



Economic & Financial Markets Monthly Review | September 2026

Sharp rise in energy prices to lift inflation and rates



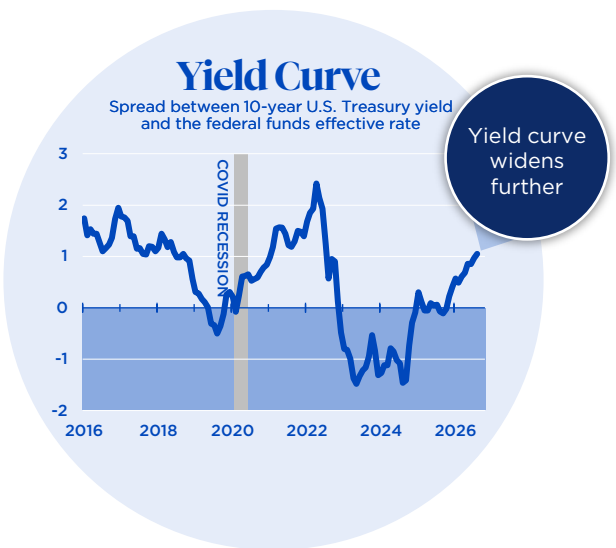
Where is the economy now?

Recent economic readings have been better than expected despite a renewed spike in energy prices. The rising fuel prices are driving inflation higher and leading the Federal Reserve to tighten monetary policy with modest rate hikes. We look for economic momentum to cool moderately in Q4 due to the inflation headwinds, but activity should remain resilient. Buoyant employment and income gains along with AI investment and tax incentives support economic growth.



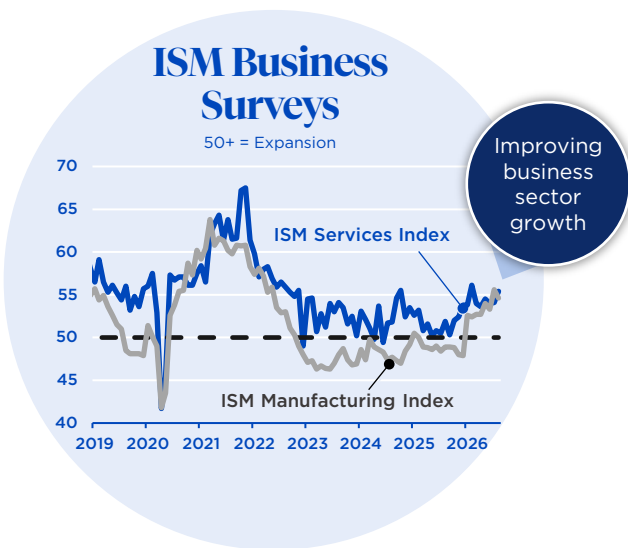
Energy price jump adding to inflation

Economic growth during the third quarter looks strong despite the reacceleration in fuel prices. But higher costs have boosted the inflation risks and led the Fed to start to raise interest rates. We look for higher fuel prices to dampen economic activity a bit in Q4, but a sharp slowdown is not expected given the resilience of the labor market and AI investment.



Treasury rates rise further

Inflation concerns, accelerating economic growth in Q3, deep fiscal deficits, strong AI corporate bond issuance, and likely another Fed rate increase continue to push interest rates higher. The 10-year Treasury crossed 5.0 percent in mid-September for the first time in nearly 20 years. Shorter-term rates also climb as markets price in several rate hikes by the Fed over the next few months.



Businesses activity accelerates

Growth readings for services and manufacturing have improved even amid rising costs for energy and other inputs. A surge in new orders for manufactured goods, partially fueled by AI demand, has lifted sector growth and boosted hiring by producers. Spending on services has remained resilient even as many firms contend with lingering labor supply shortages.

What does this mean for the economic outlook?

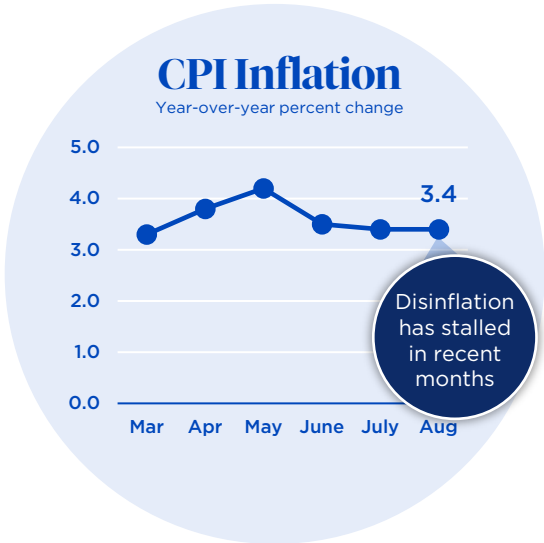
Even if oil supply in the Middle East normalizes, the lingering disruptions to refining activity will keep gasoline and diesel prices elevated. This creates a headwind for consumer spending, but the healthy employment and income gains are a key offset.

After tightening in September, we expect the Fed to raise rates again before year end. Given the uncertainty around energy prices and the potential pass through into other costs, the FOMC likely remains on hold over 2027 or tighten further if conditions warrant — creating a higher-for-longer rate outlook.

Strong business investment, driven by AI capital spending and enhanced federal tax incentives, should continue to support economic growth into 2027. Hiring should also remain solid over the next year, although rising input costs and a limited labor pool could temper employment gains.

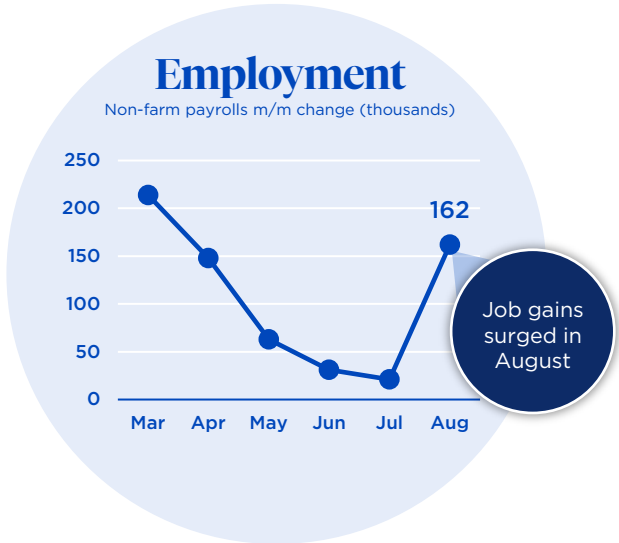
Accelerating economic growth in Q3

Broad-based August job gains and upward revisions to prior months point to an upbeat labor market that supports solid household income and spending. Hotter-than-expected inflation raises the likelihood of further Fed rate hikes as price pressures may not slow meaningfully until the second quarter of 2027. Meanwhile, robust retail sales show consumers remain resilient, but high costs could temper spending and growth a bit in Q4.



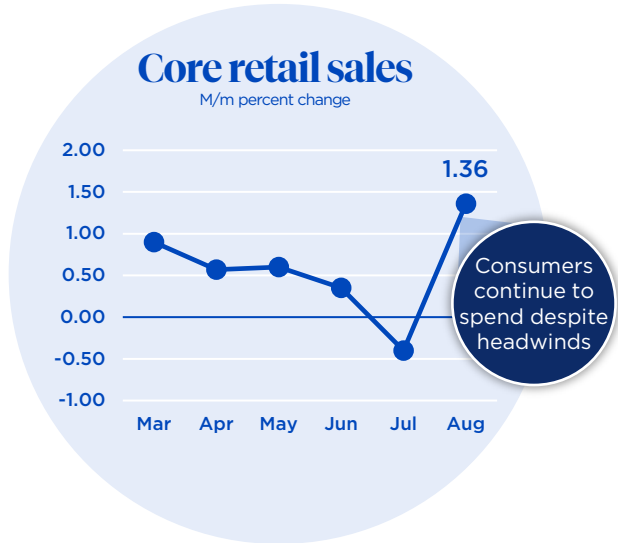
Firm inflation, upside risks remain

The August CPI report came in hot, with headline prices rising 0.4 percent and core CPI increasing 0.3 percent. Core inflation barely eased to 2.4 percent year over year from 2.5 percent, while headline inflation held at an elevated 3.4 percent. Higher oil, gasoline, and diesel prices add to concerns about inflation pressures.



Broad job gains in August

The August employment report showed broad-based job gains across goods and services, with upward revisions of 55,000 to prior months. Unemployment held at 4.1 percent even as participation rose to 61.6 percent. Wage growth firmed 0.3 percent in August but eased to 3.1 percent year over year.



Consumers ramp up spending

Retail sales rose a strong 1.2 percent in August after a pause in July. Gains were broad-based with core retail sales posting the fastest monthly growth in nearly two years. Online, general merchandise, sporting goods, and food-service spending all strengthened as consumers continued to spend on discretionary items.

What does this mean for the economic outlook?

With upside risks to inflation building, the FOMC is expected to follow up September's rate hike with one more, totaling 50 bps by year end and lifting the fed funds target range to 4.00-4.25 percent. Inflation is unlikely to slow meaningfully until at least the second quarter of 2027

Stronger hiring, a longer workweek, and firm wage gains point to solid income growth and healthy consumer spending in August. Alongside continued AI investment, these trends support our forecast for real GDP growth to accelerate to at least 3.3 percent in Q3.

Strong August spending supports our forecast for faster GDP growth in Q3, but higher gasoline prices are likely to weigh on consumption and slow growth a bit in Q4. Even so, growth should remain near 2.0 percent, supported by higher-income households and substantial AI investment.

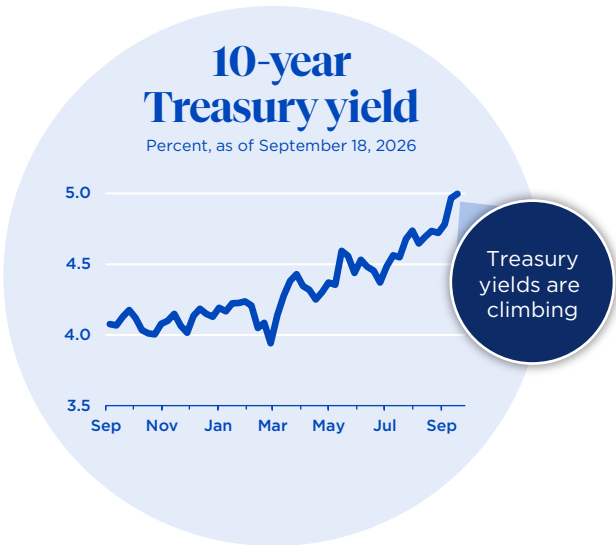
Rising interest rates and oil prices pressure investors

The resilient economy and strong corporate revenue growth support equity valuations near all-time highs despite rising input costs and interest rates. The Treasury curve (10-yr less 2-yr) has flattened as investors are betting on additional Fed tightening and for the economy to stay resilient even with elevated inflation. After another 25-basis point hike before year end, we now see the Fed keeping the policy rate steady in 2027 due to sticky inflation early next year.



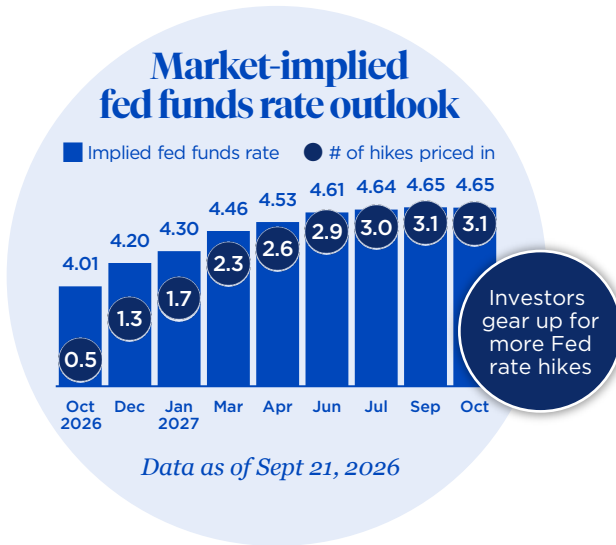
Equities move sideways

The benchmark S&P 500 index has been generally rangebound recently, with tailwinds from fast nominal GDP and revenue growth offset by headwinds from rising input costs and interest rates. Even so, it's been a good year for stock investors with the benchmark index up a healthy 14 percent year-to-date.



Borrowing costs rise

Increasing bets for Fed rate hikes are raising short-end Treasury yields while expectations of higher inflation, solid economic growth, fiscal concerns, and AI debt issuance are pressuring long-end yields higher. The spread between the 2- and 10-year is narrower as short-end yields have risen faster than long-end rates.



The Fed gets serious about inflation

In a unanimous decision, the FOMC raised the fed funds target range by 25 basis points (bps) to 3.75-4.0 percent in September, marking the first hike since 2023. The decision, policy statement, and updated forecasts signal that policymakers have lost patience with elevated inflation.

What does this mean for the economic outlook?

We expect continued healthy corporate earnings and economic growth to keep stock prices buoyant and outweigh pressures from rising input prices and borrowing costs. Most analysts remain bullish on equities despite prevailing risks. The stock market is forecast to rise and earnings to remain upbeat as AI leads the charge.

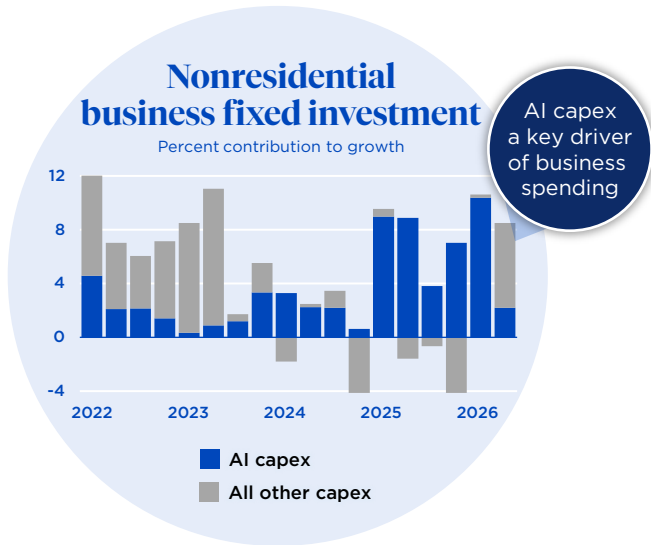
We see a hawkish Fed and positive economic fundamentals keeping interest rates elevated. Inflation risks are tilted to the upside, led by energy, amid increasing concern it will filter into the broader inflation basket. Rising interest rates continue to pose downside risks for equities.

The policy rate is not overly restrictive, so the hike shouldn't lead the economy to stumble. The hike is also unlikely to greatly slow the drivers of higher inflation, but it bolsters the Fed's credibility. We expect another 25-basis-point hike before year end followed by an extended pause in 2027.

Economic Influence of Artificial Intelligence

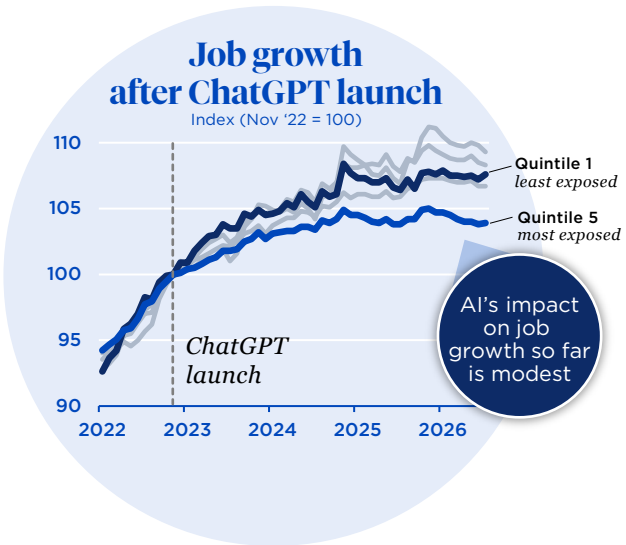
AI's growing footprint on the economy

Gen-AI is emerging as a major investment super-cycle, driving large scale capital spending across computing infrastructure, semi-conductors, data centers, and energy, with the potential to reshape economic growth, productivity, and labor markets. Eventually AI adoption will likely help lower inflation, but in the meantime, the outsized buildout is pushing inflation higher. We have added this new page to our Monthly Report to help monitor the evolution of AI's impact.



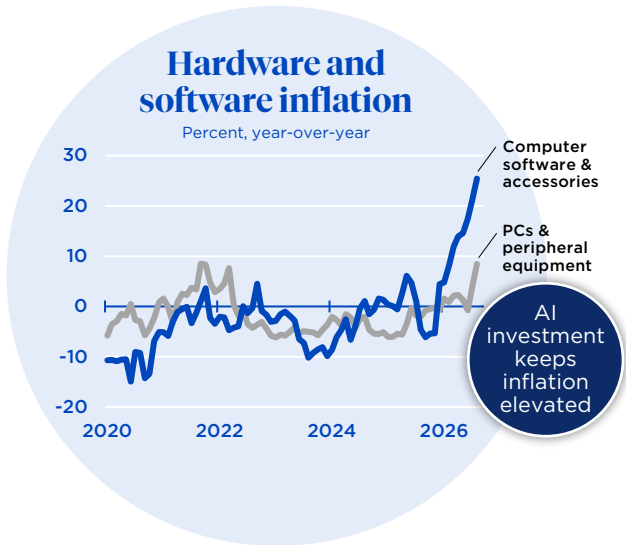
AI capex is a key engine of growth

The AI buildout has been a key propeller of nonresidential business investment growth in recent quarters, and in turn an important driver of healthy GDP growth. Forward-looking durable goods orders, alongside AI spending intentions by tech firms, indicate AI investment is set to advance at a robust clip into next year.



AI's impact on job trends is modest

Overall employment growth has improved and broadened out recently, in part propelled by the robust buildout in AI data centers. However, it's important to look beneath the headline figures to gauge how different workers could be impacted by AI-related displacement or growth according to their occupations.



Buildout pushes prices higher

AI may eventually help tame inflation, but in the meantime the buildout is pushing consumer prices higher. The cost of software and related accessories is increasing at the fastest rate on record and computer hardware costs are also advancing at a fast clip. Cost pressures are elevated from the business perspective along with the consumer.

What does this mean for the economic outlook?

Hyperscalers' capital spending intentions suggest AI investment will remain a major driver of economic growth. The AI buildout adds to economic growth both directly and through spillover effects to construction and manufacturing activity and hiring.

The Stanford Digital Economy Lab's grouping of workers by their AI exposure score, using ADP private sector employment data, shows little difference between employment trends across the groups so far. However, not surprisingly, employment growth is slowest for jobs most exposed to AI.

AI will likely persistently boost prices as the massive buildout continues. This will have cascading effects to push other related prices higher, namely electricity. Price pressures from AI investment are a key reason we do not expect PCE inflation to cool meaningfully in the near-term.

Outlook

Renewed energy price spike keeps inflation front and center

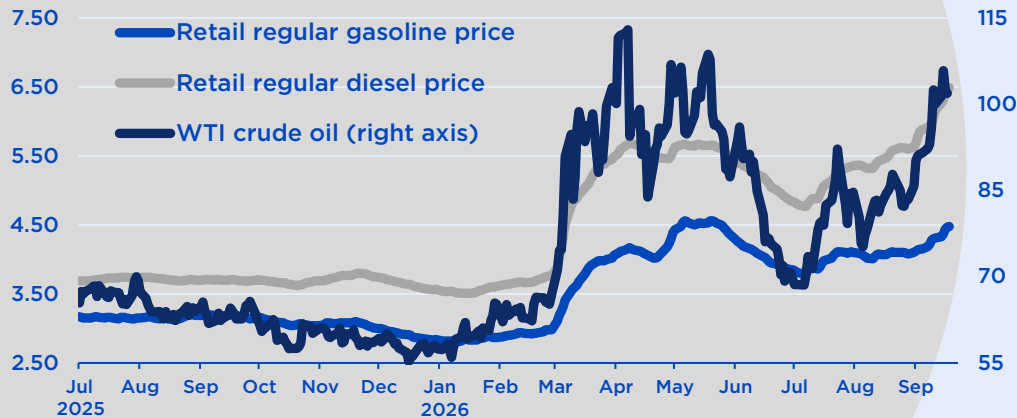
The global oil supply shock has amplified in recent weeks as renewed tensions with Iran and disruptions to Red Sea oil traffic sent crude oil prices back above \$100 per barrel. Retail diesel fuel prices climbed above \$6 per gallon in early September for the first time ever, while average gasoline prices are running at \$4.50 per gallon again. Moreover, many estimates expect that fuel prices will remain highly elevated through year end and likely into early 2027 even if oil supply trade conditions improve soon.

Beyond the upward push from higher gasoline prices for headline inflation figures, the jump in diesel fuel could drive a broader lift in prices for goods and services as businesses pass along higher transportation costs. Food inflation is highly sensitive to increased prices for diesel fuel and fertilizer. As such, CPI inflation is now expected to increase to 3.9 percent by year end and remain elevated until the second quarter of 2027, with a risk that lagged price impacts extend even later.

Given the recent jump in fuel costs, we look for some cooling in economic activity in the fourth quarter to around 2 percent following a strong 3.3 percent advance in Q3.

Refined energy products and crude oil prices

Dollars per barrel/gallon



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Forecast

Data as of September 2026

	2025 ACTUAL	2026 ESTIMATE	2027	2028	2029
			FORECAST		
REAL GDP ¹	2.0%	2.2%	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	4.67	4.82	5.36	5.70
S&P/COTALITY HOME PRICE INDEX	1.3%	2.1%	2.7%	3.0%	3.0%
LIGHT VEHICLE SALES	16.2	16.1	16.4	16.5	16.5
FEDERAL FUNDS RATE ²	3.50%	4.00%	4.00%	3.00%	3.00%
5-YEAR TREASURY NOTE ²	3.73%	4.80%	4.40%	3.85%	3.75%
10-YEAR TREASURY NOTE ²	4.18%	5.00%	4.60%	4.30%	4.30%
30-YEAR FIXED-RATE MORTGAGE ²	6.18%	6.95%	6.30%	5.80%	5.80%
MONEY MARKET FUNDS	4.03%	3.72%	4.03%	3.40%	3.03%

Higher rates to weigh on housing activity

Housing activity has slumped this year as the spike in mortgage rates has sharply reduced demand. Higher rates are expected to persist into 2027, resulting in a subdued outlook for home sales with a stronger recovery likely delayed until 2028.

Rate hikes in 2026

We expect the Fed to raise the fed funds rate by a total of 50bps before year end in response to continued inflation concerns. Depending upon the forward path of energy prices, the FOMC may choose to remain on hold over 2027 or even hike rates further.

¹ Percent change Q4-to-Q4

² Year end

³ Q4 average

Contributors

Kathy Bostjancic

SVP & Chief Economist

Ben Ayers

AVP, Senior Economist

Oren Klachkin

AVP, Financial Market Economist

Vivian Chen

AVP, Financial Market Economist

Daniel Vielhaber

Economist

Brian Kirk

Communications Consultant

Sources

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Business Cycle
Yield Curve
ISM business surveys

*Nationwide Economics
Bloomberg; National Bureau of Economic Research
Institute for Supply Management*

2 | Economic Review

Consumer Price Index
Nonfarm payroll gains
Core retail sales

*Bureau of Labor Statistics
Bureau of Labor Statistics
Census Bureau*

3 | Financial Markets Review

S&P 500
10-year Treasury yield
Market-implied fed funds rate

*Standard & Poor's
Federal Reserve Board
Bloomberg*

4 | Economic Influence of Artificial Intelligence

AI Capex contribution
Employment
Computer hardware/software Inflation

*Bureau of Economic Analysis
Stanford Digital Economy Lab, ADP Research and Eloundou et al.
Bureau of Labor Statistics*

5 | Outlook

Energy prices
Latest Forecast

*Energy Information Administration
Nationwide Economics*



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