# US Inflation Is Rising Again:

## Causes, Fed Outlook and What It Means for Sri Lanka



# Snapshot: Inflation Hot, Fed Hiking

**3.7%**

Headline CPI, Sep 2026 (y/y) -last annual reading available

**+0.4%**

Oct 2026 CPI (m/m) vs 0.3% expected, core +0.3% for 3rd month

**3.75–4.00%**

Fed funds target after the Sept 2026 hike (first since 2023)

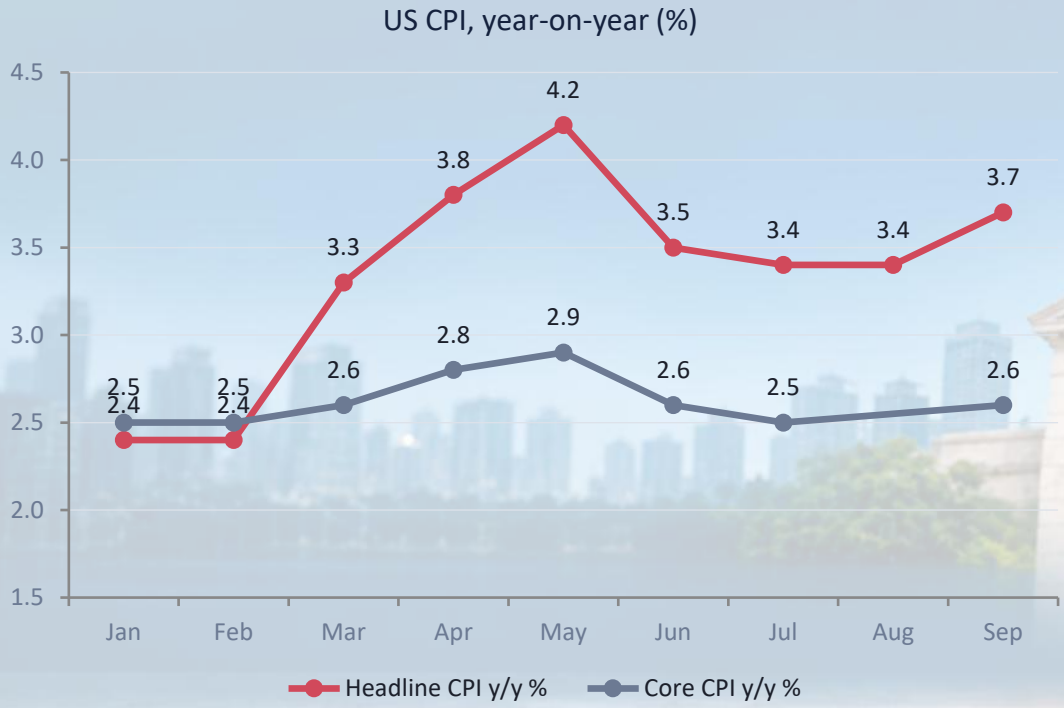
**Approx. 90%**

Market odds of a 25 bp hike on 9 Dec; approx. 10-15% odds of 50 bp

**Note:** BLS did not publish an October annual rate because October 2025 prices were never collected during the 2025 government shutdown. The Fed's next decision is 8-9 Dec, November CPI comes a day later (10 Dec).

Sources: BLS, Federal Reserve, CME FedWatch, CBSL; Nov 2026

# 2026: The Iran War Pushed CPI From 2.4% to 4.2%




**War starts 28 Feb**

Energy prices jumped 10.9% in March alone; headline CPI hit 4.2% in May, a 3-year high.

**June ceasefire = brief relief**

Gasoline fell 9.7% in June, then fighting resumed.

**Core is the worry now**

Core CPI +0.3% m/m in Aug, Sep and Oct - about 3.6% annualised.

Sources: BLS, Federal Reserve, CME FedWatch, CBSL; Nov 2026

# Main Reasons Behind the Increase

### Energy shock

US–Iran war and Gulf shipping disruption; oil above $100 in Sept, gasoline +37% y/y in Oct.

### Broad-based pressure

54% of 199 PCE components were rising faster than 3% a year - not just oil (Warsh, Jackson Hole).

### Shelter and services

Shelter drove over 30% of October's rise, insurance +0.7%, repairs +0.6% m/m.

### Strong demand

Resilient spending, firm jobs data and an AI-driven capex boom keep demand ahead of supply.

### Tariff pass-through

2025 import tariffs lifted goods prices, partly eased after the Supreme Court struck them down in Feb 2026.

### Five years above target

Inflation has not been at or below 2% for over five years - expectations risk drifting up.

Sources: BLS, Federal Reserve, CME FedWatch, CBSL; Nov 2026

# The Fed Turned From Cutting to Hiking




**Dec 2025**

**Cut to 3.50 - 3.75%**

3rd straight cut, dots showed one more cut in 2026

**Jan–Jul 2026**

**Hold at 3.50 - 3.75%**

Oil shock hits, dissent grows inside the FOMC

**May 2026**

**Warsh becomes Chair**

Replaces Powell, stresses inflation is the Fed's job

**16 Sep 2026**

**Hike to 3.75 - 4.00%**

Unanimous 25 bp, first hike since 2023

**28 Oct 2026**

**Hold, 10-2 vote**

Cook and Hammack dissented in favour of a hike

**8–9 Dec 2026**

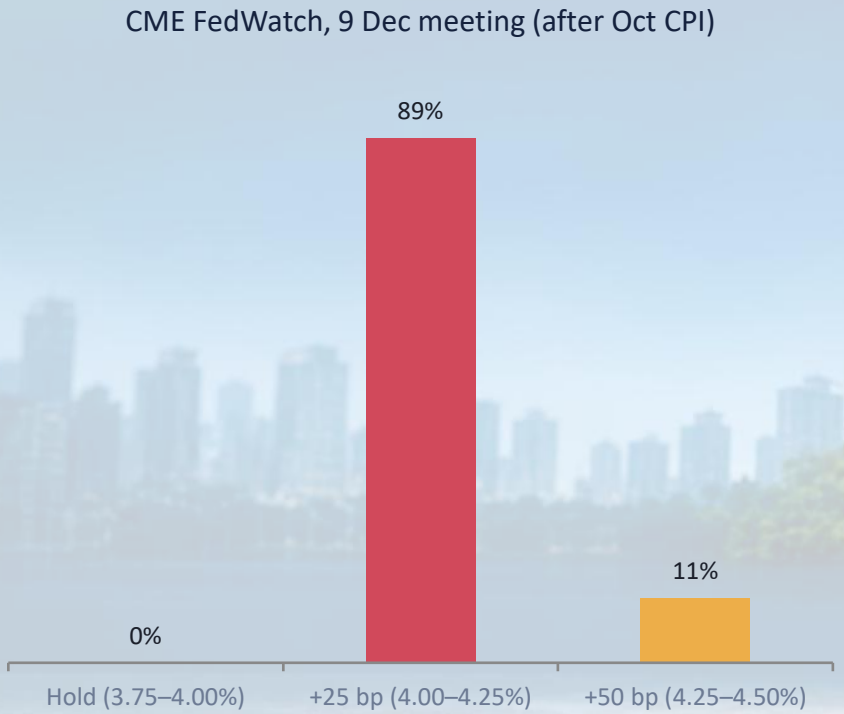
**Next decision**

25 bp hike priced, 50 bp now debated

*Sept projections: policy rate at 4.00–4.25% by end-2026 and 2027, inflation back to 2% only in 2029.*

Sources: BLS, Federal Reserve, CME FedWatch, CBSL; Nov 2026

# Markets Expect a December Hike




**Hawks lead**

Waller: a 25 bp move would put credibility at risk if core stays at 0.3% - consider 50 bp. Dallas Fed's Logan favours two more hikes.

**Bond market agrees**

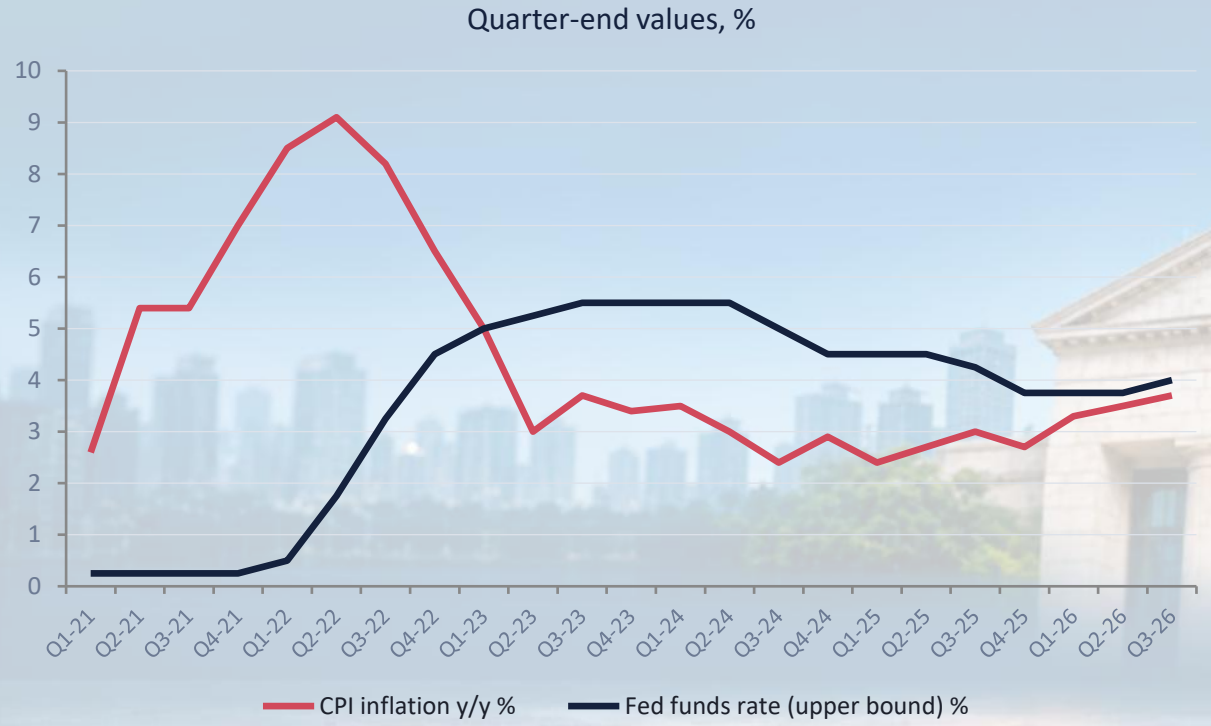
10-year Treasury yield near 5.0% (topped 5.3% in early Oct), 2-year yield jumped after CPI.

**Base case**

25 bp in Dec to 4.00-4.25%, then further gradual hikes into 2027 unless core cools.

Sources: BLS, Federal Reserve, CME FedWatch, CBSL; Nov 2026

# 5 Years of Inflation vs the Fed Funds Rate




**2021**
"Transitory" - rates at zero while CPI hit 7%

**2022**
Fastest hikes in 40 years: 0.25% → 4.50%

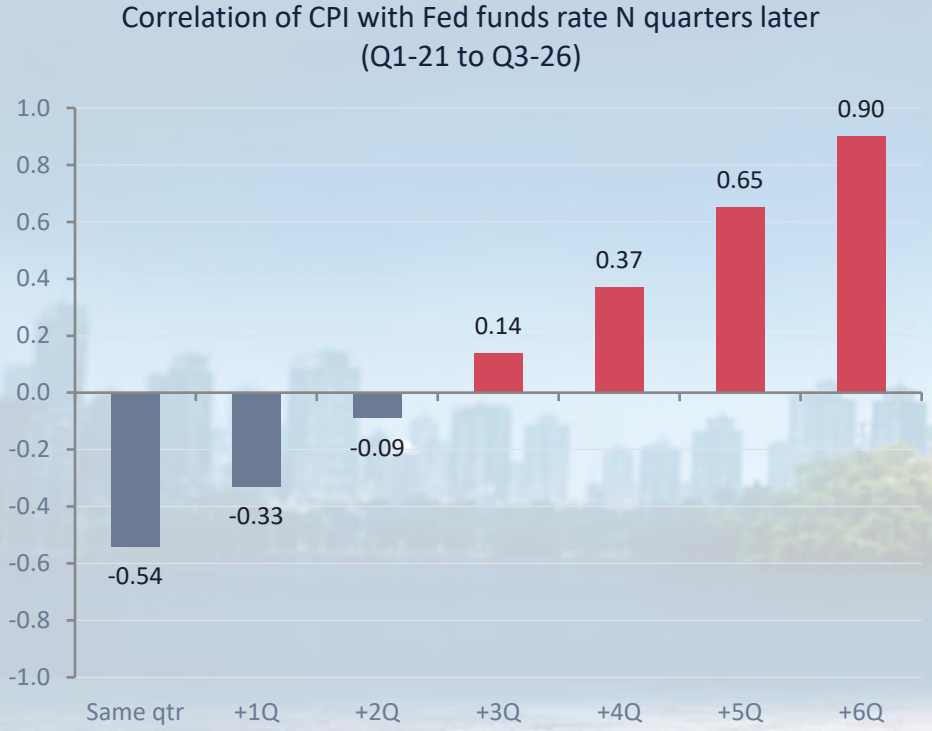
**2023**
Peak 5.50%, inflation falls to 3.4%

**2024–25**
Easing: 175 bp of cuts to 3.75%

**2026**
Re-acceleration, first hike since 2023

Sources: BLS, Federal Reserve, CME FedWatch, CBSL; Nov 2026

# Correlation: The Fed Follows Inflation With a Lag




**−0.54**

Same-quarter correlation: rates were lowest when inflation was highest (2021–22).

**+0.90**

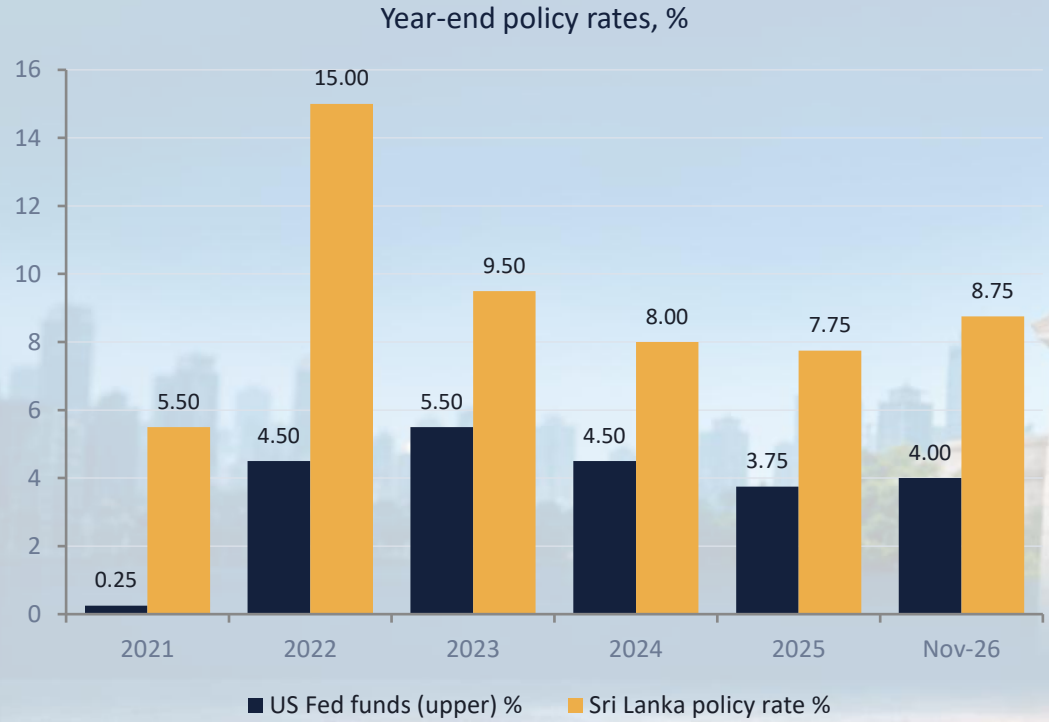
With a 6-quarter lag: the Fed rate tracks inflation of approx. 18 months earlier.

**Real rate squeeze:** Fed funds minus CPI went from −8.0 pts (2022) to +2.6 pts (2024) and is back to just +0.3 pts (Sep 2026). That thin cushion is why the Fed is hiking again.

*Pearson r on 23 quarterly points; my calculation from BLS and Fed data. Correlation ≠ causation.*

Sources: BLS, Federal Reserve, CME FedWatch, CBSL; Nov 2026

# Fed Funds Rate vs Sri Lanka's Policy Rate




| Year | SL CCPI (Dec) | US–SL gap |
|---|---|---|
| 2021 | 12.1% | 5.3 pts |
| 2022 | 57.2% | 10.5 pts |
| 2023 | 4.0% | 4.0 pts |
| 2024 | −1.7% | 3.5 pts |
| 2025 | 2.1% | 4.0 pts |
| Oct-26 | 8.3% | 4.75 pts |

*2021–23 = midpoint of SDFR/SLFR corridor; OPR from Nov 2024. Correlation of the two rate series ≈ 0.58 (6 points; driven by 2022).*

Sources: BLS, Federal Reserve, CME FedWatch, CBSL; Nov 2026

# How Fed Policy Reaches the CBSL

### Exchange rate

Higher US rates strengthen the dollar, the rupee faced depreciation pressure in 2026, feeding import prices.

### Capital flows and reserves

Wider US yields pull money out of frontier markets, reserves (approx. USD 6.5 bn mid-2026) must cover debt service.

### Shared oil shock

The same Middle East shock that lifted US CPI pushed Sri Lanka's CCPI from 2.1% to 8.3%.

### Rate differential

CBSL keeps a premium over the Fed (now 4.75 pts) to hold LKR assets attractive.

**Key relationship:** Domestic inflation drives the OPR, the Fed sets the backdrop. CBSL hiked 100 bp to 8.75% in May 2026 - four months before the Fed - and its inflation forecasts explicitly assume global conditions implied by the Fed funds rate.

Sources: BLS, Federal Reserve, CME FedWatch, CBSL; Nov 2026

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