

2026/27 Economic Outlook:

Are We Done With Rate Cuts?

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Agenda

**FED POLICY AND
MARKET
EXPECTATIONS FOR
2026**

**WAR & INFLATION
IMPACT - WILL WE
EVER GET TO 2%?**

**MEANWHILE,
WHAT'S THE
OUTLOOK FOR THE
ECONOMY?**

CONCLUSION



In April, the Fed paused for the third meeting in a row, keeping the funds rate at 3.50% - 3.75%. **Three dissents on the pause vote were for the committee to assert a neutral policy bias vs. easing bias. This was messaging for incoming Fed Chair Kevin Warsh.**



Fed Funds Futures pricing now expects no rate cuts, while odds of rate hikes increase into 2027. The Fed will update its Fed Funds Dot Plot in June. We expect it to closely follow Futures pricing as increasing committee dissents speak to a more divided Fed as to future policy direction.

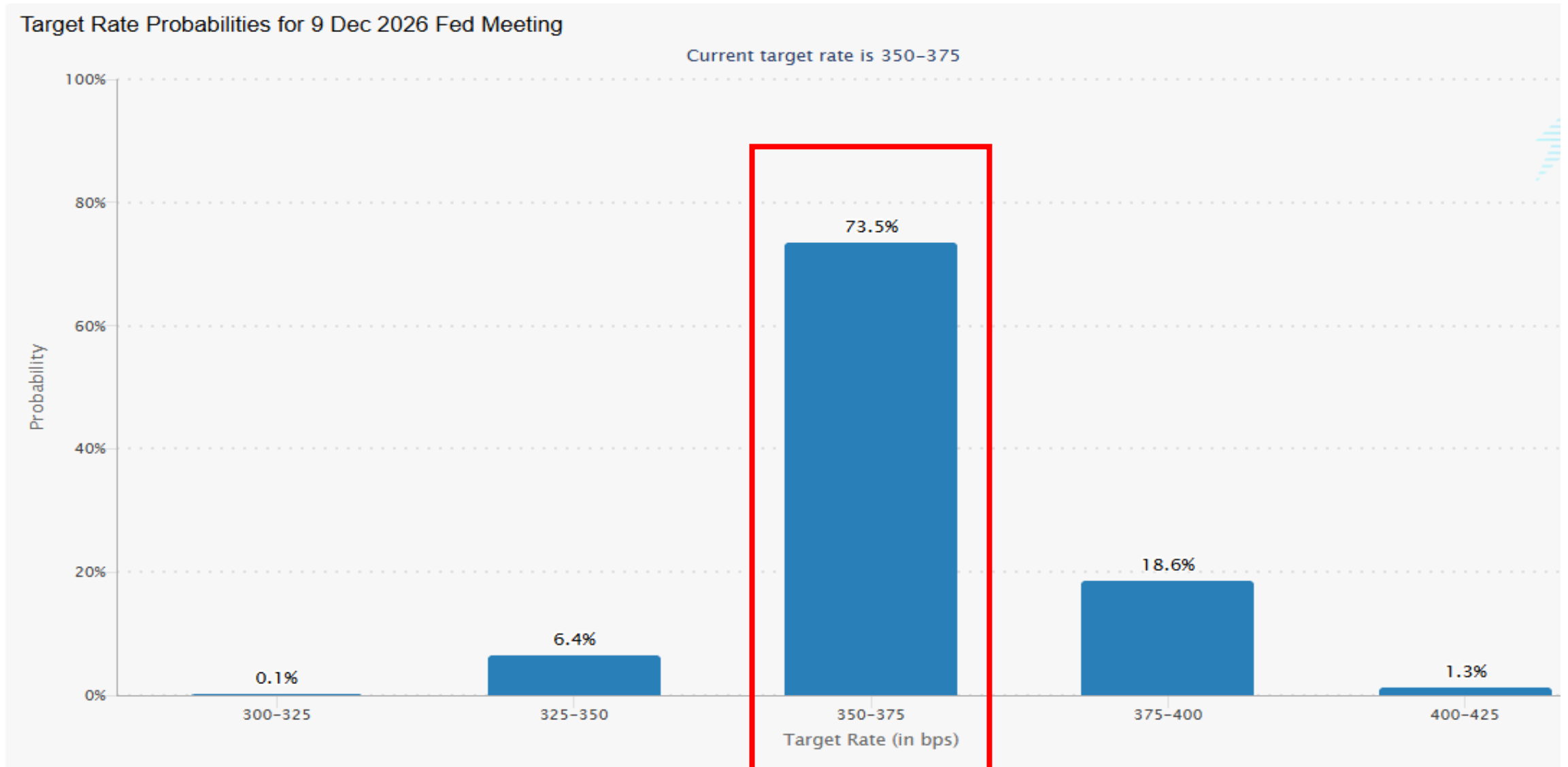


While labor market momentum has slowed, it has been stable with little signs of imminent weakness. **This gives the Fed time to keep rates unchanged due to increasing inflation risk, but the slowing labor market will make rate hikes a tough sell, unless inflation moves considerably higher.**



The Iran war complicates the picture for the Fed and the markets. Inflation will increase, which, all else equal, extends the Fed's rate cut pause. **However, slowing demand and/or increased deterioration in the labor market could complicate that hold posture.**

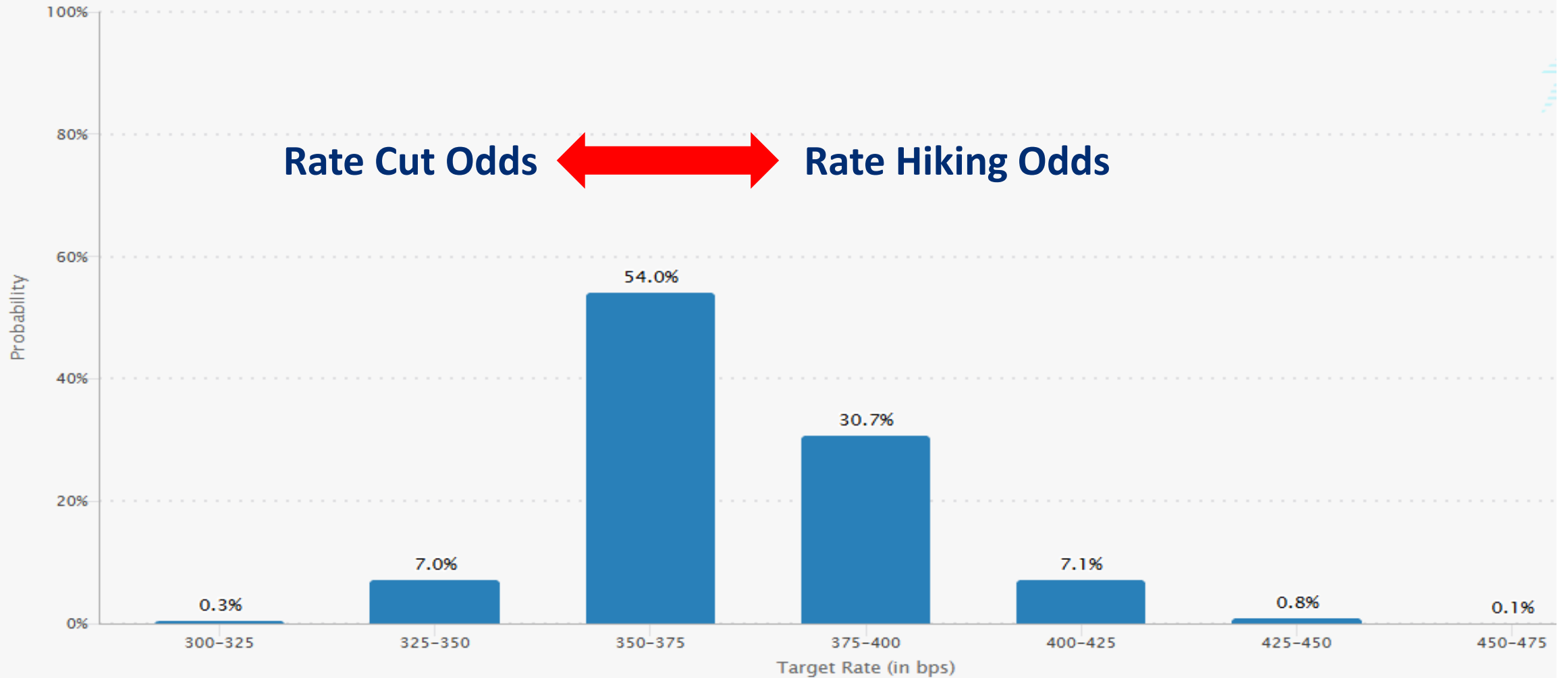
Futures See Little Chance of a Rate Cut this Year



Futures Market Sees Little Chance of Rate Cuts in 2027 and Greater Odds of Rate Hikes

Target Rate Probabilities for 9 Jun 2027 Fed Meeting

Current target rate is 350-375

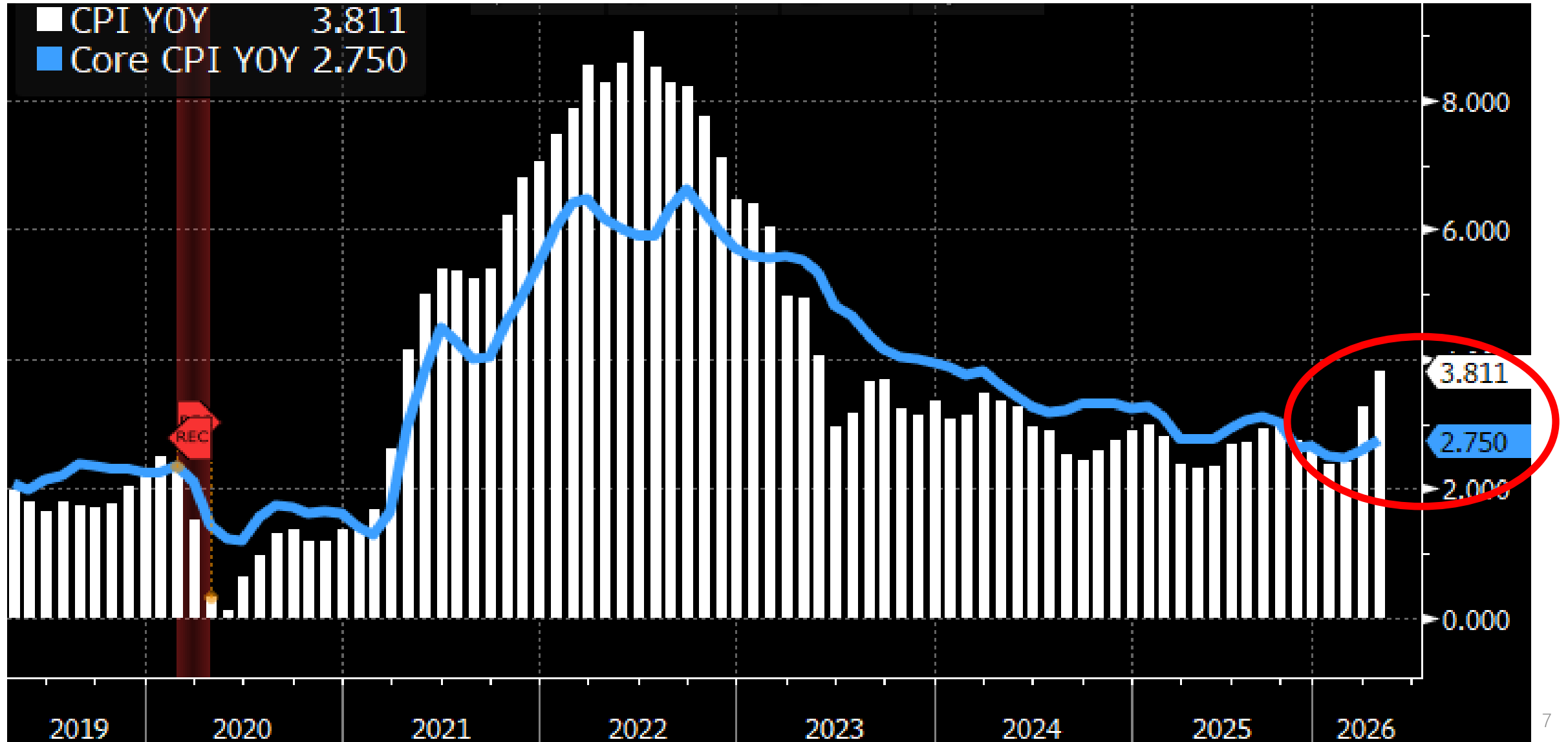


Inflation Trends:

Iran War Will Add Price Pressures, but for How Long?

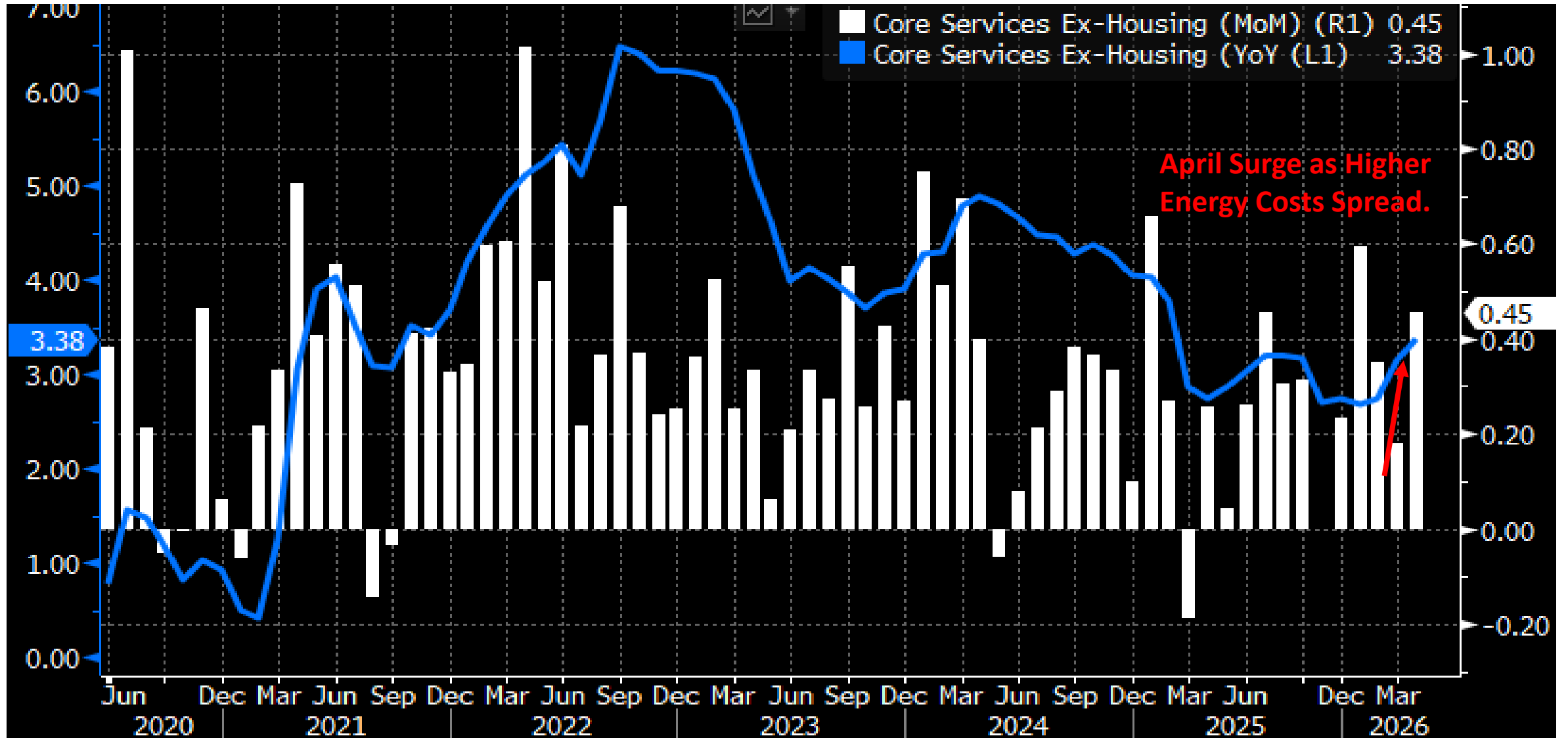


CPI and Core CPI – Moving in the Right Direction Until the War





Core Services Inflation Ex-Housing – Improving in 2026 until War

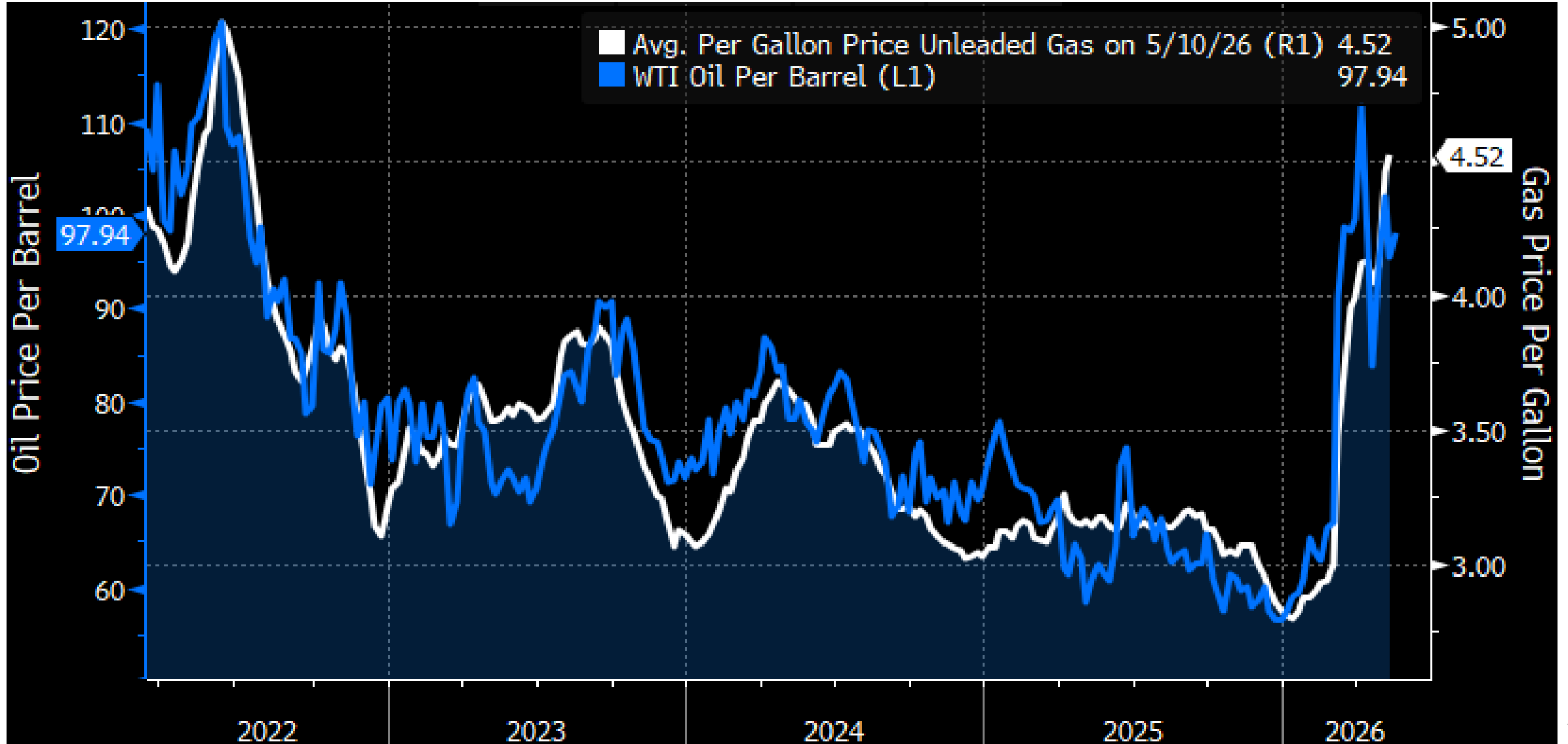


Monthly Change in Owners Equivalent Rent (OER): After Being Elevated Since 2022, it Finally Returned to Pre-Pandemic Levels, Until Repricing of Missed Data from Lockdown



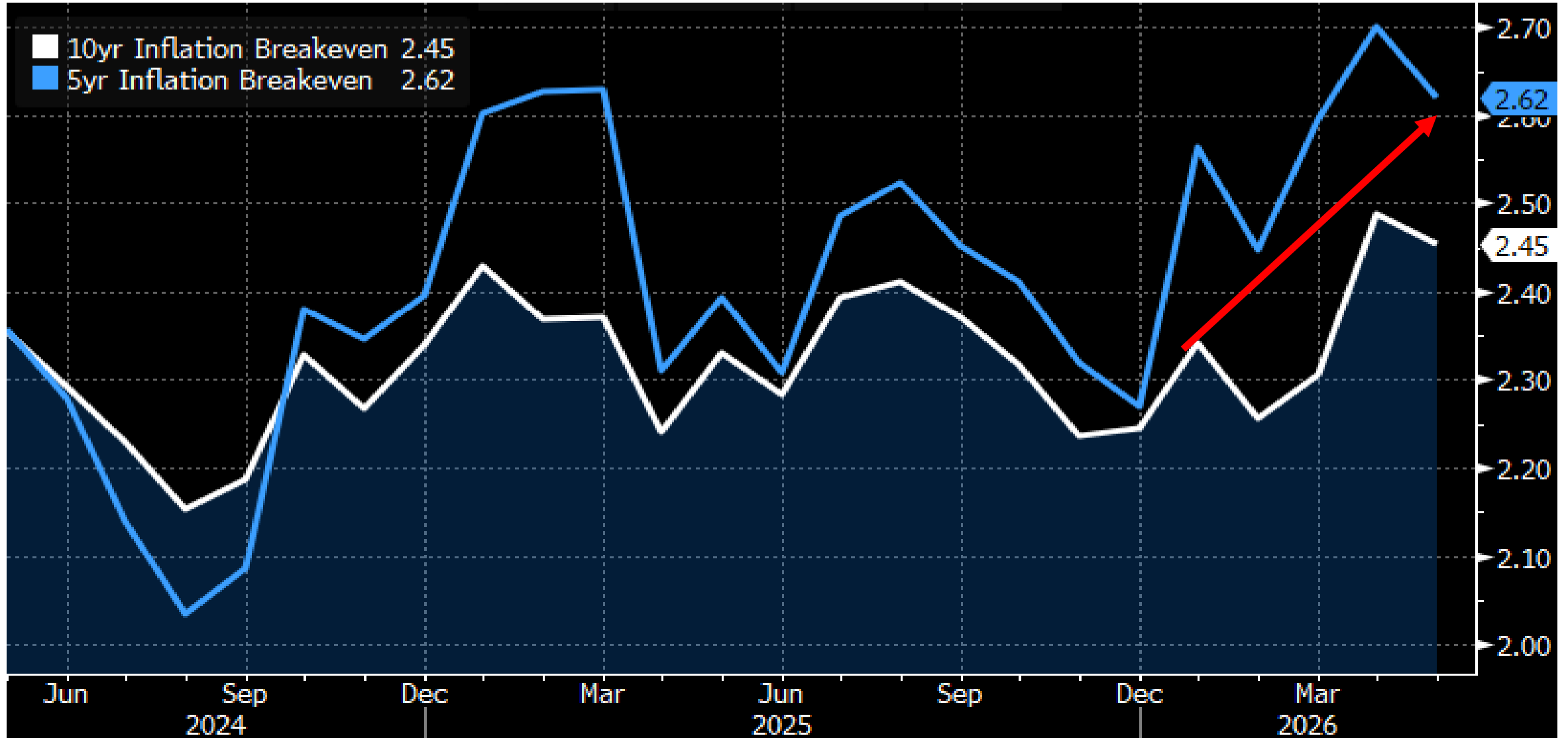


Oil Near \$100/bb and Gas Prices Move Over \$4.50/gal.

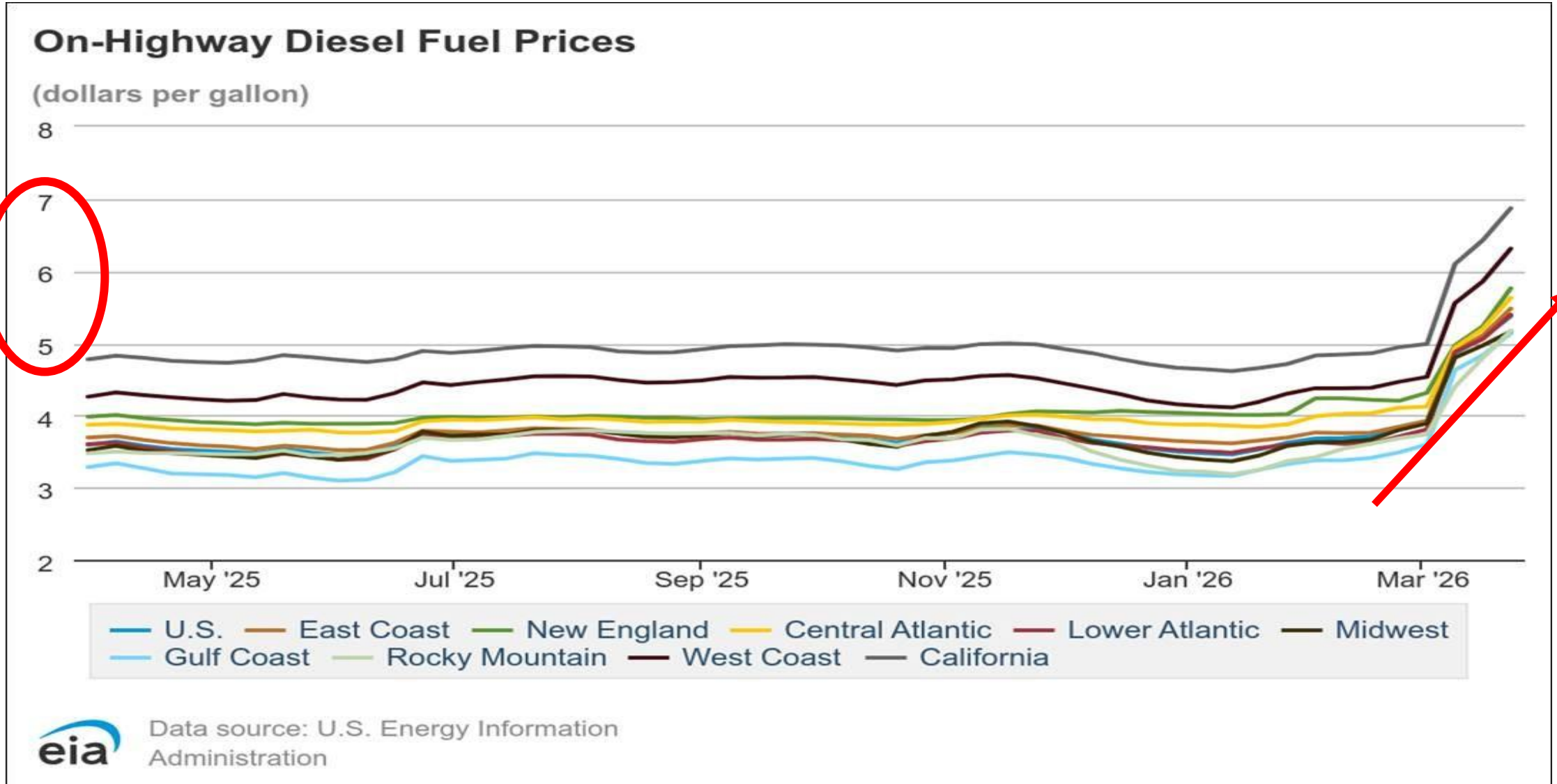




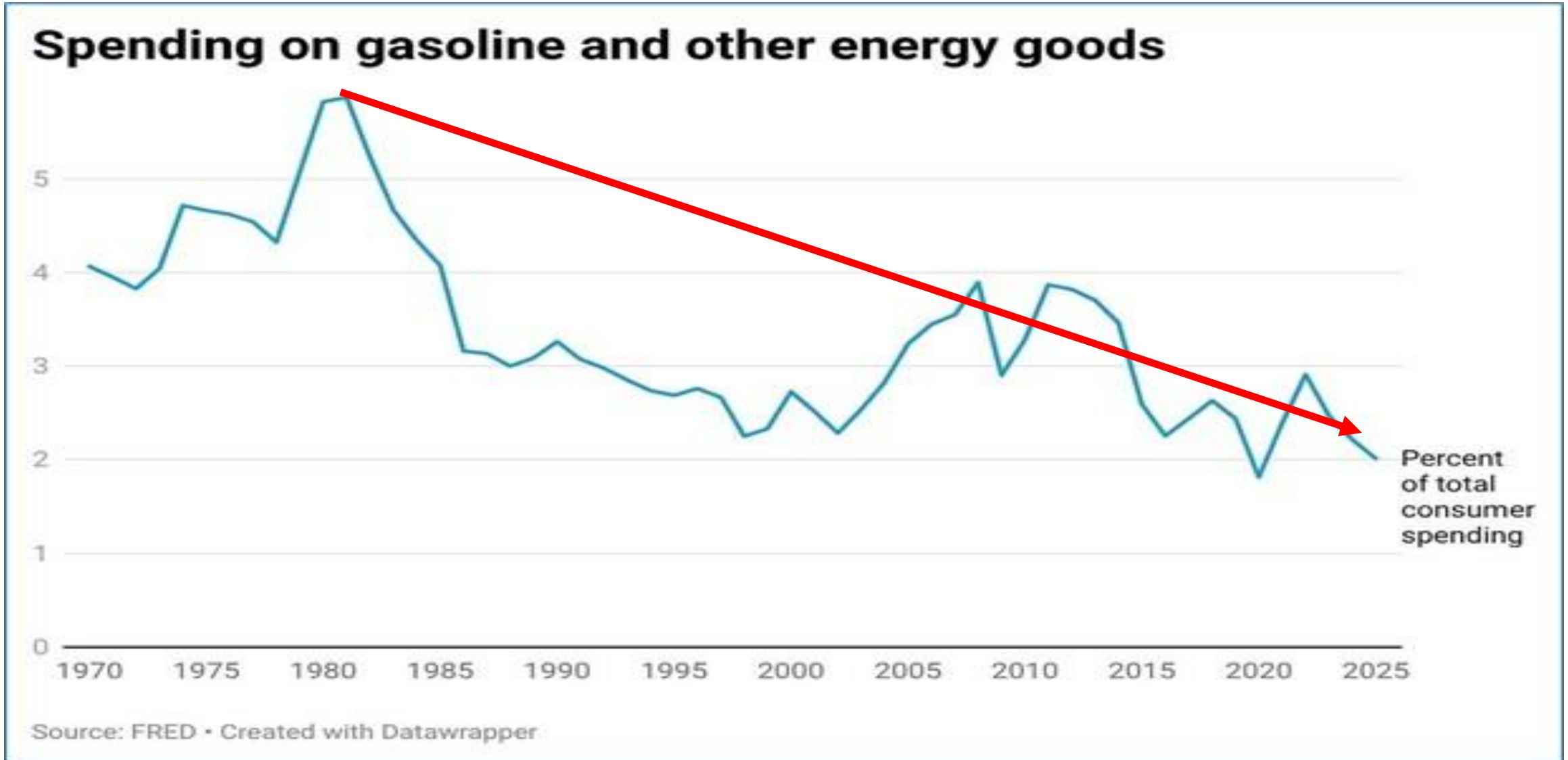
TIPS Inflation Breakeven – Moving Higher in 2026, Implies Greater Inflation Expectations



Forget Gas, Higher Diesel Prices Will Feed into Almost Other Goods Prices

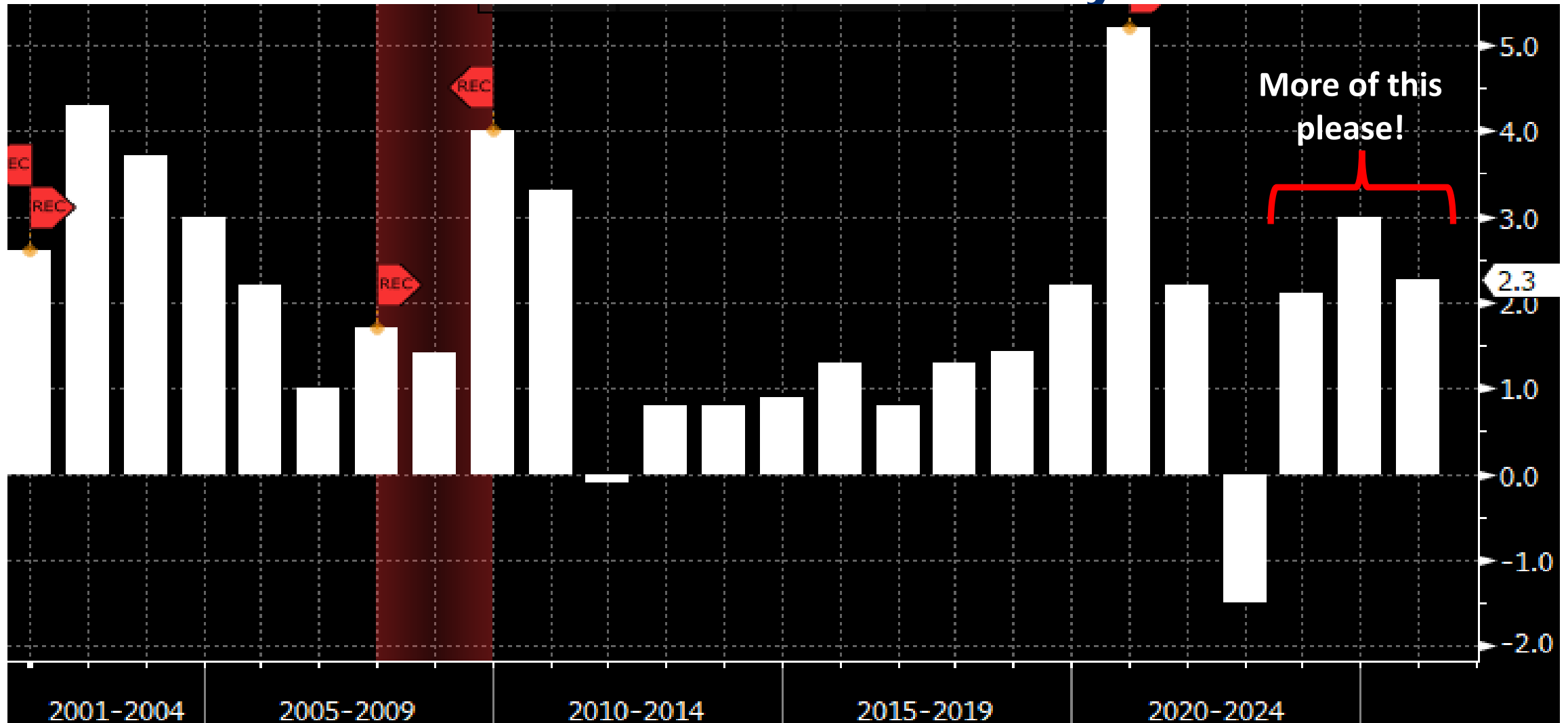


Spending on Gas Today is Much Smaller % of Total Spending vs. Prior Decades





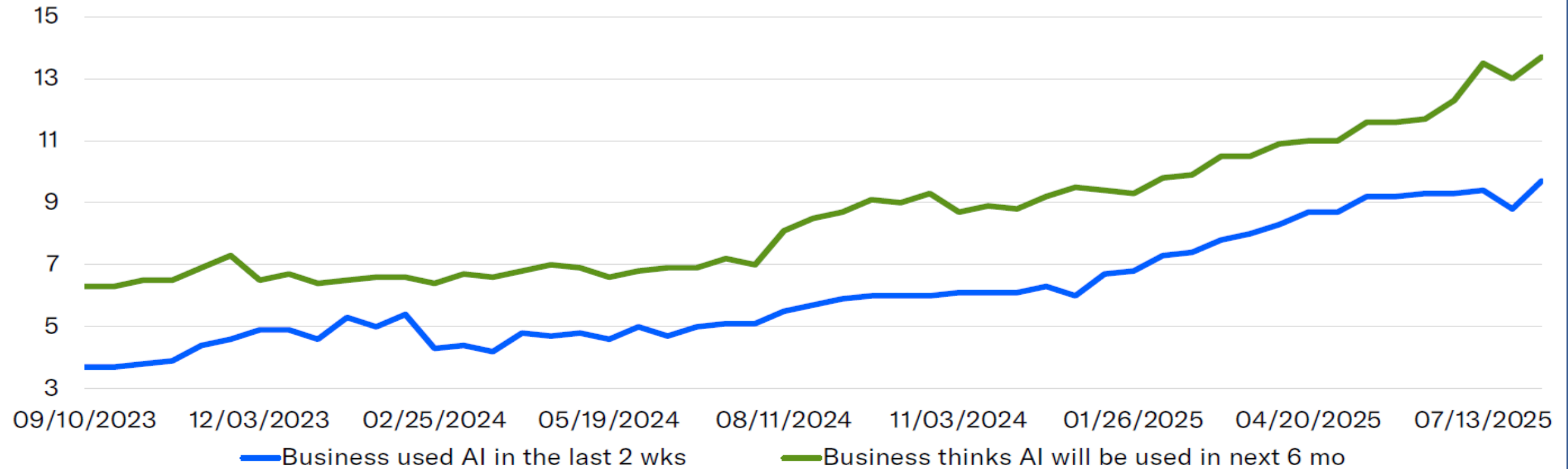
Productivity has Improved after Post-Covid Slump – That Reduces UNIT LABOR COSTS and Inflationary Pressures



AI Still in Early Stages of Corp. Adoption – More will Enhance Productivity

AI Usage Has Nearly Tripled Since Late 2023...


Share of positive responses, %



Sources: Census Bureau, Moody's Analytics

Inflation Conclusion: Plenty of Negatives but Some Positives Too



 **Increased inflation pressure from war.** Supply disruptions, higher energy costs, and military spending will pass into broader pricing pressure. **HOWEVER, economy much less oil dependent.**



OER had finally returned to pre-pandemic monthly price patterns until April's repricing of missed regions from lockdown. That will delay improvement given its heavy weight in the CPI Index.



Productivity turned positive in 2023/24 which eases inflation pressures as Unit Labor Prices decline. **This needs to continue. Increasing adoption of AI will help this.**



TIPS Inflation Breakeven Rates are rising from higher oil/energy costs and supply risk. Market is expecting higher inflation this year and into 2027.



Inflation improvement was impressive prior to 2025, but tariff costs leaked into both goods and services last year, stalling gains. Now, war impact will reverse more of those gains. Expect Inflation to move close to 4%, or above, later this year and perhaps into 2027.

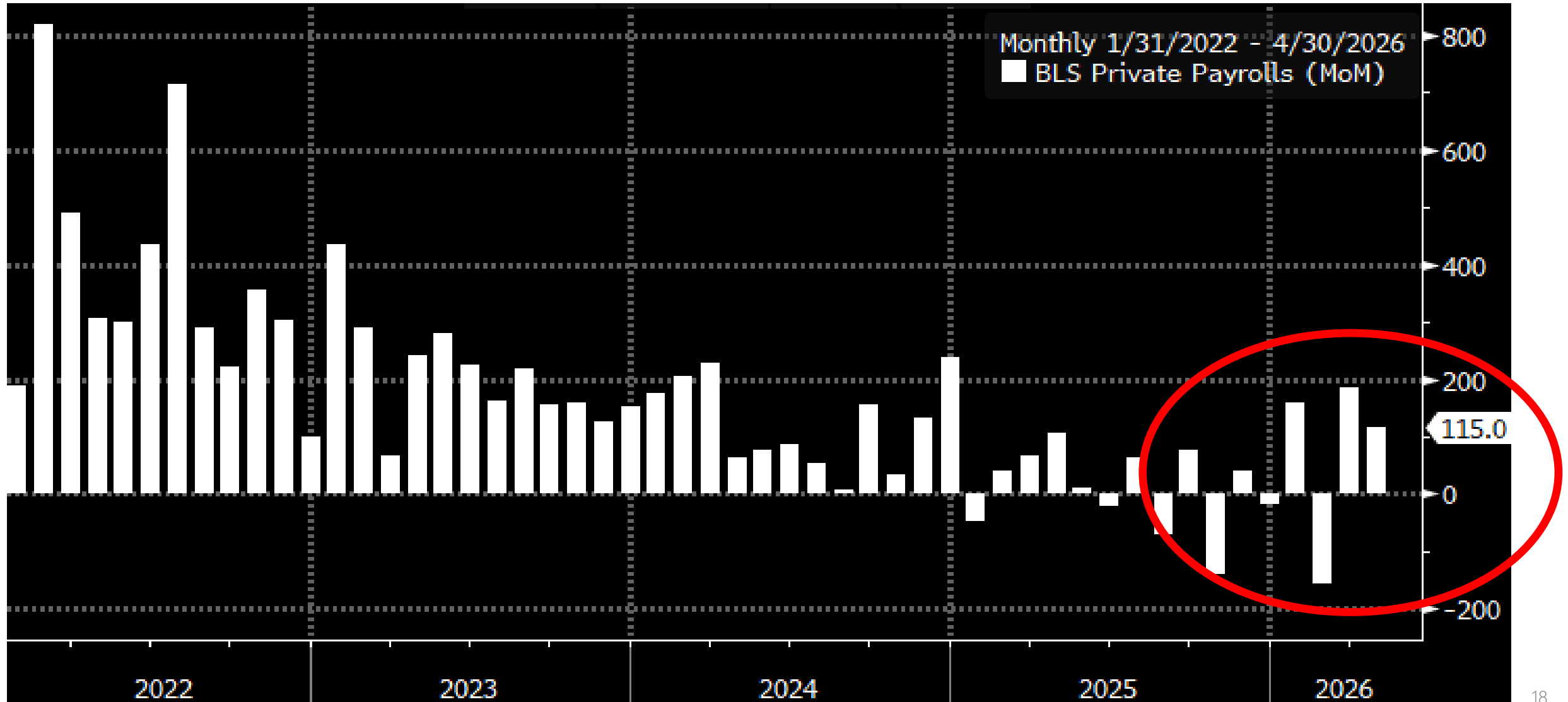
Economic Outlook

Job Growth is Slowing

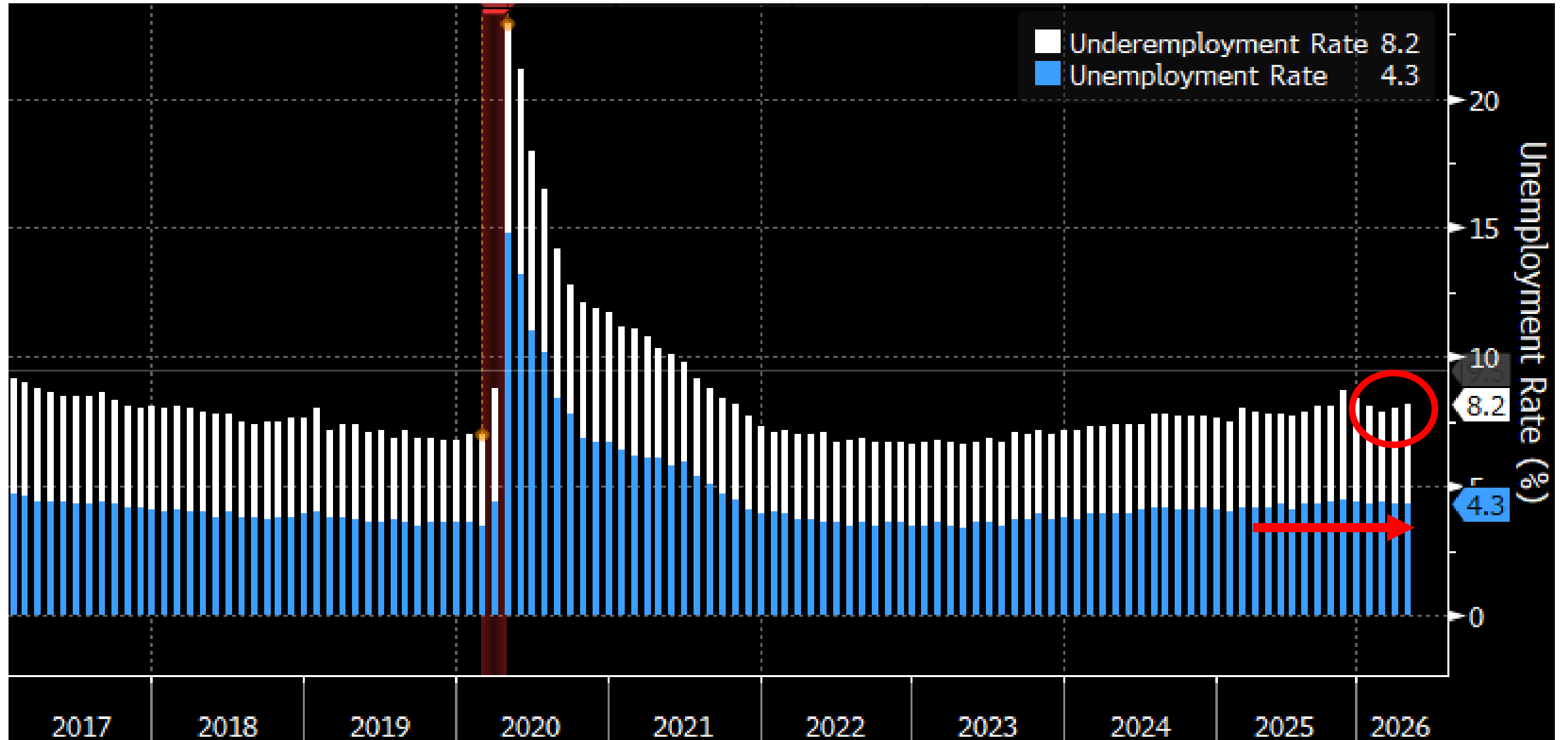
Consumer Spending Holding On But For How Long?



Job Growth Slowing and Erratic – Expect more of the Same

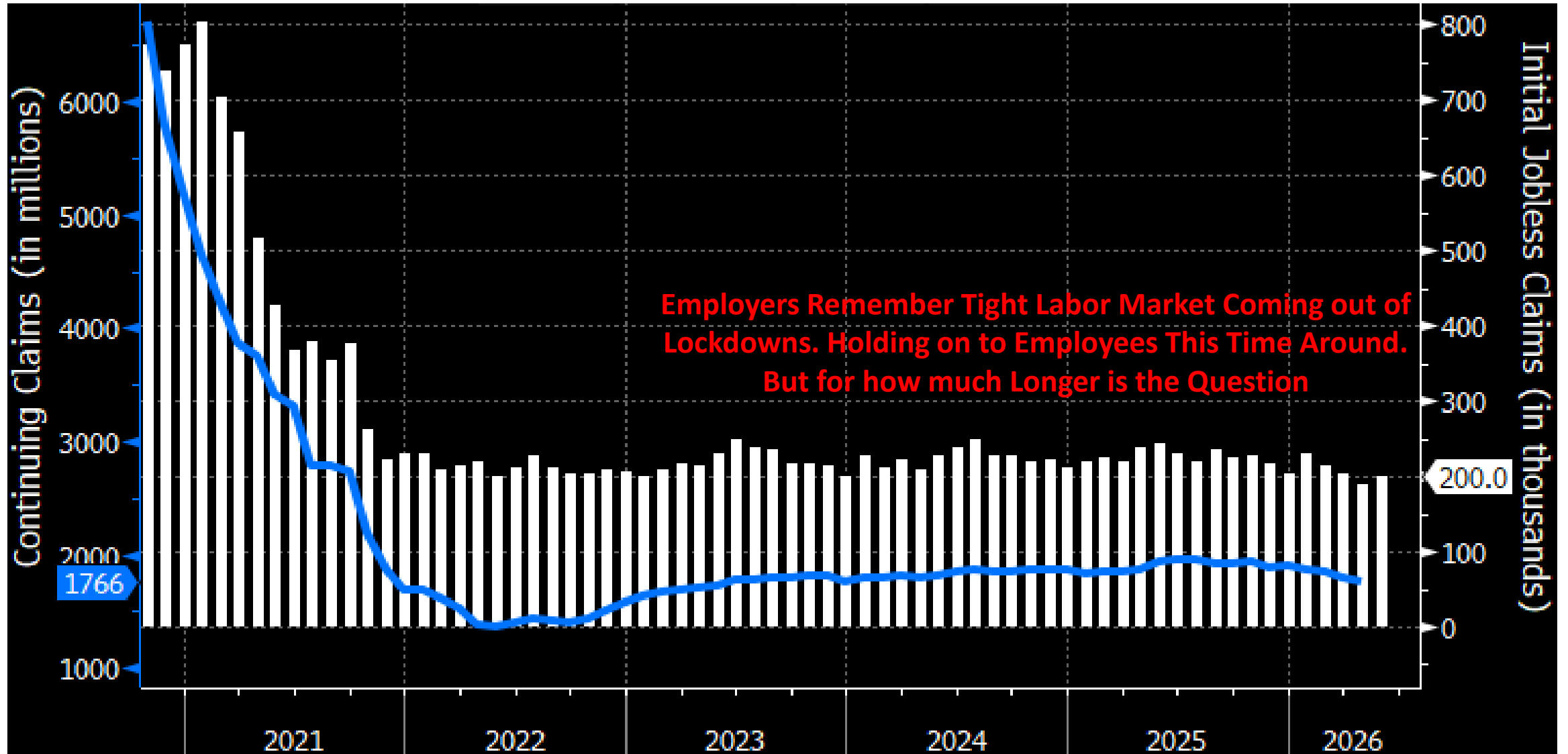


Unemployment Rate Mostly Steady to Slightly Higher – Fed Fixated on This Stability





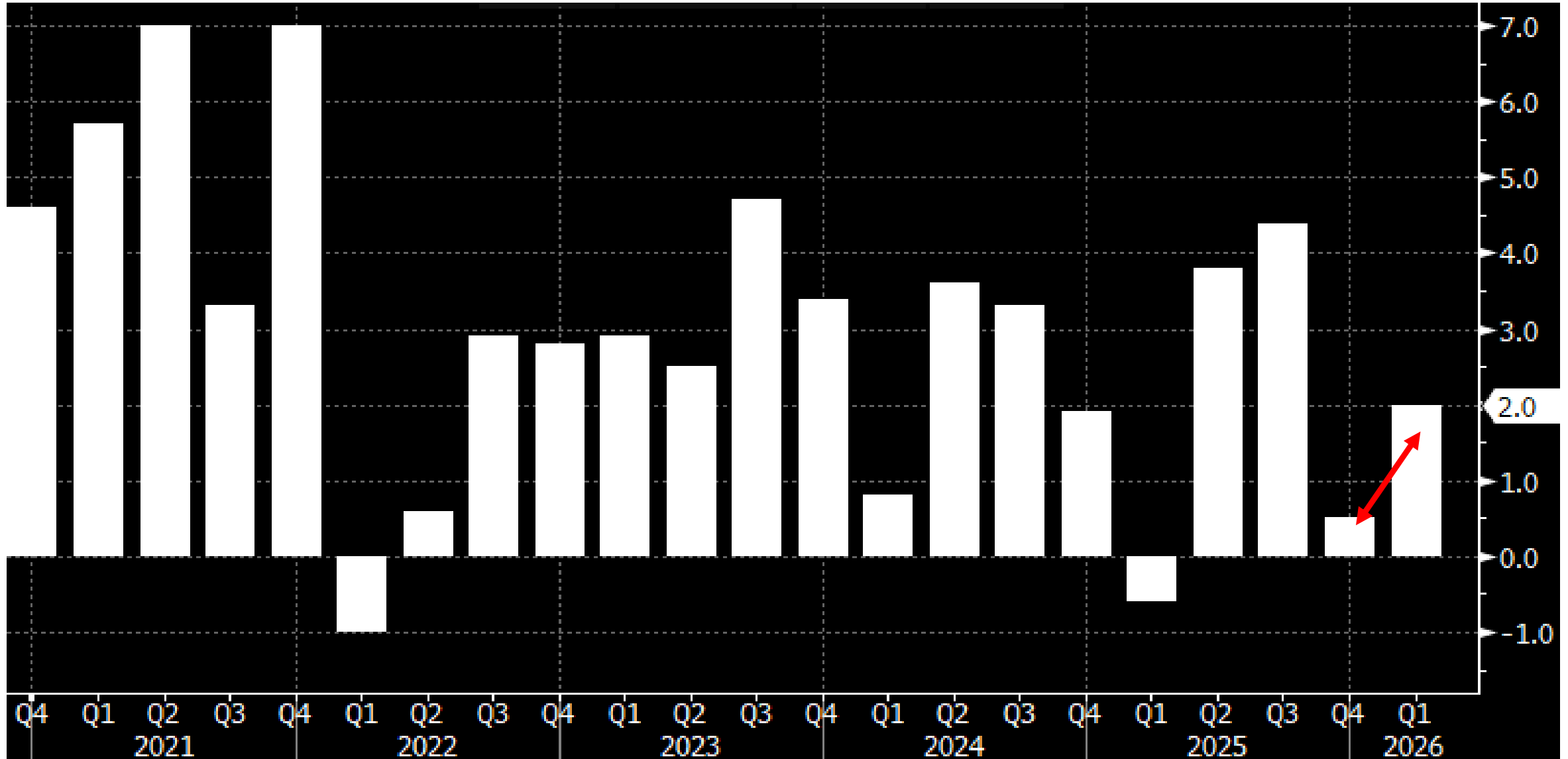
Weekly Jobless Claims – Layoffs Remain Low, Will That Continue?



Outlook for Economy

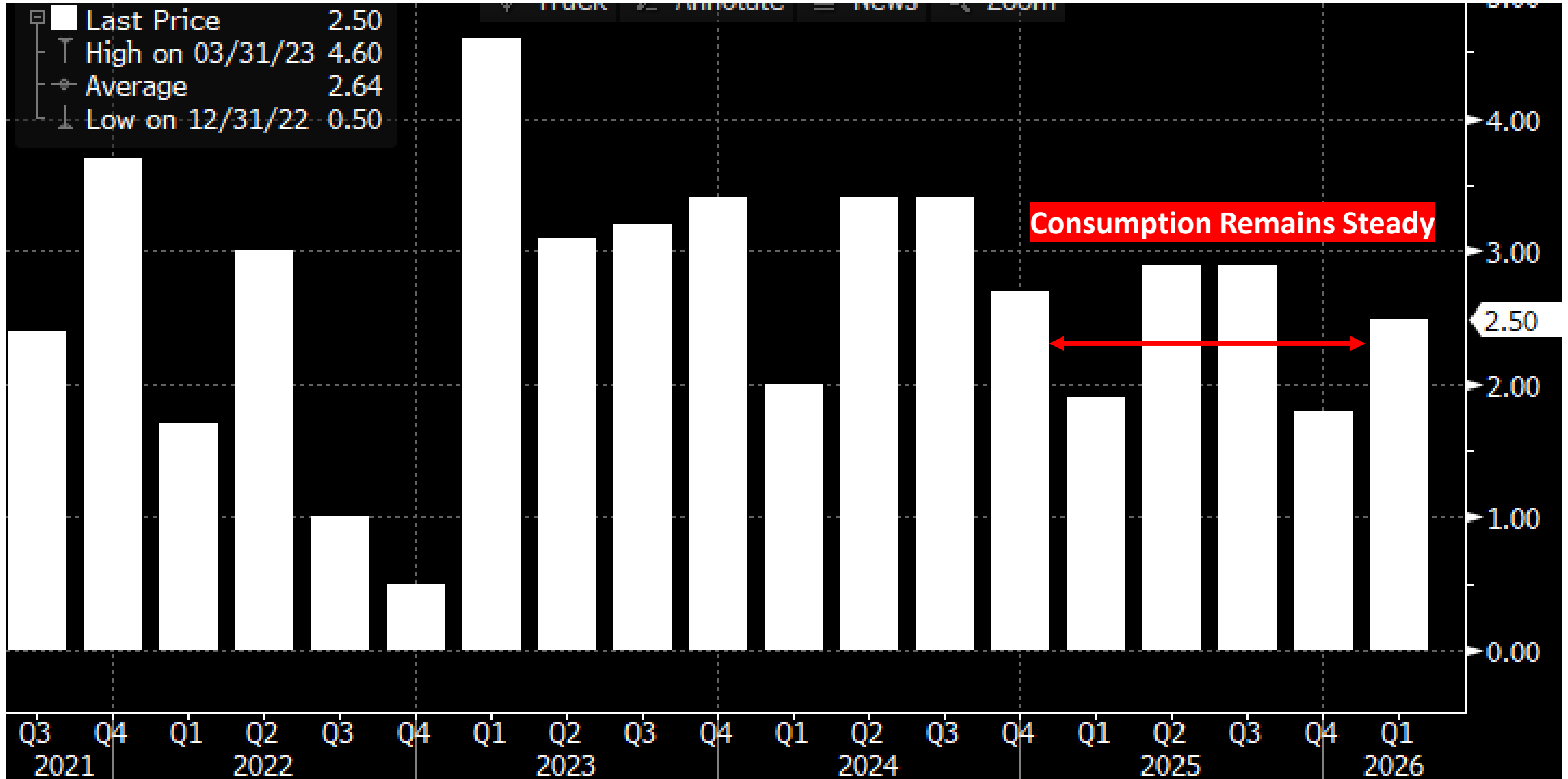


1Q26 GDP Improved to 2% after 0.5% 4Q25: Boosted by Data Center Spend and Rebound in Gov't Spdg.

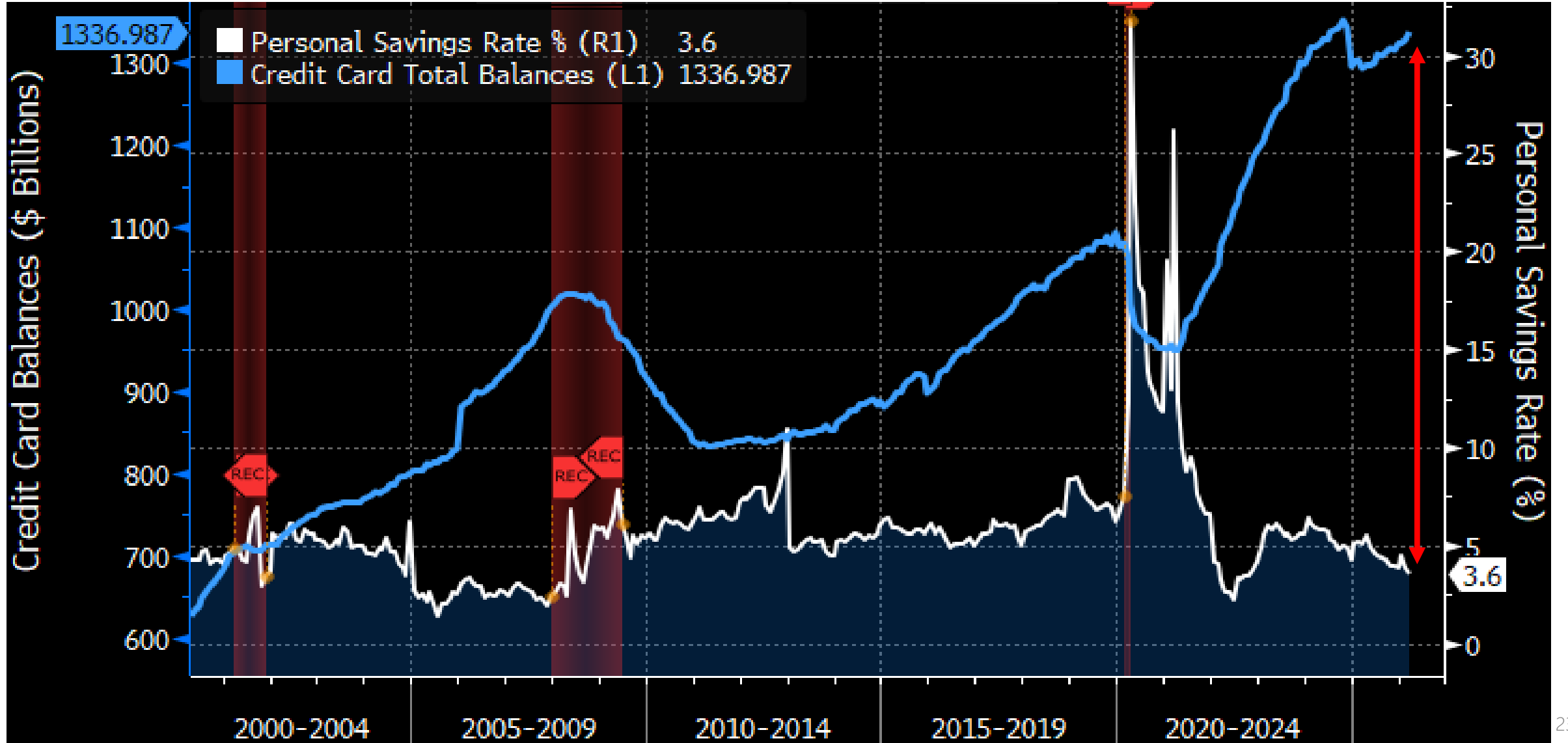




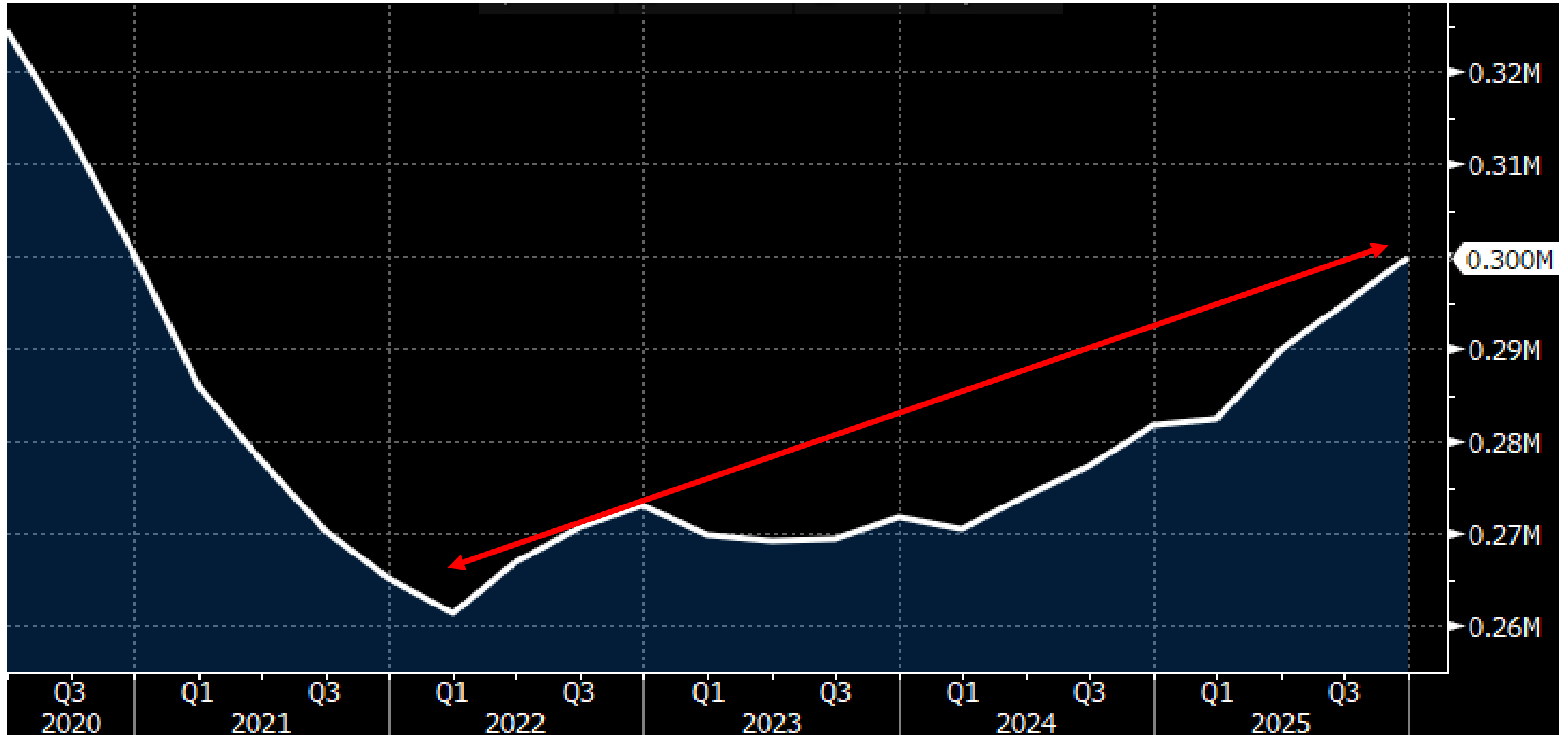
Real Final Sales to Private Domestic Purchasers – “Core Consumption” is Steady



Consumer Tapping Out? Savings Rate Slipping Lower, While Increasing Credit Card Balances Supplement Spending



Consumer Tapping Out? Not so Fast - Home Equity Loan Balances are Increasing



Outlook for the Economy - Conclusion



US growth in 2026 will slow to 1.5% to 2.0% GDP. War uncertainty may slow consumption in future months. Recession is still an outlier scenario.



Inflation will move moderately higher (say, 4.00% to 4.50%), but the full extent and duration depends on length of trade restrictions through Strait of Hormuz.



Consumer spending is moderating as lower income consumer struggles with affordability. If middle-to-higher income consumer follows, then recessionary scenario becomes possible.



We no longer expect a rate cut this year as inflation remains stubbornly high from war-driven surge, but GDP growth struggling between 1.5% to 2.0% will prevent 2027 rate hikes.



Short-end yields will follow rate-cutting/hiking expectations, which are limited in either direction, at present.



Long-end yields will be rangebound (10yr 4.25% - 4.75%). Arguing for higher yields: ongoing inflation risk and trade/supply disruptions, threats to Fed independence, and continuing budget deficit concerns. However, expected slowing in GDP should limit upward move in yields.

Thank You

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