



March 11, 2026

Ignore the Stagflation Concerns

Following last week's atrocious employment report (more on this later) and volatile crude oil prices, stagflation fears have again soared.¹ As we noted last week, the latest spike in yields is not just due to higher term premiums but also reflects fears that the Fed will keep rates higher for longer. The 5-year breakeven inflation rate has also risen from 2.46% to 2.65%, its highest level since March 2025. Stagflation fears are, however, severely misguided. **The real risk remains a demand-driven slowdown like 1990 or 2001, not a repeat of the 1970s.**

The muted response to the February CPI reading is understandable given that it was about as expected and does not reflect any impacts from the war in Iran. It does, however, confirm that, pre-war, inflation was not a major threat. Our preferred measure, core-CPI, ex-shelter, came in at 2.4% (m/m annualized), bringing its three-month average to 2.6%. This does remain above the Fed's target and, along with 4.4% unemployment, provides a reasonable justification for the Federal Funds rate's current 350-375 range. Evidence, however, continues to mount of slowing GDP growth and further weakening of the labor market. This will eliminate any remaining excess inflation this year even if the Fed resumes rate cuts in June, as we expect.

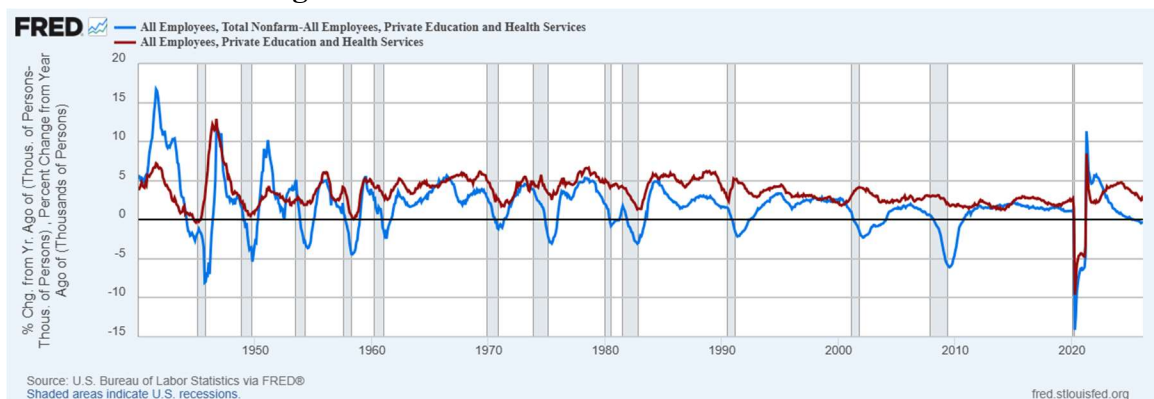
We are not optimistic that the conflict in Iran will soon end. The sources of the war are no closer to resolution, and any cessation in hostilities is likely to be temporary. Absent the war, fundamentals suggest a price for Brent crude around \$65 per barrel, but we expect much higher prices for most of 2026. Any release of strategic reserves will have only small and fleeting effects on prices. **Nevertheless, the connection between oil prices and U.S. inflation remains among the most outdated and overrated ideas in all of economics.** Beyond a direct impact on headline measures of inflation through higher energy prices, there will be neither major indirect effects, nor any important impact on core-inflation. The bigger, though still modest, impact will be to further slow growth. As we wrote last week, if Brent crude oil settles around \$100 for a few months, we expect a 0.2% hit to GDP growth and a 0.1% boost to unemployment.

Other Developments in Macroeconomics:

¹ Baccardax, M. March 5, 2026. "[The Stock Market's New Fear Is an 11-Letter Word That Crushed the Economy in the '70s](#)" *Barron's*.

1. The dreadful February employment report is the worst piece of economic news in many months. Some have pointed out that employment in education and healthcare fell by 34,000 both because of a strike in California and because January's growth of 129,000 was an outlier (some of the jobs lost in February never existed). This, however, misses the point. Employment outside of education and healthcare fell by another 58,000 in February. Figure 1 (blue) shows its y/y change, which is now down to -0.4%. Since World War II, it has never turned negative without a recession. **The last time it fell below 1% without a recession was 1952 and it would now be unprecedented for the U.S. to avoid one.** We also note that health and education employment (red) remains positive but, except for the worst of covid, this metric has never turned negative.

Figure 1: The Labor Market Data Are Terrible



2. **We are upgrading our chances of a U.S. recession within the next year from 55% back up to 60%.** We note that the prediction market Kalshi puts the odds of a 2026 recession at 8%. The latter odds, beyond capturing a difference of opinion, should be lower because they capture only the next 9+ months. In addition, Kalshi uses the unofficial definition of a recession as two consecutive quarters of negative GDP growth, a definition that has never been used in the U.S. This raises an important question. There is about a 25% chance that U.S. GDP slows, but stays positive, while unemployment rises to 5.5% or higher. Would this be a recession? The question is not one of semantics because it relates to whether the FOMC would respond by lowering rates. We strongly suspect that they would. The Fed's mandate is maximum employment, not GDP. Also, we cannot imagine a new Fed Chair convincing Congress that maximum employment is consistent with a much higher unemployment rate. **We still see the Federal Funds rate falling to 250-275 bps by 1Q2027.**
3. We have written that when GDP growth exceeds employment growth, the former usually slows to match the latter. It is thus important that the Atlanta Fed, which has been accurate, has significantly downgraded its forecast for 1Q2026 consumption growth from

3.0% to 1.8%, with its with its GDP growth prediction also falling from 3.1% to 2.1%. This large downgrade comes from recent weak employment and retail sales data. The updated GDP and consumption figures are still decent, but following weaker than expected 4Q2025 data, growth is slowing as we expected. This will prove disinflationary; another reason we remain sanguine about inflation.

-Paul Shea

Strategic Economist, Miller Tabak