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Economic & Financial Markets Monthly Review | October 2026

Consumers push through inflation and rate headwinds

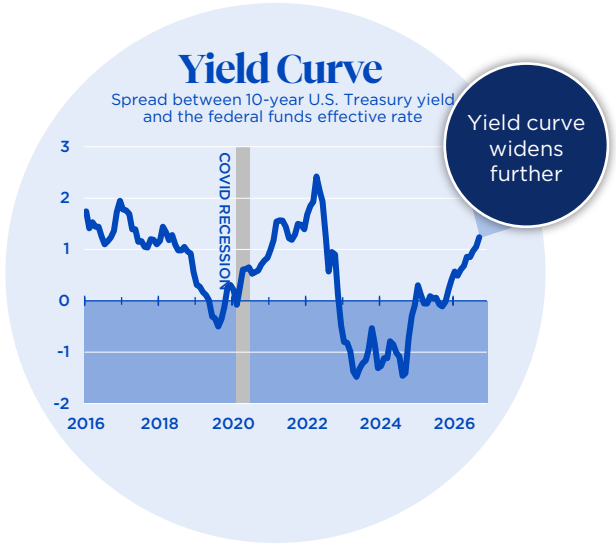
Where is the economy now?

Despite the widespread cost pressures from higher fuel prices, growth readings through the third quarter strengthened. While activity could soften moderately to end 2026 due to higher energy bills and interest rates for households and businesses, the underlying support from AI investment and resilient consumer spending should remain intact heading into 2027. Also providing upside support is solid productivity growth.



Resilient activity supports growth

The economy ended Q3 with solid momentum, fed by strong investment in AI and buoyant spending by consumers. While higher fuel prices and interest rates are likely to dampen economic activity a bit in Q4, GDP growth is expected to remain solid at around a 2.0 percent annualized. Strong productivity growth provides underlying support.



Back up in yields continues

Both the 10-year and 30-year Treasury rates climbed to 24-year highs in early October as bond investors reacted to robust economic growth readings, deep fiscal deficits, large AI corporate bond issuance, and likely Fed tightening. Corporate spreads have widened in a sign of building financial stress in response to the jump in interest rates and large AI-related borrowing.



Wages are not adding to inflation

The annual increase in average hourly earnings dropped to 3.0 percent in September and has run below the pre-Covid average for several months. Softer hiring trends and pressure from AI adoption has cooled wage gains within service industries. With the demand and supply of labor in relative balance, wage gains should stabilize in coming months.

What does this mean for the economic outlook?

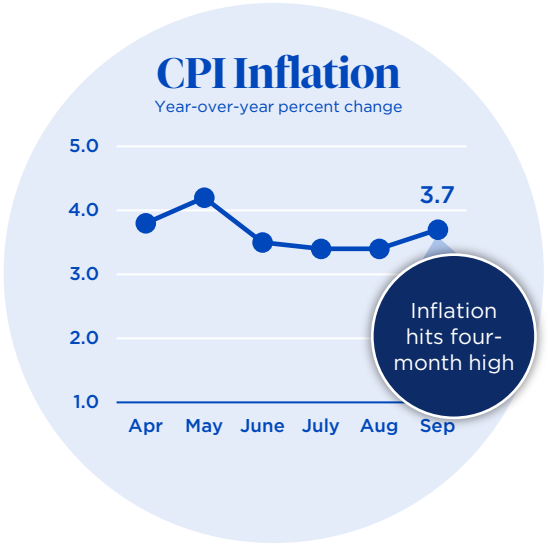
Businesses and consumers are pushing through the higher fuel due to personal income and household wealth gains, strong corporate profits, and tax incentives. Interest rate sensitive areas like housing and autos likely slow even more, modestly easing projected growth heading into 2027.

We expect the Fed to raise rates by a further 50 basis points over the next few FOMC meetings. Given the uncertainty around energy prices and the potential pass through into other costs, the FOMC likely remains on hold over 2027 or tightens further if conditions warrant extending the higher rate environment.

Slower wage growth indicates that the labor market is not a significant source of inflationary pressure for the economy. This supports the view that underlying inflation trends, beyond the direct impacts from energy prices, tariffs, and AI-related price pressures, are less concerning — which could help to limit Fed rate hikes.

Employment remains solid, but cost pressures build

Employment gains cooled, but solid labor demand and low unemployment should continue to support household income and consumer spending. Inflation ran hot in September, supporting likely further Fed hikes. Meanwhile, input costs in service industries reached a four-year high, adding upside risk to inflation, although companies may continue to limit the pass-through of higher costs to consumers.







CPI ran hot in September

Headline CPI rose a hot 0.6 percent in September, while core CPI rose a firm 0.3 percent. Headline inflation accelerated to a four-month high 3.7 percent from 3.4 percent in August, and core inflation to 2.6 percent from 2.4 percent. Shelter inflation also firmed to 3.2 percent, pausing the prior disinflationary trend.

Employment gains cool but remain solid

Payroll gains slowed to 29,000 in September from 133,000 in August, while annual wage growth ticked down to 3.0 percent. The unemployment rate edged up to 4.2 percent due to a rise in the labor participation rate of 0.2 percentage points, while employment in the household survey rose a strong 406,000.

Cost pressure for services intensifies

The ISM services prices paid index rose to 74 in September, its highest level in four years. The reading highlights intense cost pressures across the service sector, which have climbed substantially as supply-chain disruptions have intensified due to the extended nature of the Iran conflict.

What does this mean for the economic outlook?

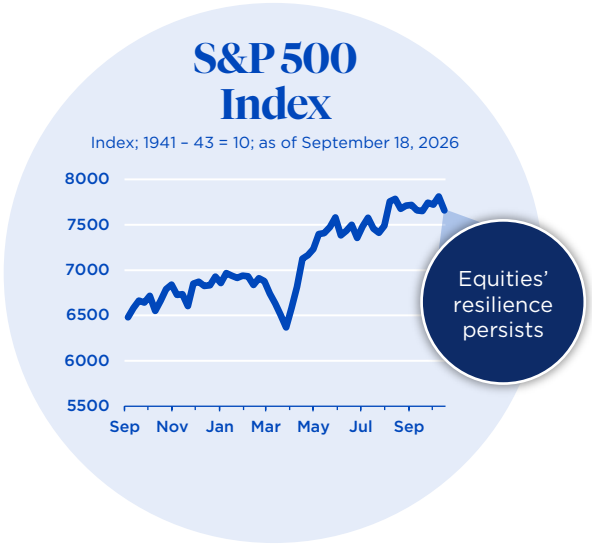
The faster core reading keeps pressure on the Fed to raise rates further. But monetary policy has little impact on the global energy supply shock or the AI buildout. The FOMC could skip October considering several key Fed officials have suggested there is no urgent need to hike rates, but we still see additional tightening ahead.

Labor demand remains solid: three-month average payroll growth is 51,000, well above our estimated 20,000–30,000 monthly break-even rate. Slower wage growth should ease core inflation pressure, while continued hiring and rising employment support household income and spending.

These cost pressures are an upside risk for inflation as service prices tend to lead headline inflation by a few months. However, companies may hold off on passing through higher costs while awaiting a sustainable resolution in the Middle East, which could limit the near-term impact on consumer prices.

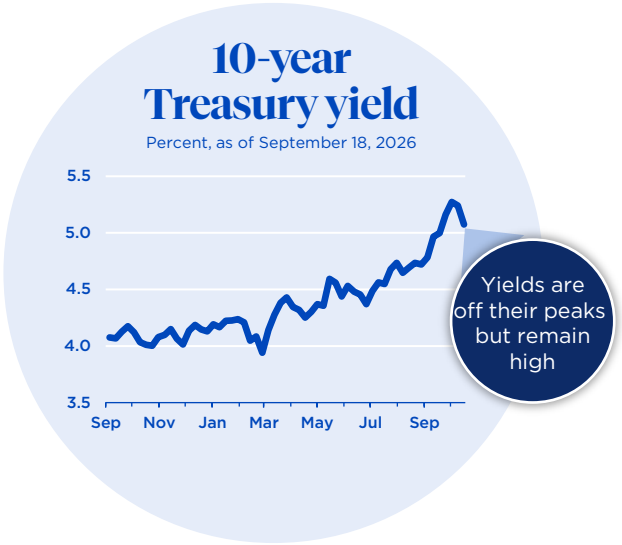
Earnings season kicks off on a positive tone

Third-quarter earnings results so far are somewhat mixed, but it's early in the reporting cycle and the overall tone is positive as strong domestic demand and AI investment tailwinds overpower interest rates and input price headwinds. We look for stock prices to stay upbeat into 2027. The Treasury curve spread (10-yr less 2-yr) is modestly steeper as investors temper Fed rate hike bets and long-end Treasuries have rallied. We don't expect rates to fall sharply in the near term.



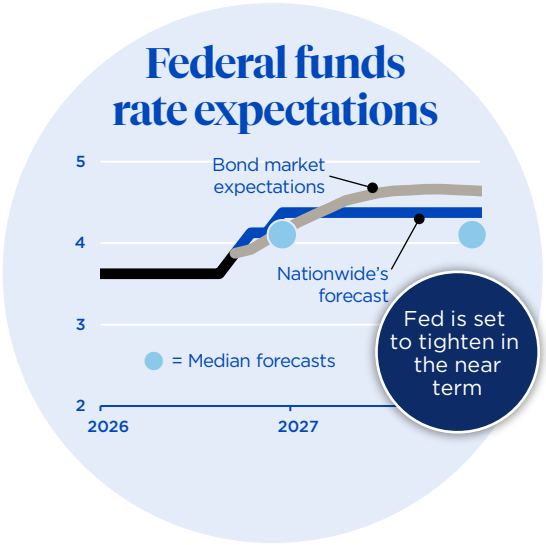
Equities are persevering

The benchmark S&P 500 index is holding close to its historic highs as strong nominal GDP, profit growth, and healthy earnings expectations, led by AI, eclipse stress from elevated input costs and interest rates. This should be a commendable year for the stock market, with the S&P 500 on track for a double-digit return.



Borrowing costs remain high

Investors are paring their bets on rate hikes as Fed officials signal less urgency to tighten, lowering short-end Treasury yields. Yields at the long-end have fallen recently but elevated inflation, strong GDP growth, fiscal worries and competition for capital from AI debt issuance are keeping interest rates buoyant.



Fed signals a pause in October

Recent comments from Fed officials has expressed less urgency to raise interest rates at the upcoming October FOMC meeting. However, heightened inflation concerns and a fully-employed economy suggest the path for the federal funds rate over the near term is higher.

What does this mean for the economic outlook?

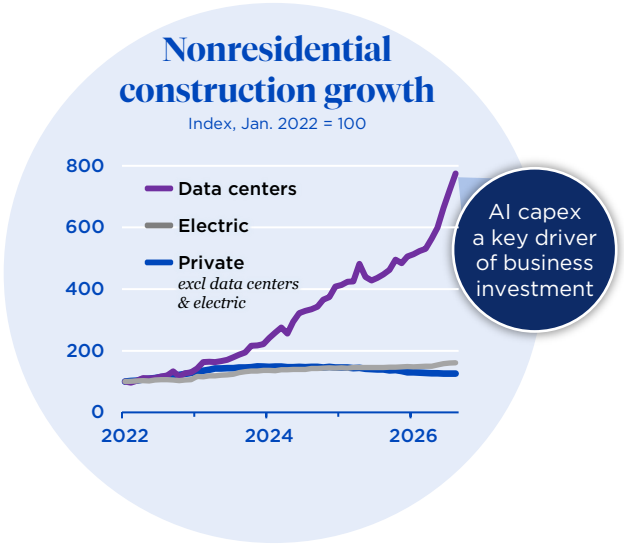
Most sectors comprising the S&P 500 stock index are up year-to-date. We anticipate very solid corporate earnings and buoyant economic growth ahead to support equity valuations despite elevated inflation, borrowing costs, and geopolitical uncertainty.

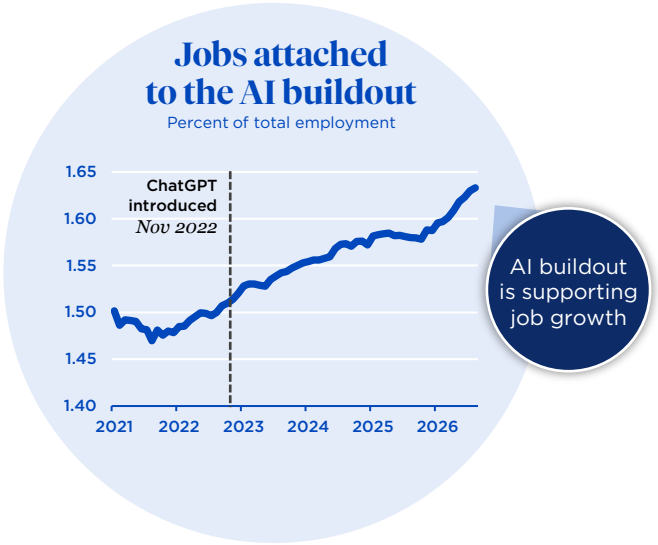
Elevated inflation and healthy economic growth will keep long-end Treasury yields from retreating. The hawkish Fed is likely to keep short-end yields firm as well, though we expect the Treasury curve spread to stay positive. High interest rates continue to pose some downside risks for equities.

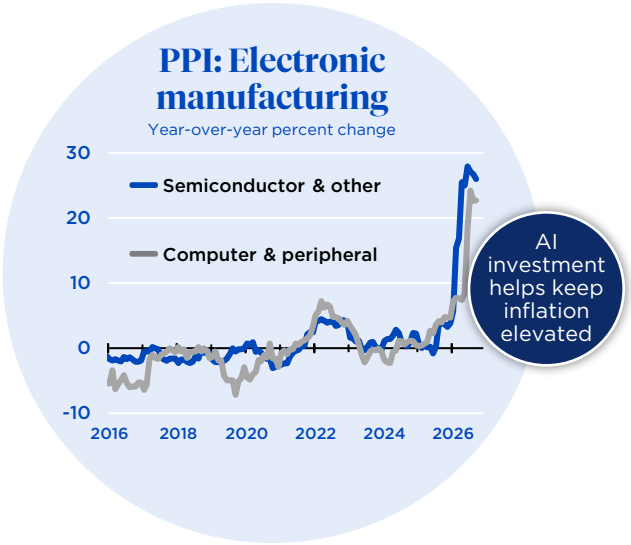
Elevated inflation running at nearly twice the Fed's two percent target supports our call for two more consecutive rate hikes in October and December. However, several key Fed officials have opined there is no immediate need to raise rates, suggesting the FOMC might wait until December to hike again.

AI drives spending and jobs, but also inflation

Investment tied to the AI buildout, including computing infrastructure, semiconductors, data centers, and energy, remains a key driver of business spending and employment growth that is increasingly diffusing across the wider economy and supporting productivity gains. The scale of this investment is also raising demand for the raw and intermediate goods needed to expand AI capacity, driving up near-term cost pressures.







AI pushes up construction spending

Data center construction continues to advance at a strong clip and was a key driver of nonresidential business investment growth through late summer, sharply outpacing non-tech spending. Forward-looking domestic and global data and the hyperscalers' investment intentions indicate no significant let up into 2027.

AI buildout supports job growth

The AI buildout is also an engine of job creation. Employment growth in industries tied to this investment is significantly outpacing job gains in the rest of the economy. Further, we are seeing positive knock-on effects to other types of jobs and minimal AI-related displacement across occupations so far.

Buildout boosts inflation

The cost of the AI buildout is rippling through the economy and putting upward pressure to prices as it raises the price of raw and intermediate input goods. The cost of related equipment including semiconductor chips and computer equipment are up around 25 percent year-over-year – so-called "chipflation".

What does this mean for the economic outlook?

The AI buildout will remain a steadfast contributor to construction and business investment growth. The hurdle interest rate to slow this investment is quite high and the hyperscalers have strong balance sheets to navigate the recent escalation in borrowing costs.

The AI buildout will likely support job growth into next year given the long nature of this investment super-cycle and hyperscalers' spending plans. Incomes spent by workers employed in these industries will have cascading positive impacts for the wider economy.

AI investment will lend upward pressure to the cost of critical inputs as activity advances robustly into 2027. The buildout, which we view as largely immune from rising interest rates, is an important driver of our elevated near-term PCE inflation forecast.

Outlook

Higher long-term Treasury yields likely here to stay

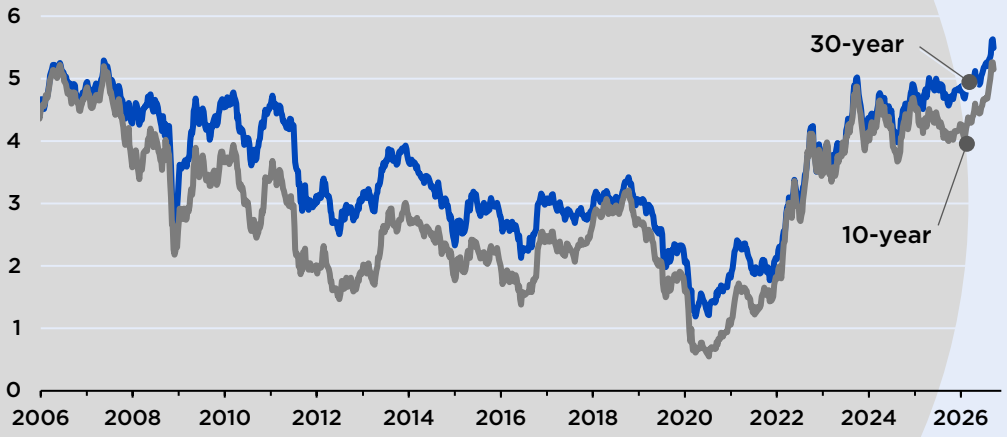
Bond yields in the U.S. and abroad have risen to pre-Great Financial Crisis levels for a variety of reasons. A jump in real yields in response to strong current U.S. economic growth and projected Fed tightening has led the increase, rather than an upward shift in longer-term inflation expectations which have remained well anchored. Deep fiscal deficits and competition from the massive corporate borrowing by tech hyperscalers have also added to the upward shift in rates in recent months.

Higher interest rates will tighten financial conditions and should ease the upside for growth over the next year. That said, the strong investment in AI is likely largely immune to higher borrowing rates that should prevent a sharp slowdown for the economy. But non-AI business spending and interest rate sensitive sectors such as residential housing, commercial real estate, and autos likely take another step down.

Looking ahead to future years, investors probably expect stronger productivity growth stemming from increased adoption and development of AI to underpin sturdier real economic activity. These expectations, projected fiscal deficits, and sturdy economic growth should keep yields elevated over 2027.

Long-term Treasury rates

Percent



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Forecast

Data as of October 2026

	2025 ACTUAL	2026 ESTIMATE	2027 FORECAST	2028 FORECAST	2029 FORECAST
REAL GDP [1]	2.0%	2.4%	2.3%	2.3%	2.3%
UNEMPLOYMENT RATE [3]	4.5%	4.2%	4.2%	4.2%	4.2%
INFLATION [1] (CPI)	2.8%	**3.9%**	**1.9%**	2.0%	2.0%
TOTAL HOME SALES	4.74	4.68	4.70	5.05	5.40
S&P/COTALITY HOME PRICE INDEX	1.3%	2.2%	2.3%	2.7%	2.8%
LIGHT VEHICLE SALES	16.2	16.0	16.3	16.5	16.5
FEDERAL FUNDS RATE [2]	3.50%	4.25%	4.25%	3.00%	3.00%
5-YEAR TREASURY NOTE [2]	3.73%	5.00%	4.90%	4.00%	3.95%
10-YEAR TREASURY NOTE [2]	4.18%	**5.25%**	**5.25%**	4.50%	4.50%
30-YEAR FIXED-RATE MORTGAGE [2]	6.18%	7.25%	6.95%	6.00%	6.00%
MONEY MARKET FUNDS	4.03%	3.78%	4.28%	3.47%	3.03%

[1] *Percent change Q4-to-Q4*
[2] *Year end*
[3] *Q4 average*

Inflation to remain elevated into 2027

Elevated fuel prices are expected to push CPI inflation to nearly 4.0 percent by year-end. Annual readings should remain near 3.5 percent through Q1 2027 and then cool off later in the year — but there remain upside risks depending upon geopolitics.

Higher rates likely throughout 2027

The factors lifting long-term interest rates are expected to remain intact over 2027, lifting the term premium and real yields. As a result, the 10-year Treasury rate should be stable over the year, in line with the steady Fed outlook, producing a higher for longer rate path.

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Sources

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2 | Economic Review

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Nonfarm payroll gains	*Bureau of Labor Statistics*
ISM services: prices paid	*Institute for Supply Management*

3 | Financial Markets Review

S&P 500	*Standard & Poor's*
10-year Treasury yield	*Federal Reserve Board*
Fed funds rate expectations	*Federal Reserve, Bloomberg, Nationwide Economics*

4 | Economic Influence of Artificial Intelligence

Nonresidential construction growth	*Census Bureau/Haver Analytics*
AI Employment	*Stanford Digital Economy Lab, ADP Research and Eloundou et al.*
PPI: Electronics	*BLS, Haver Analytics, Nationwide Economics*

5 | Outlook

10- and 30-year Treasury rates	*Federal Reserve Board*
Latest Forecast	*Nationwide Economics*

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