

Corporate Bond Market Insight | May 2026

# The Fed Sees Dissents Amid a Fluctuating Economy

## Key takeaways

- » Geopolitical turmoil and elevated energy prices marked April, yet corporate earnings stayed strong and major equity indexes reached new highs.
- » The Federal Reserve maintained rates at its April meeting, facing dissent from four voting members as inflation remains persistent and labor metrics show mixed signals.
- » Jerome Powell concluded his term as Fed chair, with Kevin Warsh poised for Senate confirmation. In an unusual move, Powell will remain a voting member of the FOMC.
- » Despite economic challenges like tariffs and higher energy prices, employment rebounded in March, and investment-grade credit spreads narrowed while new issuance was well received.

## Recap

Geopolitical chaos and high energy prices dominated April. Despite the turmoil, corporate earnings remained strong, most macroeconomic indicators strengthened and inflation rose. The Federal Reserve (Fed) left rates unchanged. Several large-capitalization equity indexes set new all-time highs, intermediate Treasury rates rose moderately and investment-grade (IG) credit spreads recovered to near their pre-Iran war levels.

The Fed left rates unchanged at its April meeting. This extended the pause that began after the 0.25% rate reduction at the January meeting. The Fed also kept its easing bias. For the first time since 1992, four of the twelve voting members dissented. Three objected, stating the easing bias is no longer appropriate given the upside risks to inflation. One voter, Steven Miran, argued the Fed should lower rates on the grounds that current policy is restrictive and risks damaging the labor market.

This is a tricky time for the dual-mandate Fed. On one hand, the threat that artificial intelligence will reduce demand for labor is rising and some labor metrics have softened. On the other hand, the sharp rise in energy prices risks a sharp increase in near-term inflation. Core inflation has been above the Fed's long-term 2.0% target since March 2021 and has been steadily rising since mid-2024. Recent developments in energy and commodities make increases above the current 3.2% year-over-year growth rate likely.

The main risk is the unanchoring of inflation expectations. When expectations become unanchored, long-term expectations rise and behavior among both consumers and businesses leads to even higher inflation. While the rapid rise in energy prices explains most of the Fed's unease, it's also aware that commodities rallied before the Iran conflict began because the build out of AI infrastructure created fresh demand for materials. Following the meeting, the market effectively priced out all cuts through 2026. In our view, considering the dissents and the rebound in employment, the Fed will remain on hold for the near future.

April was Jerome Powell's final meeting as chair. While the Senate has yet to confirm Kevin Warsh as the new chair, he has cleared the Senate Banking Committee. The vote is scheduled for mid-May, and he should be in office prior to the next meeting on June 16. He inherits a Fed that is becoming increasingly divided while economic uncertainty builds.

Though his term as chair is ending, Jerome Powell has chosen to remain on the Federal Open Market Committee (FOMC) board as a voting member. Marriner Eccles was the last chairman to remain after his term, but he stayed at the explicit request of the President. We expect that Powell will stay on the board until his legal jeopardy ends, at which point he will resign. He, like Eccles, will remain a strong voice for Fed independence.

IG corporate spreads improved and returned to near pre-war tights. Private credit, particularly business development companies, also recovered. April again saw substantial new IG issuance. The \$184 billion issued marks the second-highest April issuance ever. Activity was concentrated in banks but the hyperscalers were also active. The new issuance was well received as demand was strong and spreads moved tighter.

Against this backdrop, the 10-year Treasury yield rose five basis points (bps) for the month and 1–10-year IG credit spreads narrowed by nine bps for the month. As a result, the ICE BofA/Merrill Lynch 1–10 Year US Corporate Index returned 0.54% for the month, and 5.28% over the trailing one year. For the month, all sectors tightened. The best-performing sectors were automotive and basic industry, while media and telecommunications lagged somewhat. The market continues to prefer higher quality.

Despite tariffs, war, higher energy prices, political dysfunction and worries around artificial intelligence, the economy continues to perform well. After weakening the prior month, employment rebounded. March nonfarm payrolls rose 178,000, up from February's downwardly revised -133,000, and the unemployment rate declined to 4.3%. Importantly, private payrolls added 186,000 jobs even while government employment declined for the sixth consecutive month. In retrospect, major healthcare strike and disruptions from the winter storms largely explain February's sharp slowdown.

Other high-frequency employment anecdotes remain solid. For instance, only 189,000 applications for unemployment benefits were filed for the week ending April 25. This leaves initial jobless claims at their lowest level since 1969. Adding more credibility to the improvement in the employment economy is the sharp rise in the private weekly ADP NER Pulse employment index. After averaging 10,800 new jobs over the last 12 months, the last four weeks have shown a sharp acceleration to 39,250 new jobs. Despite significant layoff announcements from several firms, the low-hire, low-fire employment economy appears to be intact.

The advanced estimate for first-quarter 2026 GDP suggests that GDP grew at an annualized 2.0% rate. This was a significant increase from the 0.5% growth rate in the fourth quarter of Q4 2025. The building of artificial intelligence infrastructure fueled a substantial increase in private domestic investment. Household spending slowed, but winter weather had an outsized impact on spending as many consumers stayed home rather than shopping.

## Looking forward

We're still constructive on IG corporate investments. IG earnings are solid, and all-in yields, which combine rate and credit spreads, offer attractive investment yields. Defaults are also still very manageable. Since the start of the year, upgrades have outpaced downgrades five to one. Granted, headwinds remain. If they stay high, energy prices will slow growth, but there are offsets. Fiscal stimulus is still in the pipeline, corporations are receiving refunds for the IEPA tariffs they paid and banks continue to report that consumer health is good.

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