



# Economic Commentary:

War, Rising Oil Prices and Softening  
Labor Market Shape the Outlook

*March 2026*

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The war with Iran has introduced a new variable for policymakers as they navigate the existing challenges of elevated inflation and a softening labor market. Real incomes are likely to come under further pressure as rising oil prices add to inflation. Any boost to consumer spending from increased tax refunds will likely be absorbed largely by higher energy costs.

At the same time, non-farm payrolls have declined in three of the past five months, resulting in a net loss of 82,000 jobs. This backdrop points to slower economic growth and suggests that Federal Reserve policy will be more reactive than proactive, likely keeping monetary policy on hold longer than was expected just a month ago.

### Persistent service-sector inflation

The headline February Consumer Price Index (CPI) rose to +0.3% from +0.2% in January, while core CPI eased to +0.2% from +0.3%. On a year-over-year basis, headline inflation held at 2.4% and core at 2.5%, both unchanged from January. Core goods prices continued to show little impact from tariffs, rising just +0.1% for the month, while services prices increased +0.3%, accounting for most of the upward pressure. These readings reflect inflation conditions prior to the onset of the war; significantly stronger readings are expected for March due to higher oil prices.

The release of the Fed's preferred inflation gauge — the core Personal Consumption Expenditures (PCE) deflator — remains delayed following the October government shutdown. The latest available reading, for January, rose +0.4%, lifting the year-over-year rate to 3.1% from

3.0% in December. As with CPI, price pressures were concentrated in services. Based on available inputs, February core PCE is also expected to rise +0.4%, marking three consecutive monthly increases at that pace for the first time since early 2022. The persistence of inflation pressures even before the war began is a growing concern for the Fed.

*“Higher oil prices effectively act as a tax on the economy.”*

**John Beuerlein**  
Chief Economist, Pohlads Companies

## Consumer spending faces energy cost pressures

Real personal spending increased +0.1% in January for the third consecutive month, bringing the year-over-year gain to +2.4%. Spending on services rose +0.3%, while adverse weather weighed on goods spending, which declined -0.4%. On the income side, real disposable income rose +0.7% (1.8% year over year), supported by a 3.2% decline in personal taxes due to the One Big Beautiful Bill Act (OBBBA) and a 3.1% cost-of-living adjustment for Social Security. Much of this additional income was saved, pushing the personal saving rate up to 4.5% from 4.0% in December — the highest level since July.

However, excluding government transfer payments, real disposable income is growing only +0.6% year over year. The inability of wages and salaries to keep pace with spending has led to a record number of workers tapping their 401(k) plans for hardship withdrawals.



## Slower GDP growth and mixed manufacturing trends

One of the most notable recent developments was the sharp downward revision to fourth quarter real GDP, now estimated at a +0.7% annualized rate, down from the initial +1.4%. For full-year 2025, real GDP growth slowed to 2.1% from 2.8% in 2024. Roughly half of the downward revision reflects weaker business investment and intellectual property exports, with the remainder due to softer consumer spending. Final sales to private domestic purchasers — a key measure of underlying demand — was revised down to 1.9% from 2.4%.

The ISM Manufacturing Index edged down slightly in February to 52.4 from 52.6 but remained in expansion territory for a second consecutive month for the first time since September–October 2022. Strong new orders, rising backlogs and low customer inventories suggest continued expansion. However, the prices paid index climbed to its highest level since June 2022, while the employment index remained in contraction. In fact, manufacturing employment has contracted in 37 of the past 38 months, reflecting continued workforce reductions amid uncertain demand.

The ISM Services Index strengthened to 56.1 in February from 53.8 in January, marking its 20th consecutive month of expansion and its highest level since July 2022. All ten sub-indices were in expansion territory for the first time since March 2021. Unlike manufacturing, the services prices paid index declined to an eleven-month low of 63.0, indicating some easing in price pressures. Employment in services expanded for a third consecutive month, with 39% of industries reporting increased hiring.



## Labor market weakens across key sectors

The February employment report reinforced signs of a cooling labor market. Non-farm payrolls declined by 92,000, while revisions reduced December and January job gains by a combined 69,000. Private payrolls fell by 86,000 and government employment declined by 6,000. Although the headline figure was affected by a medical worker strike (-31,000) and severe weather (-25,000), job losses persisted even after adjusting for these factors.

Losses were broad-based across the private sector, with the largest declines in leisure and hospitality, healthcare, and educational services — sectors that had previously been among the strongest.

Over the past 12 months, nonfarm payrolls have increased by just 156,000 — an average of 13,000 per month, or 0.1%. The unemployment rate rose to 4.4% from 4.3%, as the household survey showed a decline of 185,000 jobs, including a loss of 100,000 full-time positions.

With labor input growing only +0.1% year over year, it has been strong productivity growth (+2.8%) that has supported overall economic activity.

The January Job Openings and Labor Turnover Survey (JOLTS) showed a rebound of 396,000 job openings, partially reversing declines from the previous two months. However, openings remain 224,000 below October levels and are down 6.5% year over year. There are still more job openings than unemployed workers, indicating that labor demand continues to exceed supply.

## The Fed balances inflation and growth risks

The Federal Reserve's latest Beige Book, covering early January through February 23, 2026, pointed to a modest deterioration in economic activity. While growth remained positive, momentum slowed, and increased price sensitivity among lower-income consumers was noted. The impact of tariffs was expected to moderate.

The Fed is also keeping an eye on the developing credit bubble in private debt and equity. The amount of stressed debt in the market for leveraged and direct loans is now greater than the entire size of subprime mortgages heading into the 2008 Financial Crisis.

Looking ahead, the Fed is likely to keep monetary policy on hold as it assesses the effects of the war on inflation and growth. Historically, the Fed has tended to look through temporary energy price spikes. However, the key uncertainty now is the duration of the conflict and the persistence of elevated oil prices.

Higher oil prices effectively act as a tax on the economy, dampening growth. As a result, the Fed may face a difficult trade-off between supporting economic activity through easing policy and maintaining restrictive conditions to contain inflation. Reflecting this uncertainty, markets have reduced expectations for rate cuts this year from two to one.

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