

At their March meeting, the U.S. Federal Reserve Open Market Committee voted to keep the Fed funds rate unchanged at the current range of 3.50-3.75%. There was one dissent from member Stephen Miran, who wanted a quarter-percent rate cut.

The formal statement was little changed, noting that the unemployment rate changed from “some signs of stabilization” to “little changed in recent months.” Also, it was unsurprisingly mentioned that “implications of developments in the Middle East for the U.S. economy are uncertain.”

The quarterly Summary of Economic Projections (SER) component to the meeting noted an expected Fed funds rate of 3.4% for year-end 2026, 3.1% for year-end 2027, and 3.1% for year-end 2028, respectively, all of which were unchanged from the Dec. 2025 meeting. However, the expected long-term rate ticked up from 3.0% to 3.1%.

According to CME Fed funds futures, the chances of no change had steadily risen from 95% to 99% this month. Most notable has been the reduced expected number of cuts to just one -0.25% by Dec. 2026, and even odds of a -0.25% to -0.50% cut in Dec. 2027, ending with rates around 3.00%. That point is seen as falling close to ‘neutral,’ the point of being neither stimulative or constricting, and offering a small real interest rate on top of the Fed’s long-term inflation target. That seems appropriate according to historical precedent, absent other factors that could (and usually do) pop up in the meantime. On the other hand, a recession could prompt the Fed to take rates down a percent or two below neutral, but markets don’t seem to be pricing that in.

Economy. GDP growth for Q4-2025 was revised down to a disappointing 0.7%, pulled down by unique elements such as the lengthy federal government shutdown. The Atlanta Fed GDPNow indicator for Q1-2026 is calling for 2.7%, half of which is consumer spending, as usual, along with strength in inventories, which tends to be a transitory influence. The SER noted growth expectations of 2.4% for 2026 (up from 2.3% in Dec.), 2.3% for 2027 (up from 2.0%), 2.1% for 2028 (up from 1.9%), and 2.0% for the long-term (up from 1.8%), in keeping with broader U.S. trend growth. Recovery from a weak Q4 was expected to show up as better Q1 growth, although negative influences from the military actions in the Middle East are now obvious, specifically if higher oil prices start to act as a tax on consumers, weighing on spending and sentiment over the coming weeks. Already, some oil importing countries (particularly in Asia, most heavily impacted by the Middle East supply reduction) have been making pre-emptive moves to conserve petroleum. That negative pressure depends on how long the stretch of high oil prices lasts and magnitude of the conflict—both to be determined.

Inflation. Over the trailing 12 months ending in February, headline CPI rose by 2.4% and core CPI ex-food and energy increased 2.5%, both little-changed from the prior month. Core PCE for January ticked back up to 3.1%, over a percent beyond the Fed’s target. Inflation expectations, as measured by the 5-year/5-year Treasury rate, have optimistically fallen back again from a high of 2.4% last summer to 2.1%. Looking ahead, the first question is whether the recent oil price spike, if sustained, will carry over into headline inflation, as well as other core segments, such as transportation, chemicals, fertilizers, and other goods. This tightens financial conditions and makes the Fed’s job more difficult, with inflation still running above target anyway before the Middle East conflict. Impacts from that would run counter to the earlier

narrative that inflation had been gradually easing toward target levels (previously expected to be reached by later this year). Instead, a variety of estimates are again showing future inflation staying elevated in the intermediate term. For March, the SER noted core PCE expectations of 2.7% for 2026 (up from 2.5% in Dec.), 2.2% for 2027 (from 2.1%), and 2.0% for 2028 (unchanged).

Employment. Labor conditions started to become a concern a few months back, with weaker job openings, and a drop in payrolls. However, some of the effects can be due to changes in government sampling and modeling, in no small part to dramatic changes in immigration policies and work force size over the past two years. Real-time jobs data is surprisingly imprecise, with a high standard deviation each month, and subject to dramatic revision later. Job growth is indeed slowing, which has been acknowledged by the Fed, although the magnitude of the decline remains an open question. So far, there hasn't been a jump in jobless claims or layoff announcements, with a broad assumption that companies are keeping workers, but just aren't eager to add staff, with uncertainty about how strongly artificial intelligence (AI) could act as a future productivity enhancement. At the very least, it seems some firms have been redirecting budgets away from hiring towards AI productivity projects. The SER noted an unemployment rate of 4.4% for 2026 (unchanged from Dec.), 4.3% for 2027 (up a tenth), and 4.2% for 2028 and over the long term, both unchanged from December

As Fed Chair Jerome Powell's term winds down, the Fed again finds its dual mandate potentially caught between opposing forces. Inflation remains higher than target, although whether 2.5% versus 2.0% being a real problem is debatable, other than for consistency in policy and messaging. Though, the recent Middle East conflict has certainly raised the chances of another inflation spike (and recession risk), with daily financial market movements hinged on how quickly the conflict might come to an end, or at the very least, removal of impediments in the Strait of Hormuz to get global oil shipments moving again. On the other hand, labor has stabilized, but continues to trend lower, with a lack of clarity about AI contributions.

On an internal level at the Fed, a few outstanding issues remain as Powell's tenure as Chair winds down in mid-May. This week, a federal judge tossed out the U.S. administration's DOJ subpoenas (concerning his Congressional testimony about the expensive Fed headquarters renovation), with negative legal commentary about the prospective aims behind the investigation (as a push for lower interest rates). While behind the scenes, such issues continue to raise questions globally about the Fed's continued independence, although Powell and other committee members have continued to downplay those concerns. It also appears that, due to perhaps his own personal indignation at the matter, Powell might be compelled to stay on as a Fed Governor until that term ends in Jan. 2028. Adding even more complexity to the situation, the nomination of Kevin Warsh as Powell's replacement is being held up by Sen. Thom Tillis and others, until the Powell legal case is satisfactorily resolved. In practical terms, if Powell doesn't continue as interim Chair after May (which itself might be controversial), it appears that role by statute would be filled by Vice Chair Philip Jefferson (ironically, a Biden nominee). Ultimately, the FOMC features 12 voting members, so the voices of a few would still not likely sway the consensus path.

Financial markets appear to have made their peace with interest rates being where they are, with the U.S. Treasury yield curve again becoming positively sloped, although that is more a matter of long-term rates rising with concerns about fiscal debt and deficits, as well as inflation staying higher for longer. The current 10-year yield level of around 4.2%, and trading range of 4.00-4.50% range for much of the past two years, shows it hovering around the classic 'rule of thumb' of inflation plus real economic growth. Market complacency appears to be based on a near-term resolution of the Middle East conflict, and decent fundamental conditions elsewhere, although a lengthy escalation could quickly change the market's mind.

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Sources: CME Group, Federal Reserve Bank, U.S. Bureau of Economic Analysis, U.S. Bureau of Labor Statistics, Palouse Capital Management.

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