to limit the emissions and resource footprint of new facilities. A third "wait and see" approach requires data centers to report detailed energy and water use so regulators can design more proactive policies at a later date. California, for example, scaled back more ambitious proposals under intense tech industry lobbying and instead opted for SB 57, which directs regulators to study data center impacts before imposing stronger limits on cost shifting (Lazo, 2026). With recent policy moves, regulation appears to be moving in a more restrictive direction, driven by concerns about risks to consumers and the negative externalities associated with data centers.

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# Outlook: The New Rules of the Game

This past year saw the institutions undergirding global markets have been strained, but the U.S. economy has stayed resilient. January 2026 has already introduced a new set of challenges that threaten the stability that the economy has settled into. The U.S. intervention in Venezuela and overtures towards annexing Greenland have shaken confidence in a multilateral, rules-based international order. The breakdown of international security and economic partnerships and increasing adoption of AI across industries have created significant disruptions in labor markets. The jobs market has continued the cooling trend from 2024, stagnating into a low-fire, low-hire market with young jobseekers being especially impacted. Concerns about AI and political instability have driven consumer sentiment downwards, even among high-income households who are typically insulated from economic downturn. Market concentration in tech has carried into the new year, but it seems that investors are now expecting firms to justify these valuations. Though inflation remains only moderately elevated, the federal investigation into Federal Reserve Chair Jerome Powell threatens perceptions of the Fed's independence and could fuel inflation expectations in the future.

The path ahead is marked by heightened uncertainty. The continued stability of the economy depends in a large part on the ability of firms to stay agile and swiftly adapt to market shocks and political instability. It remains to be seen whether the incentives and tax cuts passed by the Trump administration will help businesses jolt the labor market back to life. At the same time, developments in the financial markets or political arena could send the economy into crisis. If firms fail to demonstrate profitable AI strategies to shareholders, losses would not be restricted to tech in the least. Trump's confrontational NATO policy puts pressure on the EU to transform into a hostile economic bloc, which would create shocks in the global economy. Although Donald Trump has pushed the powers of the executive to their greatest extent to enact his economic agenda, he now operates in uncharted territory and the fallout of his actions may be far beyond his control.

In this setting, economic performance will be shaped less by the absolute stance of policy and more by how expectations, credibility, and coordination evolve across markets and institutions operating under sustained uncertainty.

# Statistical Appendix

## *Appendix A: Empirical Methodology for "MEO Spotlight: The Post-Global World"*

### *Appendix A.I: Data Sources and Methodology for Indicator I: Trade Policy Uncertainty vs Trade Participation*

**Appendix A.I.I: Global Economic Policy Uncertainty (GEPU)**

The Global Economic Policy Uncertainty (GEPU) index is sourced from Baker, Bloom, and Davis (2016) and obtained via policyuncertainty.com. The GEPU aggregates country-level newspaper-based measures of economic policy uncertainty across major economies. For each country, the index captures the frequency of newspaper articles that jointly reference (i) economic conditions, (ii) policy-related terms, and (iii) uncertainty or risk, normalised over time to ensure comparability. The global index is constructed as a GDP-weighted aggregation of these country-level measures.

Monthly GEPU observations are used throughout this report. For presentational consistency and interpretability, the index is rebased to January 2018 = 100, with all subsequent values expressed relative to this baseline. No additional smoothing or filtering is applied.

Readers are directed to the GEPU project website for data access, documentation, and annotated historical indices: https://www.policyuncertainty.com/global_monthly.htmlData. For a detailed methodological discussion, see Baker, Bloom, and Davis (2016), Measuring Economic Policy Uncertainty, and related documentation linked on the site.

**Appendix A.I.II: Global Trade Volume and Trade Momentum**

Global trade data are drawn from the CPB World Trade Monitor (WTM), produced by the CPB Netherlands Bureau for Economic Policy Analysis. The WTM aggregates and summarizes monthly international trade data at the global and regional level with the explicit objective of providing the earliest possible signal of turning points in world trade activity. The trade monitor covers merchandise (goods) trade only and achieves approximately 96% global coverage by value.

At the core of the WTM is a four-stage production system. First, CPB standardizes raw trade series collected from a wide range of national and international sources (including national statistical offices, Eurostat, the IMF, OECD, and the World Bank). Second, CPB constructs country-level monthly trade series, harmonizing frequency, currency denomination (US dollars), index base years, and seasonal adjustment. Where necessary—particularly for the most recent months—missing observations are imputed using secondary source series or regression-based methods. Third, country series are aggregated into regional and global totals. Finally, the

resulting series are published as level indices, price indices, and volume indices, accompanied by summary tables and charts.

The global trade volume index used in this report corresponds to CPB's world goods trade volume series, defined as the average of world imports and exports of goods, expressed in constant prices and seasonally adjusted.

To capture short-horizon shifts in trade dynamics that are more sensitive to policy uncertainty, we transform CPB's level index into a three-month annualised trade momentum measure, defined as:

$$Trade\ Momentum_t = \left(\frac{V_t}{V_{t-4}}\right)^4 - 1$$

where $V_t$ denotes the CPB world trade volume index in month t. This transformation is not produced by CPB but is computed by the authors to approximate the marginal decision environment faced by firms with respect to shipping, sourcing, and inventory accumulation.

**Appendix A.I.III: Global Trade Volume and Trade Momentum**

The analysis uses monthly data spanning January 2018 through September 2025, reflecting the latest available observations from the CPB World Trade Monitor at the time of publication. The sample window encompasses multiple global shocks—including the COVID-19 pandemic and geopolitical disruptions—while allowing for comparison across distinct policy environments.

**Appendix A.I.IV: Limitations**

The indicators presented in the sub-section within the MEO: Spotlight Section titled "The Price of Uncertainty" are descriptive and illustrative. Observed co-movements between policy uncertainty and trade momentum should be interpreted as conditional correlations rather than causal relationships. Global trade outcomes are jointly influenced by macroeconomic demand conditions, financial constraints, supply-chain disruptions, and geopolitical developments, in addition to policy uncertainty.

Accordingly, the figures are intended to motivate and contextualise the conceptual mechanisms discussed in the subsection within the MEO titled, "The Mechanics: How State-Contingent Policy Enters Macro Pricing"—particularly the role of trade-cost variance, discount-rate adjustments, and real-options effects—rather than to establish econometric identification or quantify causal elasticities.

## *Appendix A.II: Data Sources and Methodology for Indicator II: Policy Risk and the Global Cost of Capital*

**Appendix A.II.I: Global Trade Volume and Trade Momentum**

The U.S. term premium series is taken from the Adrian–Crump–Moench (ACM) model published

by the Federal Reserve Bank of New York. The ACM framework decomposes Treasury yields into expected future short rates and a residual term premium, estimated using a no-arbitrage affine term structure model. The term premium represents the compensation investors require for bearing interest rate risk over longer maturities.

Monthly averages of the 10-year ACM term premium are used to smooth high-frequency volatility and to align the series with macroeconomic indicators. A rising term premium indicates increased compensation for long-horizon uncertainty, even if expected policy paths remain stable.

**Data access:**
Federal Reserve Bank of New York — Treasury Term Premium:
https://www.newyorkfed.org/research/data_indicators/term-premia-tabs#/interactive

**Appendix A.II.II: Cross-Currency Basis (EUR/USD)**
The cross-currency basis is sourced from CME Group historical data and reflects deviations from covered interest parity in the EUR/USD swap market. The basis captures the premium paid by non-US institutions to obtain dollar funding via FX swaps, net of interest rate differentials.

Monthly averages of the EUR/USD basis are used. Persistent negative values indicate structural demand for dollar liquidity and heightened sensitivity of global funding conditions to risk perceptions rather than to policy rates alone.

**Appendix A.II.III: Limitations:**
Neither the ACM term premium nor the cross-currency basis should be interpreted as causal measures of policy actions. Rather, they reflect market pricing of policy-contingent risk. Movements in these series capture changes in expectations over the distribution of future policy states, not realised macroeconomic outcomes. Accordingly, Indicator II is interpreted as corroborative evidence for the discount-rate channel outlined in Section II, not as a standalone diagnostic of monetary or fiscal stance.

# *Appendix B: Empirical Methodology for "Persisting Falling Labor Demands"*

**Appendix B.1: Data and Variable Construction.**

The study conducted uses publicly available data from the Federal Reserve Economic Data (FRED) database. Initial Unemployment data with weekly frequency are obtained from *ICSA*, and unemployment data with monthly frequency are obtained from *UNRATE*. The analysis utilizes data from January 1994 to December 2025 as observed on January 15, 2026.

The model uses a sample that spans January 1994 to November 2025. Observations from March 2020 through June 2021 are excluded to avoid distortions related to temporary expansions of unemployment insurance during the COVID-19 pandemic. December 2025 is excluded and reserved for out-of-sample forecasting. Weekly initial claims are aggregated to monthly frequency using two methods, aligned to monthly unemployment rates by calendar month.

**Appendix B.2: Model Specifications.**

Model I compares monthly unemployment rate to the average level of initial claims observed during the same month. The equation for the linear regression is

$$u_t = \alpha + \beta \bullet X_t + \varepsilon_t$$

where $X_t = \frac{1}{t+n-1} \sum_{i=t}^{t+n-1} IC_i$

Where $u_t$ is the observed unemployment rate, $X_t$ is the average initial claims $IC_t$ of month t of n weeks and $\varepsilon_t$ is the residual between $u_t$ and $\widehat{u_t}$. Inclusion within the month is based on the date of the observation. If an observation landed on January 1st, the data is included in January's initial claims and not December. This specification captures the synchronous relationship between flows into unemployment and the stock of unemployed workers.

To normalize the data and account for continual change in unemployment due to previous layoffs, Model II uses a rolling 4 week average with the same structure for the linear model:

$$u_t = \alpha + \beta \bullet X_t + \varepsilon_t$$

where $X_t = \frac{1}{4} \sum_{i=0}^{3} IC_{t-i}$.

Each rolling average corresponds with its final week's monthly unemployment rate. The final week of $X_t$ is mid January, $X_t$ uses data from both December and January and measured against January's unemployment rate. There is no additional lag structure imposed.

**Appendix B.3: Estimation and Forecasting.**

Both models are estimated using ordinary least squares in EXCEL using the Data Analysis add-on. No observations were used from December 2025 in estimation. Out of sample forecasts for December 2025 are found by applying estimated coefficients to observed claims data for that month. Model I uses the monthly average of December 2025 claims. Model II uses rolling 4-week averages corresponding to each week ending in the month of December 2025.

**Appendix B.4: Key Assumptions and Limitations.**

The models assume initial claims capture the flow of workers entering unemployment, while the unemployment rate measures the stock of unemployed individuals. The models implicitly assume a stable relationship between inflows and unemployment stock. The model does not incorporate job-finding rates, frictional unemployment, vacancy or labor force participation. By using initial claims levels, we are assuming aggregate labor is constant (workforce population is constant). Deviations from the estimated relationship may reflect changes in these factors. No leads or lags are imposed and unemployment is treated as a monthly stock.

**Appendix B.5: Model Visualizations.**

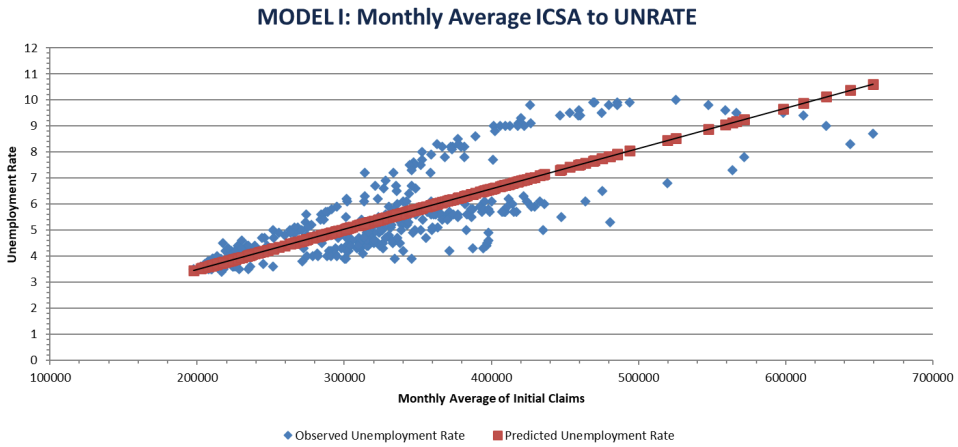


**Figure 7:** Linear relationship between monthly average initial claims and the unemployment rate, illustrating the contemporaneous flow–stock dynamics in labor markets.

**Source:** Federal Reserve Economic Data, Federal Reserve Bank of St. Louis.

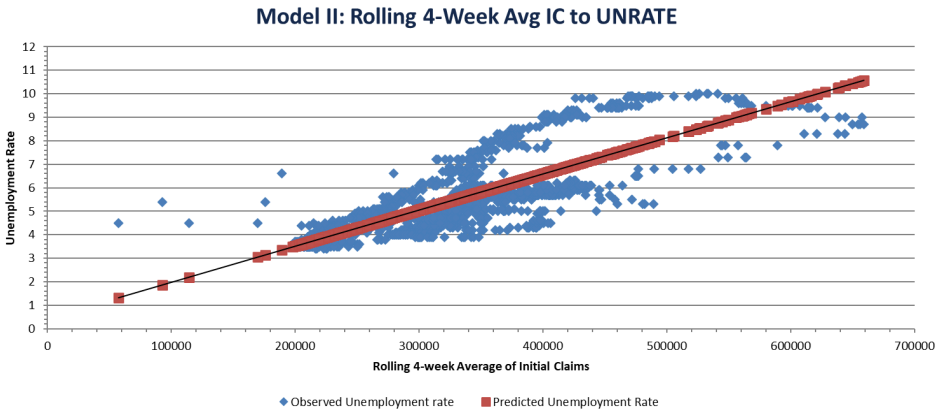


**Figure 8:** Rolling four-week average specification smooths short-term volatility, improving fit while preserving contemporaneous unemployment dynamics.

**Source:** Federal Reserve Economic Data, Federal Reserve Bank of St. Louis.

## Appendix B.6: Data Tables.

### Model I:

| | Coefficients | Standard Error | t Stat | P-value | Lower 95% | Upper 95% | Lower 95.0% | Upper 95.0% |
|---|---|---|---|---|---|---|---|---|
| Intercept | 0.38871 | 0.212183 | 1.83196 | 0.067777 | -0.02855 | 0.805971 | -0.02855 | 0.805971 |
| 359200 | 1.55E-05 | 6.3E-07 | 24.6069 8 | 2.34E-79 | 1.43E-05 | 1.67E-05 | 1.43E-05 | 1.67E-05 |

**Table 1:** Contemporaneous relationship between initial claims inflows and unemployment.

| Regression Statistics | |
|---|---|
| Multiple R | 0.790693 |
| R Square | 0.625195 |
| Adjusted R Square | 0.624162 |

| | |
|---|---|
| Standard Error | 1.015011 |
| Observations | 365 |

**Table 2:** Regression diagnostics for Model I.

**Model II:**

| | Coefficients | Standard Error | t Stat | P-value | Lower 95% | Upper 95% | Lower 95.0% | Upper 95.0% |
|---|---|---|---|---|---|---|---|---|
| Intercept | 0.441912 | 0.100127 | 4.413496 | 1.09E-05 | 0.245517 | 0.638307 | 0.245517 | 0.638307 |
| 87750 | 1.54E-05 | 2.98E-07 | 51.58267 | 0 | 1.48E-05 | 1.6E-05 | 1.48E-05 | 1.6E-05 |

**Table 3:** Normalized claims specification using rolling four-week averages.

| Regression Statistics | |
|---|---|
| Multiple R | 0.790891 |
| R Square | 0.625509 |
| Adjusted R Square | 0.625274 |
| Standard Error | 1.01051 |
| Observations | 1595 |

**Table 4:** Regression diagnostics for Model II.

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