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Inflation isn't a Core problem, yet

The concern the US financial markets and the Federal Reserve have that the Iran conflict will accelerate inflation seems to be playing out. But so is the thesis that these price pressures will be short-lived.

These narratives stem from the two different inputs of the major indices that the federal government calculates: the Consumer Price Index (CPI), the Personal Consumption Expenditures Index and the Producer Price Index. The markets tend to move on the “headline,” or comprehensive numbers, and the Fed on the “Core” readings. That’s because calculating the former rate includes volatile economic inputs such as food and energy prices. Consumers feel these effects acutely, especially gasoline, which the conflict has put on a roller coaster. By ignoring those factors, Core offers a bird’s eye view of the economy, which tends to shrug off temporary shifts at the pump and in grocery stores. In the present interest-rate environment, you would expect it to be the lower of the two.

The US Bureau of Labor Statistics showed just that with its release of the March CPI report. Headline CPI increased from a month-over-month (m/m) rate of 0.3% in February to 0.9%; the year-over-year (y/y) rate increased from a rate of 2.4% to 3.3%. In contrast, March Core CPI increased at the same 0.2% rate as it did in February, and it increased just a tick y/y, from 2.5% to 2.6%.

The big question — answered only after the Iran conflict has decisively ended — is if higher gasoline and food costs will spread to the greater economy. If a broader increase in inflation slows corporate expenditures, the buying of durable goods or other big spending decisions by companies and individuals, headline and Core measures might resemble each other in the months to come.

Views are as of the date above and are subject to change based on market conditions and other factors. These views should not be construed as a recommendation for any specific security or sector.

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