THREE ON THURSDAY

First Trust

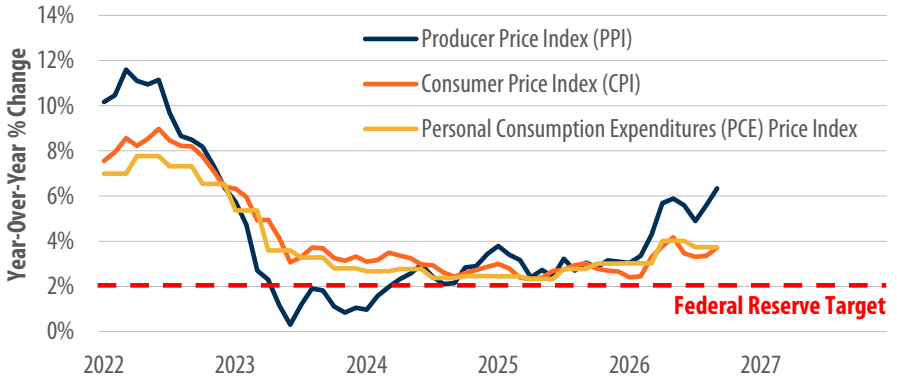
FIRST TRUST ECONOMICS

November 5, 2026

Inflation: Not as High as You Think

Last week, the Federal Open Market Committee (FOMC) held short-term interest rates steady but left the door open for another hike before year-end, as concerns over resurgent inflation continue to mount. But will higher interest rates really solve the problem? The data show much of the recent inflationary pressure stems from an energy supply shock caused by the war in Iran and the partial closure of the Strait of Hormuz. No matter how high the Federal Reserve ("Fed") raises rates, it can't produce another barrel of oil or reopen a critical shipping route, which will be what is ultimately needed. Hopefully there will be an end to the conflict sooner rather than later, which should restore oil flows and ease price pressures. In the meantime, higher rates risk putting unnecessary strain on interest rate-sensitive sectors of the economy without addressing the root cause of inflation. In today's "Three on Thursday," we examine what's driving inflation and how those pressures are evolving. Check out the two charts and table below to learn more.

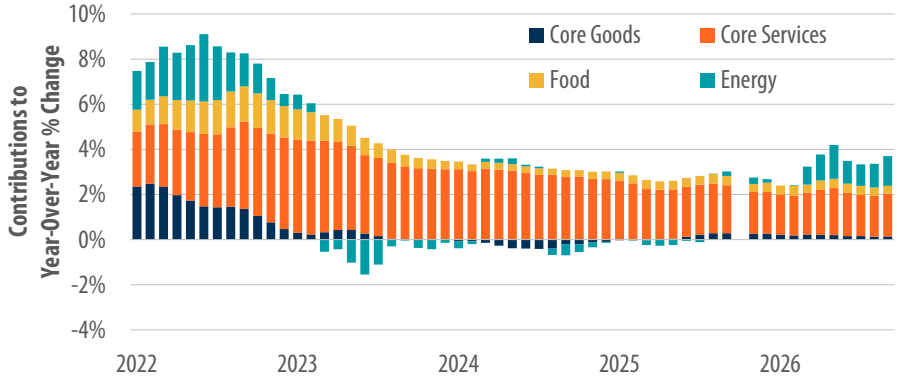
Major Measures of Inflation



Source: Bureau of Labor Statistics, Bureau of Economic Analysis, First Trust Advisors. PPI and CPI monthly data with October 2025 interpolated due to the Federal Government shutdown, as no data was collected for the month. PCE Price Index data is quarterly. All data from Jan 2022 - Sep 2026.

There are many ways to measure inflation, but three stand out as the most widely followed. First, the Producer Price Index (PPI) measures the prices domestic producers receive for the goods and services they sell. Because businesses can absorb rising costs rather than pass them directly on to consumers, PPI tends to be more volatile than consumer inflation measures. Second, the Consumer Price Index (CPI) tracks price changes across a representative basket of consumer goods and services, with spending weights updated annually. Finally, the Personal Consumption Expenditures (PCE) Price Index adjusts its spending weights more frequently, reflecting changes in consumer behavior. PCE is also the Federal Reserve's preferred inflation gauge, and its annual rate hasn't been at or below the Fed's 2.0% target since Q4 2020. What has been most concerning is all three measures have been moving in the wrong direction (higher) over the past year, suggesting to many inflationary pressures are once again building.

Contributions to Headline CPI



Source: Bureau of Labor Statistics, Bloomberg, First Trust Advisors. Monthly data from Jan 2022 - Sep 2026. Oct 2025 data not collected due to the Federal Government shutdown.

Although inflation has remained elevated since the post-COVID surge, it had been steadily moderating until the past year. More importantly, today's inflation looks very different from 2022, when CPI peaked at 9%. During the pandemic, the M2 money supply surged 42%, leaving more money chasing fewer goods and fueling broad-based price increases throughout the economy. Today, money supply growth is closer to the 6% annual average seen during the 2010s, when inflation consistently ran below 2%. Yet inflation has recently reversed course, moving further above the Fed's 2% target. Unlike 2022, however, today's inflationary pressures appear to be driven primarily by rising energy costs rather than excessive money growth. With one category accounting for much of the recent inflationary pressure, looking beyond headline inflation provides a clearer picture of what's really happening beneath the surface.

Measures of Underlying Inflation

	12-Month Growth Rate		Avg. Difference: Measure – CORE PCE	Target Based on 2% Core PCE
	Sep '25	Sep '26	2009-2019	
Core CPI	3.0	2.6	0.3	2.3
FRB Cleveland Median CPI	3.5	2.6	0.6	2.6
FRB Cleveland 16% Trimmed-Mean CPI	3.2	2.7	0.3	2.3
Atlanta Fed Sticky CPI	3.3	2.8	0.5	2.5
Core PCE	2.8	3.1	–	2.0
Market-Based Core PCE	2.6	3.1	-0.2	1.8
FRB Dallas Trimmed-Mean PCE	2.8	2.3	0.1	2.1
FRB San Francisco Cyclical Core PCE Inflation	3.7	3.1	0.6	2.6
Cyclically Sensitive Inflation (Stock and Watson (2019))	3.0	3.4	-0.1	1.9

Key: Range (-/+0.25 ppt from target). Measure is between 0.25 and 0.50 ppt above target. Measure is more than 0.50 ppt above target.

Source: Federal Reserve Bank of Atlanta. Data as of 10/29/2026.

Every month the Federal Reserve Bank of Atlanta publishes the Underlying Inflation Dashboard, which looks at nine different inflation indicators believed to best show the true picture of underlying inflation in the US Economy. The dashboard also includes the inflation rate that each indicator would need to reach to be consistent with the Federal Reserve's 2% inflation target. For example, a 2.3% annual growth rate in core CPI is historically consistent with core PCE inflation of 2.0%. As they state, "Measures of underlying inflation are useful in separating inflation signal from relative price noise, and in such a way that they are good predictors of future inflation."What is fascinating is that of the nine measures they deem most important for the underlying state of inflation in the US, six, or two-thirds, of the measures are lower than where they were a year ago! We believe this broader cooling (and what everyone should be looking at) is a result of money supply growth returning to its historical trend, and shows that the underlying inflation picture looks much better than most believe.

This report was prepared by First Trust Advisors L. P., and reflects the current opinion of the authors. It is based upon sources and data believed to be accurate and reliable. Opinions and forward looking statements expressed are subject to change without notice. This information does not constitute a solicitation or an offer to buy or sell any security.