

A longer pause: The Fed weighs conflict and growth

The Federal Reserve held interest rates steady today for the third consecutive meeting as the Middle East conflict continues to cloud the outlook. Higher oil prices are beginning to push inflation higher and weigh on the growth outlook, reinforcing the Fed's cautious stance and prompting us to revise our forecasts.

Key takeaways

- The Fed kept interest rates unchanged once again, with the target policy rate range remaining at 3.50% to 3.75%.
- Governor Miran dissented again in favor of a cut. Regional presidents Hammack, Kashkari and Logan supported the hold but favored removing the “easing bias” from the policy statement.
- The statement retained its “easing bias,” keeping language referencing “additional adjustments to the target range for the federal funds rate.”
- Chair Powell struck a slightly hawkish tone at his press conference but characterized current policy as well positioned.

What happened?

The U.S. Federal Reserve held rates steady, keeping the target range at 3.50% to 3.75%, in line with market expectations. The pause in rate cuts that began in January continues.

Governor Miran dissented in favor of a rate cut, as expected. More surprisingly, President Hammack (Cleveland), Kashkari (Minneapolis) and Logan (Dallas) dissented in favor of more hawkish policy statement language. In particular, removing the “easing bias” in favor of two-sided language that would keep a rate hike on the table as the next possible move.

Breaking news

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At his press conference, Chair Powell cited “so much uncertainty” in the current environment, saying the committee would likely need to see oil prices begin to fall – “the backside” of the energy shock – before considering rate cuts. He described the current policy stance as “at the high end of neutral or perhaps mildly restrictive” and now “just the right place to be,” pointing to higher inflation and a stronger labor market as reasons to hold for longer.

Powell also announced he will step down as Chair when his term ends next month, with Kevin Warsh expected to succeed him pending Senate confirmation. Powell said he will remain as a governor for an unspecified period while the Department of Justice’s investigation of the Fed concludes.

We now expect the Fed to remain on hold longer than previously anticipated. We still expect one 25 basis point cut this year but have pushed our forecast for the second cut into 2027. Our forecast for the 10-year Treasury yield remains in a 4.00% to 4.25% range for the year.

Oil prices weigh on growth, but data hold up

Since the last meeting, economic data has been clouded by the ongoing war in the Middle East. Though the full impact of higher oil prices has yet to materialize, early effects are visible. We have revised our 2026 GDP growth forecast modestly lower and our inflation forecast modestly higher.

Oil prices have pulled back from their peaks. WTI trades around \$100 per barrel today after touching nearly \$120 last month. But the broader futures curve has moved higher, with year-end implied prices near \$78 per barrel. Near-term recession risk has eased, but the medium-term drag has likely increased.

Higher oil prices affect the U.S. economy through several channels. Most immediately, consumers are paying more for energy: headline CPI rose 0.9% in March, the highest monthly reading since 2022. National average gasoline prices have topped \$4 per gallon for the first time since that year. Less disposable income for non-energy spending should weigh on growth.

That said, U.S. consumers devote less than 4 cents of every dollar spent to energy — half as much as at the 2008 peak — which cushions the blow. Higher oil prices also tend to stimulate investment in the energy sector, providing a partial offset to the broader growth headwind.

Away from energy, incoming data has been solid. Retail sales point to a resilient consumer, the unemployment rate fell to 4.3% in March and jobless claims remain low. Business activity has held up despite higher energy costs.

Weighing these crosscurrents, we have lowered our 2026 GDP growth forecast by 0.2 percentage points to 1.8%. We now expect core inflation of 2.8% year-over-year for 2026, up from our prior forecast of 2.5%.

What does this mean for investors?

With the Fed holding rates steady today and signaling a more prolonged pause, we see opportunities for investors across fixed income markets. With a longer delay before the next move in rates, shorter-duration segments may outperform. At the same time, given our constructive macroeconomic outlook even in the face of higher oil prices, we believe in positioning for income in the current environment. Several asset classes meet these criteria.

U.S. high yield corporate bonds have proved resilient in 2026. Through 24 April, the Bloomberg U.S. Corporate High Yield Total Return Index is up 1.30% year-to-date, outperforming similar-duration Treasuries by 75 bps — despite escalating volatility from the Middle East conflict, AI-related risks for software and concerns about private credit.

High yield has undergone a meaningful structural improvement since the 2007–2009 financial crisis. BB rated bonds — the highest quality tier — now represent roughly 57% of the market, up from 38% pre-

crisis. The market has also shifted toward larger, more established issuers. The result is a higher-quality universe with a default rate that remains below long-term historical averages. Corporate earnings among high yield issuers continue to be strong, net leverage is healthier than in private debt and interest coverage ratios are solid at approximately 4.2x.

High yield also stands out from an AI perspective. Exposure to software — the sector most vulnerable to AI disruption — is less than 5%. Meanwhile, high yield is meaningfully overweight AI enablers and beneficiaries: fiber optics, power, data centers, tech services and health care. The combination of attractive yields, improved credit fundamentals and relative insulation from AI risk may make high yield a compelling option for investors seeking below-investment-grade credit exposure.

Emerging markets (EM) debt remains a favored allocation despite a difficult first quarter. The Middle East conflict drove risk-off sentiment, widening spreads and pushing Treasury yields higher. Local markets, as measured by the JPMorgan GBI-EM Global Diversified Composite, were hardest hit, returning -2.3% for the quarter as the dollar strengthened and the Fed leaned hawkish. One bright spot: Net fund flows into EM debt were a positive \$17.4 billion, reflecting sustained investor demand.

Fundamentals remain healthy overall. EM high yield corporate defaults have ticked up to 4.0% but are below prior-year levels. The projected default rate for EM high yield sovereign bonds is less than 1% for 2026 — well below its 7% five-year average and 2% longer-term average. EM sovereign debt offers a risk premium relative to historically tight developed market spreads, and a benign inflation outlook supports EM local debt as well. We view the dollar's recent strength as a short-term headwind and expect downward pressure on the currency to resume over the medium to long term.

Senior loans (also known as leveraged or syndicated loans) have seen spreads widen by 33 bps in 2026 through 27 April, based on the S&P UBS Leveraged Loan Index. The technology sector has driven most of that widening (251 bps year-to-date), particularly software, as investors price in the risk that AI will disrupt traditional software business models. Valuations in the sector are at multiyear lows, pushing up loan-to-value ratios and introducing refinancing risk.

Not all software names are equally affected, however, and we view the current environment as a transitional period that could create meaningful opportunity for active managers. We are underweight software overall but favor higher-quality businesses with durable competitive advantages — companies where AI is more likely to enhance margins than erode them.

Spread widening in 2026 has been notably uneven across the broader loan market: BB spreads are up just 7 bps year to date, while B and CCC spreads have widened by 41 bps and 207 bps, respectively. The average price of CCC loans is approaching Covid-era lows, suggesting meaningful total return potential for disciplined credit selection.

Currently, approximately 17% of the loan market trades below \$95, while about 38% trades above par — compared to roughly 60% trading above par at the start of the year. We expect performance dispersion to persist, creating opportunities to add risk selectively as fundamentals become further mispriced. Loans trading below \$90 could generate outsized returns, but only for investors who prioritize patience, fundamental analysis, and selectivity over near-term noise.

For more information, please visit us at nuveen.com.

Endnotes

Sources

Federal Reserve Statement, April 2026.

Bloomberg, L.P., S&P Markit, JPMorgan.

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