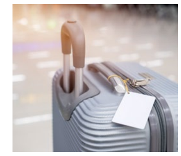
Inflation Outlook

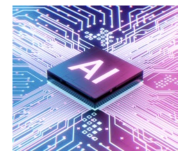
Nationwide Economics | August 2026

Inflation likely to remain a thorn in the economy and Fed's side

Energy, tariffs, and AI investment are key drivers of today's high inflation problem, affecting a broad-based array of services and goods prices.

There's good news and bad news regarding the inflation outlook. The good news is we forecast inflation to slow going forward. The bad news is the deceleration won't be quick. We expect the Fed won't get to its 2 percent inflation goal until well into 2027.



Inflation is a sore spot for consumers and businesses alike, consistently topping their list of concerns, while also keeping investors on edge about interest rates. Fed officials feel pressure from missing their inflation mandate for five years running, leading some policy makers to contemplate raising interest rates.

Our detailed bottom-up, analysis of the PCE price indices – the Fed's preferred inflation measure – sheds light on the drivers of the elevated inflation and why Fed policymakers are unlikely to achieve their 2 percent inflation target for prices until spring 2027 at the earliest.

What is driving high inflation today?

The jump in energy prices and airfares sparked by the Iran conflict are well-known leading contributors of current hot inflation readings. The rise in energy prices (namely refined oil products) has contributed a sizable 0.8 percentage points on average to headline PCE inflation since the conflict started – headline PCE inflation has averaged an estimated 3.8 percent year-over-year (y/y) since March. Gasoline prices are up around 25 percent y/y and about 20 percent from their pre-Iran conflict level.

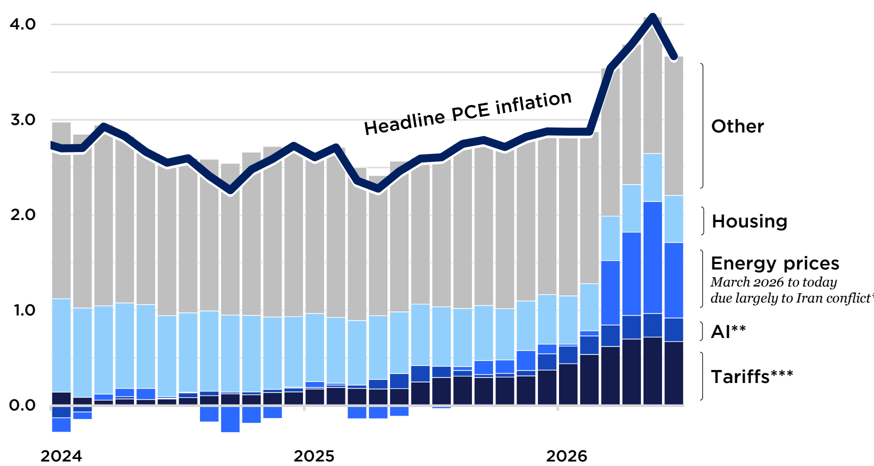
Airfares have also jumped since the start of tensions, up an estimated 16 percent y/y in July and stand 6 percent above its pre-conflict level. Airline fares could prove a lot stickier as consumers have not balked at the higher fares, providing airlines with a sense of pricing power.

Tariff- and AI-driven inflation are also notable contributors to today's problem, accounting for about 25 percent of the average increase in headline PCE inflation so far in 2026 and about 30 percent of the rise in core prices.

Excluding energy and tariffs, headline PCE is running a much slower rate of around 2.3 year-on-year percent, versus the published 3.7 percent.

Contribution to headline PCE inflation

Percentage contribution to y/y percent change



*Energy prices/Iran conflict (March 2026 to current) include motor vehicle fuels, lubricants, fluids, and airfares.

**AI includes computer software/hardware, and utilities (electricity and natural gas).

***Tariffs include components of PCE prices subject to tariffs.

Source: Bureau of Economic Analysis, Haver Analytics, Nationwide Economics

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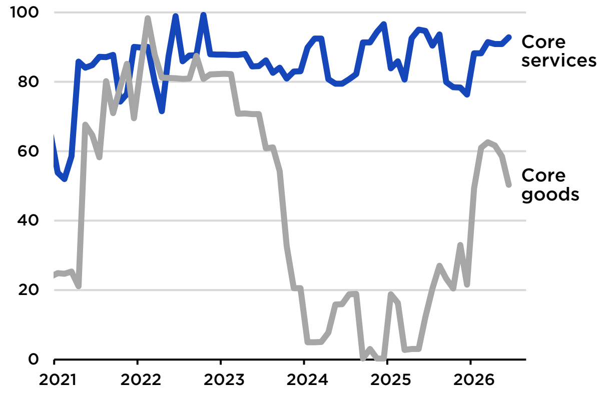
Looking at core services and goods prices that exclude food and energy, the epicenter of the problem is core services. Our analysis finds that prices in about 90 percent of the core PCE services basket rose faster than 2 percent y/y in June (latest data) and 75 percent when the threshold is raised to a steamy 3 percent y/y.

The recent diffusion of price increases across a broader range of goods is also contributing to the elevated pace of inflation. Around half of the core goods basket is running above 2 percent y/y by our estimates. This is down from the peak just above 60 percent a few months ago but remains historically high. For comparison purposes, only a small minority of core goods prices rose above a 2 percent annual rate in the decade prior to the pandemic, rending overall core goods prices to be deflationary and serving as an offset to faster running core services inflation. That dynamic is not currently in play as core goods prices are now increasing at a positive rate.

Share of inflation basket increasing above 2% y/y

Percent



Note: Calculations are Nationwide Economics estimates.
Source: Bureau of Economic Analysis, Haver Analytics, Nationwide Economics

Other notable drivers of inflation within services: healthcare, hotel accommodations and financial services. On the goods-side many of the categories affected by tariffs include clothing and footwear, recreational goods (such as video/audio equipment, some technology goods, sporting goods and recreational vehicles), and furniture.

The labor market is a key part of the puzzle that is not exerting upward pressure on inflation today. Wage growth looks stable around 3.5 percent y/y, which approximately aligns with the Fed's inflation target. Another notable part of the inflation puzzle that isn't lifting inflation is the price of food, which is up a contained 3 percent y/y and in line with the average over the last ten years (though prices are historically high in absolute terms). However, high diesel and fertilizer prices could flow through to faster food price increases in the future.

Current inflation drivers — Key takeaways

Energy prices are a key driver of elevated inflation.

Higher energy prices tied to the Iran conflict continue to exert significant upward pressure on inflation, contributing roughly 0.8 percentage points to headline PCE inflation since March.

Airfares have also climbed sharply and may prove sticky given strong consumer demand despite elevated fares.

Upward pressures across services and goods prices are keeping inflation elevated

Tariff- and AI-related costs account for a notable share of current inflation, particularly within core inflation.

Services remain the primary inflation hotspot, but price increases have also spread across a wider range of goods than was typical before the pandemic.

Energy, travel, financial services, healthcare, and some tariff-sensitive goods are underpinning inflation today.

By contrast, wage growth is roughly consistent with the Fed's inflation target and food price inflation is relatively contained.

Next page: What's the outlook for 2027? ▶

Inflation to stay elevated into 2027

Our bottom-up PCE inflation forecast, constructed by projecting the underlying components of the Fed's preferred measure, suggests headline price increases will decelerate going forward after peaking above 4 percent in May.

However, a quick return to the Fed's 2 percent goal is unlikely. We look for headline PCE inflation to average around 3 percent y/y by Q4 2026, with core inflation trailing not far behind. Our forecast shows the Fed won't achieve its 2 percent PCE inflation target until Q2 2027.

Various headwinds are expected to temper the disinflationary impulse from other fronts and keep PCE inflation elevated into next year. Aside from the fact that a growing economy will naturally raise prices, structural forces will also exert upward pressure. AI will likely persistently boost prices as the massive AI buildout continues, and we also see sustained upward pressure in medical care costs. A rising stock market will likely exert upward pressure on financial services inflation.

On the other hand, we see tariffs largely dropping out of the inflation calculation shortly — unless the administration introduces new tariffs. Meanwhile, shelter is likely to contribute to disinflation in the near term given the lagged transmission of muted price gains from 2025. However, rising market rents and other housing cost measures currently suggest housing is likely to exert some upward pressure starting next year.

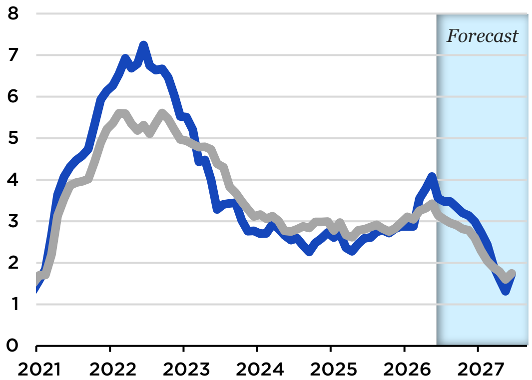
We judge risks to our inflation forecast are tilted to the upside, with energy a key source of uncertainty. We've assumed energy price inflation diminishes going forward as the U.S. and Iran find a resolution to fully re-open the Strait of Hormuz. But prices of crude oil and refined products – namely gasoline and diesel – have increased in recent weeks, and we see real risks that higher refined product prices may put renewed upward pressure on inflation.

Food prices face risks from high fertilizer and diesel prices as well as El Nino which is already impacting crop production across the globe.

All this means the Fed will likely stay vigilant. We see policymakers keeping interest rates on hold until they've seen enough progress next year toward reaching their inflation goal. While we expect they'll be satisfied, the prevailing inflation environment and risks mean that the less-inflation tolerant Fed officials may hike before year end.

PCE inflation Outlook

Percent year-over-year change



Source: Bureau of Economic Analysis, Haver Analytics, Nationwide Economics

2027 Inflation Outlook

- Inflation is expected to ease but remain above the Fed's 2 percent target into 2027.
- AI investment, healthcare costs, and economic growth should keep inflation elevated despite fading tariff and housing pressures.
- Energy and food price risks could keep the Fed cautious and interest rates higher for longer.

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