

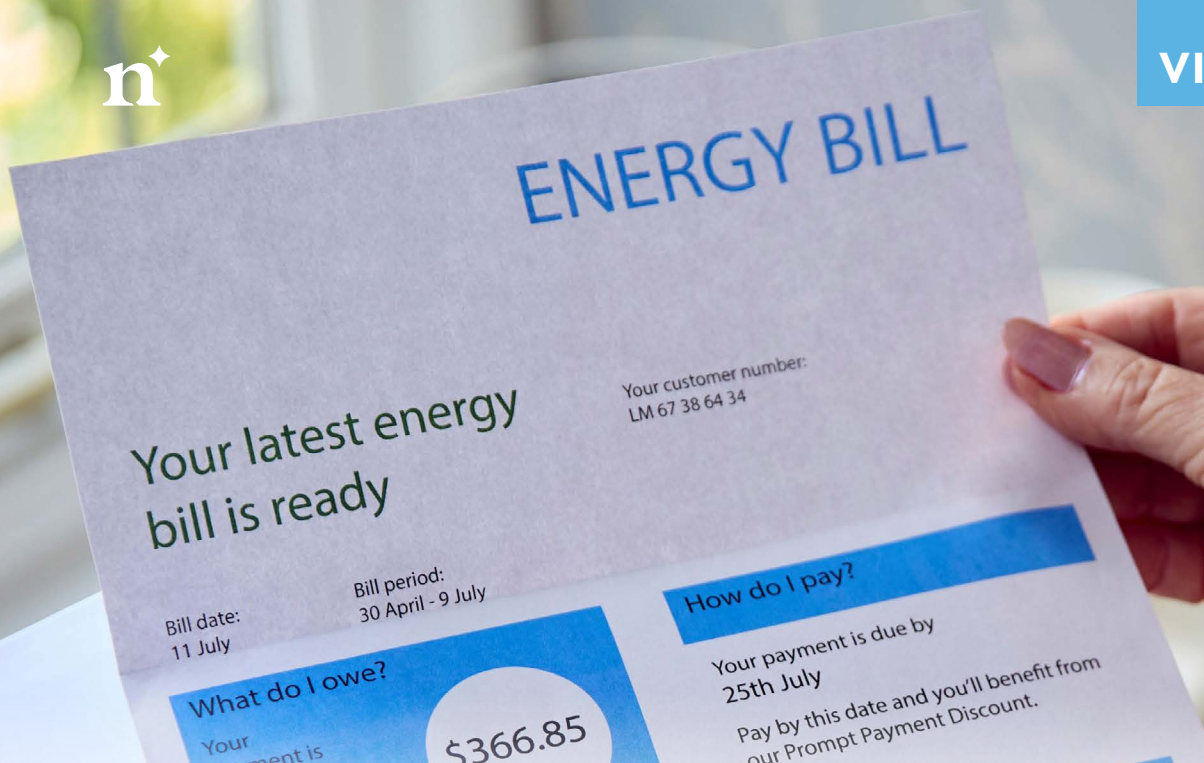


VIEWPOINT

Economic Commentary:

Energy Prices and Economic Strain

April 2026



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Economic data from the first month of the war with Iran remain incomplete. However, most reports reflecting pre-war conditions have now been released, and they suggest the economy was already losing momentum before the conflict began. The consumer, in particular, remains under pressure, a situation that will likely be exacerbated by rising energy prices. At the same time, the Federal Reserve is caught between conflicting signals related to its dual mandate — price stability and maximum employment — leaving monetary policy on hold for now.

Energy-driven inflation surge

One report that does capture the immediate impact of the war is the March Consumer Price Index (CPI). Headline CPI rose +0.9% for the month, as expected — the largest increase since June 2022 — driven primarily by a +21.2% surge in gasoline prices, the largest monthly increase on record. The year-over-year headline rate jumped to +3.3% from +2.4% in February. Excluding food and energy, core CPI increased a more modest +0.2% for the month and +2.5% year over year. Core goods prices continue to show minimal impact from tariffs, rising just +0.1% in March and only +1.2% over the past year. The sharp rise in headline inflation weighed on real earnings, with real average weekly earnings declining -0.9% in March and rising just +0.2% year over year.

The March reading of the Fed's preferred inflation measure, the core Personal Consumption Expenditures (PCE) deflator, is scheduled for release at the end of April and is expected to rise +0.3%, lifting the year-over-year rate to +3.2% from +3.0% in February. While the Fed is likely to look through the initial spike in energy prices, the longer prices remain elevated, the greater the risk they will feed through into broader inflation. With core inflation already above the Fed's 2.0% target, concerns about this pass-through effect are reinforcing the Fed's cautious stance.

Consumer spending weakens further

The February Personal Income and Spending report (released April 9) painted a sobering picture of the consumer prior to the war. Real disposable personal income declined -0.5% in February and has been essentially flat since last April. Real personal consumption expenditures rose just +0.1%, following a downward revision for January from +0.1% to flat. As has been the case for much of the past three years, the gap between spending and income has been financed by drawing down savings. The personal saving rate fell from 4.5% to 4.0% in February; absent this decline, real consumption would have fallen -0.4% in the month.

Excluding government transfer payments — providing a clearer view of underlying income trends — real disposable income is growing only +0.5% year over year, the weakest pace since 2022.

The final estimate of fourth quarter 2025 real GDP was revised slightly lower to a +0.5% annualized rate from +0.7%, largely due to inventories. Looking ahead, the Federal Reserve Bank of Atlanta estimates first quarter 2026 growth at +1.3%, down sharply from its pre-war estimate of +3.2%.

Manufacturing growth amid cost pressures

The ISM Manufacturing Index for March surprised to the upside, rising to 52.7 from 52.4 in February, likely reflecting war-related effects. The conflict contributed to inventory drawdowns and a sharp acceleration in input prices to their highest level since mid-2022. However, the New Orders sub-index eased to 53.5 from 55.8, indicating slower demand growth, and order backlogs also softened. Employment in manufacturing continued to contract despite increased output.

The ISM Services Index declined to 54.0 in March from 56.1 in February, marking its first drop since September 2025. New orders remained strong, rising to 60.6, with 14 of 18 industries reporting gains. However, the prices paid index rose to its highest level since October 2022, reflecting higher energy costs and growing concerns about supply chain resilience. The employment index slipped back into contraction after three months of expansion, as firms responded to cost pressures by tightening hiring and pricing strategies.

“With wage growth slowing and inflation rising, real incomes are set to decline. Any boost to consumer spending from tax refunds will likely be offset by higher energy costs.”

John Beuerlein

Chief Economist, Pohlrad Companies



Labor market shows underlying weakness

The March employment report showed non-farm payrolls increased by a stronger-than-expected 178,000, well above the consensus estimate of 65,000. However, February payrolls were revised down sharply to a decline of 133,000 from the previously reported -92,000, while January was revised up to 160,000 from 126,000. The timing of the war means it had little direct impact on March data. Moreover, the headline gain likely overstates underlying strength, as it was boosted by the resolution of a healthcare strike and a rebound from severe winter weather.

Even with March's gains, non-farm payrolls have risen just 0.2% over the past 12 months, with growth concentrated in the non-cyclical education and healthcare sectors. Excluding these sectors, payrolls have declined by more than 400,000 over the same period.

The unemployment rate edged down to 4.3% from 4.4%, but the improvement was driven by a 396,000 decline in the labor force rather than stronger employment. In fact, the household survey showed employment falling by 64,000, marking three consecutive monthly declines. Over the past year, the labor force has shrunk by 554,000, reflecting tighter immigration policies and an aging population.

Beneath the surface, labor market conditions appear more fragile than headline figures suggest. Labor supply continues to exceed demand, as reflected in subdued hiring rates. Wage growth slowed to +0.2% in March, bringing the year-over-year pace to +3.5% — the weakest since May 2021.

Fed faces inflation-growth trade-off

At its March 18 meeting, the Federal Open Market Committee left the federal funds rate unchanged for the second consecutive meeting. The next meeting is scheduled for April 28–29.

The Federal Reserve's latest Beige Book, covering early January through February 23, pointed to a modest softening in economic activity. While growth remained positive, momentum slowed and heightened price sensitivity among lower-income consumers was noted. The impact of tariffs was expected to moderate.

The war is expected to affect both sides of the Fed's mandate. While the inflationary impact is immediate, the negative effects on consumer spending, business investment and hiring are likely to unfold more gradually. With wage growth slowing and inflation rising, real incomes are set to decline. Any boost to consumer spending from tax refunds will likely be offset by higher energy costs.

The Fed is also monitoring risks in credit markets, particularly the growing buildup of stress in private debt and private equity. The volume of distressed leveraged and direct loans now exceeds the size of the subprime mortgage market prior to the 2008 Financial Crisis.

Higher oil prices act as a tax on the economy, weighing on growth. As a result, the Fed faces a difficult trade-off between supporting economic activity and containing inflation. Even with the recently announced ceasefire, concerns about near-term inflation have led markets to scale back expectations for rate cuts, with little to no easing anticipated for the remainder of the year.



For more information please contact:

John Beuerlein | *Chief Economist, Pohlad Companies*

Lanie Beck | *Senior Director, Content and Marketing Research*
lbeck@northmarq.com | (918) 494-2690

Northmarq⁺

3500 American Blvd W
Suite 500
Minneapolis, MN 55431
(952) 356-0100
www.northmarq.com