Chart of the Week

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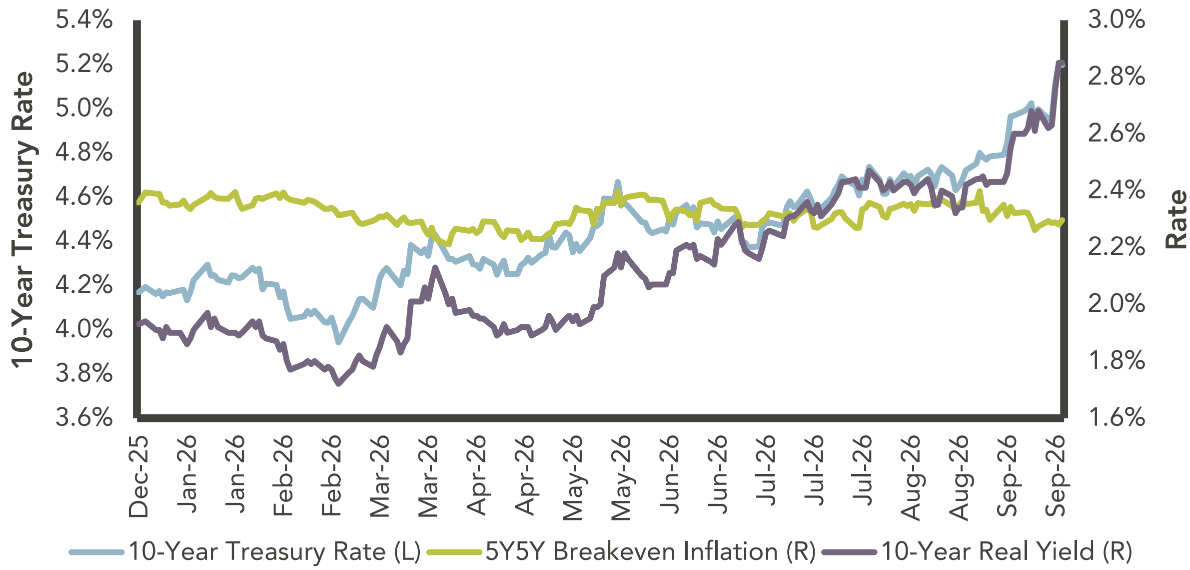
Getting Real on Inflation

JAMES TORGERSON, SENIOR RESEARCH ANALYST

Despite an increase in price levels in 2026, long-term breakeven figures remain range-bound due to the "cost-push" nature of recent inflation



Source: Bloomberg as of September 25, 2026

The phrase "expectations of higher inflation" has become a staple in financial news to explain the increase in nominal U.S. Treasury rates this year (e.g., the yield on the 10-year U.S. Treasury security has surged over 80 basis points since the start of 2026). Indeed, the U.S. has seen an uptick in inflation over the last few months, with the Consumer Price Index (CPI) reaching 3.4% on a year-over-year basis in August (up from 2.4% in February but down from an intra-year high of 4.2% in May). Higher energy prices due to the conflict in Iran are a major driver of the increase in CPI, and earlier this month the Federal Reserve hiked its benchmark interest rate for the first time in over three years in response to these price pressures. Given these dynamics, some might reasonably assume that expectations of higher inflation are putting upward pressure on interest rates, but a closer look at the data reveals there may be other factors at play.

This week's chart shows the nominal 10-year U.S. Treasury rate, the real yield on the 10-year U.S. security, and the "5-Year Forward 5-Year Breakeven Inflation Rate," which represents expected inflation over the five-year period beginning five years from today. As the chart indicates, the breakeven inflation rate has remained largely range-bound in 2026, meaning nominal interest rates and real interest rates have risen in tandem.

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Why has the breakeven rate not increased this year? Traditionally, higher inflation occurs when there is too much money chasing too few goods (i.e., "demand-pull" inflation). Supply disruptions that *temporarily* increase prices, on the other hand, can lead to what is known as "cost-push" inflation. Notably, disruptions in supply chains during the COVID-19 pandemic caused transitory inflation to become embedded since the money supply also increased dramatically during that period. It is important to point out, however, that despite the closure of the Strait of Hormuz, Federal Reserve policy has remained largely restrictive in 2026 and broader monetary conditions have not loosened significantly. Indeed, commodity shocks often lead to temporary increases in price levels, and this dynamic helps explain why long-term inflation expectations have not increased meaningfully since the beginning of the year.

In effect, rising real yields, rather than higher expected inflation, are driving nominal yields higher. Real yields are driven by economic growth and policy dynamics, and recent movements in real yields are primarily a result of stronger growth forecasts combined with a higher term premium due to concerns around fiscal sustainability and government borrowing. While inflation remains an important consideration for investors, the data suggest that the recent rise in nominal yields is being driven more by changes in the economic and fiscal outlook than by expectations of persistently higher inflation.

PREPARED BY MARQUETTE ASSOCIATES

180 North LaSalle St, Ste 3500, Chicago, Illinois 60601
CHICAGO BALTIMORE MILWAUKEE PHILADELPHIA ST. LOUIS

PHONE 312-527-5500
WEB marquetteassociates.com

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