NEWS AND VIEWS
KING & SHAXSON ASSET MANAGEMENT

What's Driving Inflation – September 2026

By King & Shaxson Asset Management

Introduction

Inflation is a sustained increase in the general price level of goods and services over time, which reduces the purchasing power of your money. It has been a major issue since 2022, driven by a number of factors which, in the words of Lemony Snicket, seem to form a "Series of Unfortunate Events".

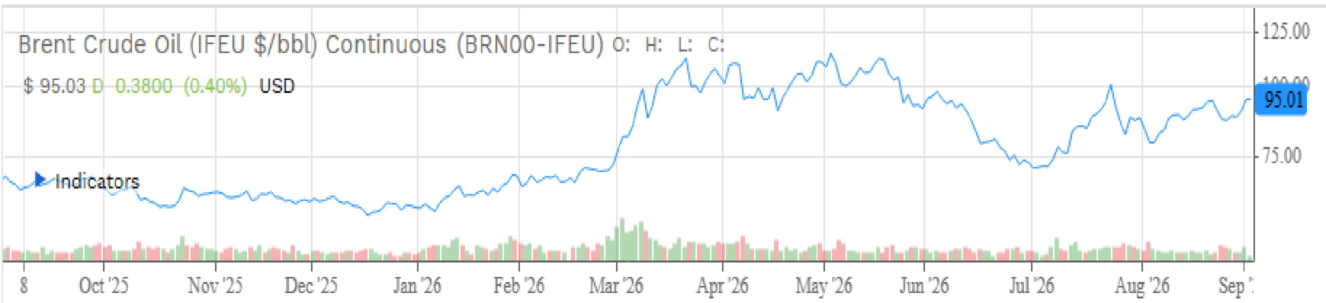
Excessive QE in 2021; the oil price shock of 2022 following on from Russia's protracted attempt to invade Ukraine; Global Tariffs and Geopolitics on key resources; Supply chain blockages in the Suez Canal and the Red Sea; higher interest rates and taxes; further conflict in the Middle East, and finally the (climate-related) weather. Global markets have had to weather some serious storms in the space of five years.

Where now for prices

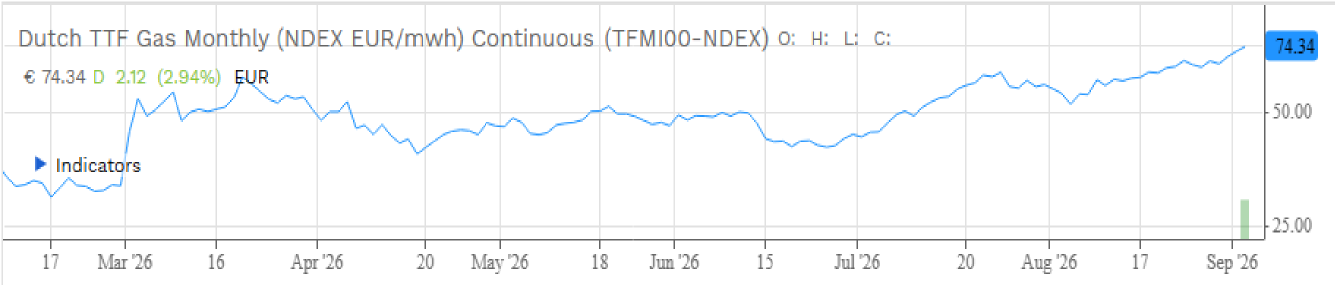
In late February 2026, Israel and the US launched coordinated strikes on Iran, hitting nuclear, military and government targets. This led to a closure of the Strait of Hormuz, disrupting global oil and shipping. A ceasefire that restored some level of peace was by no means concrete, and we are now once again at a stage of fresh US strikes on Iran.

As we saw with the Ukraine and Russia conflict, markets have reacted, with both oil and bond yields up (as bonds sell off, their yield rises) as fears of inflation spike once more. The main chokepoint driving these scares is the closure of the Strait of Hormuz, which accounted for roughly a third of global seaborne fertiliser trade and about a fifth of Liquid Natural Gas. Our Middle East Risk monitor includes both Brent Crude Oil (first chart) and Dutch Gas (second chart) prices, which highlight the rise in key energy commodities:

Brent Crude Oil ($)



Dutch Gas Prices (a benchmark for European gas) (€)



Source: FactSet

As a result, many regions saw higher headline inflation, with the effect showing up fastest and hardest at the Petrol/Gasoline pumps, and therefore impacting consumers quickly. Europe's reliance on natural gas and the feed through to inflation has seen one rate hike from the European Central Bank (ECB) in June and expectations for another rate hike in September. EU natural gas prices have risen to their highest level in over three years, exceeding their Iran War peak. Constrained supply coupled with the summer heatwave, which also disrupted hydro and nuclear supplies, left storage levels low.

ECB Executive Board member Schnabel, commented that "At the current policy rate, inflation is unlikely to return to target over the medium term, and therefore further tightening will be necessary". She went on to add that developments with natural gas are "particularly concerning" due to Europe's low storage levels.

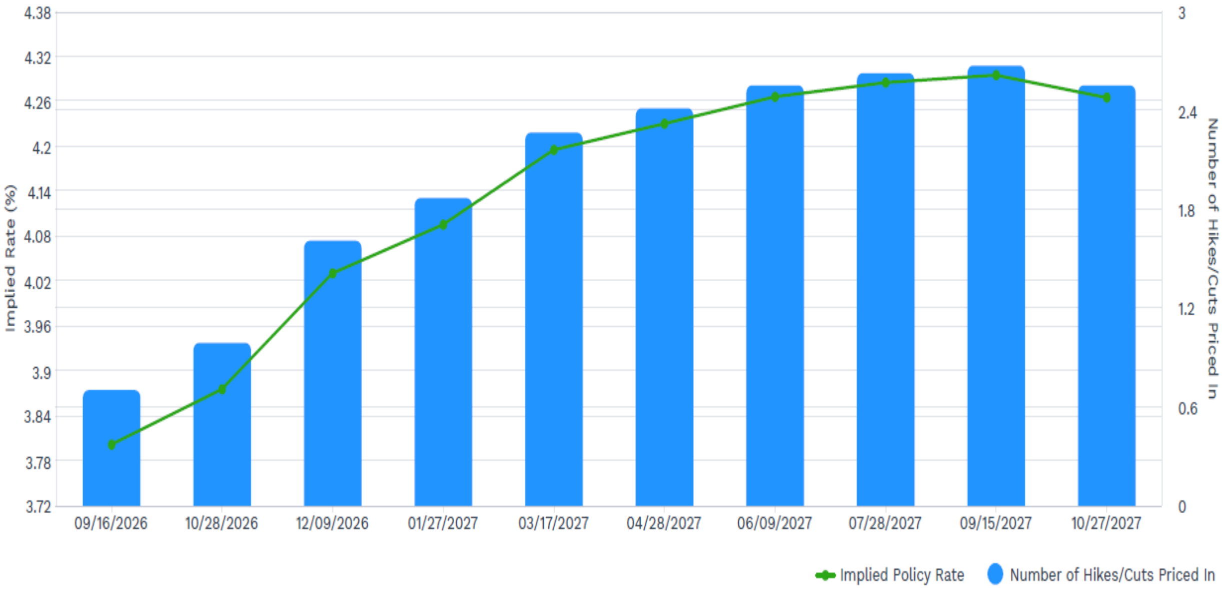
The concerns rise if the conflict is prolonged and winter weather creeps in which will see gas demand jump. Goldman Sachs has recently commented that oil exports from the Persian Gulf have recovered to two-thirds of pre-war levels, with some sources suggesting they have increased significantly in recent weeks. Despite this, flows of liquified natural gas and refined fuels still remain much lower than pre-war levels.

The US is a large domestic energy producer and a major grain exporter rather than importer, so it's less exposed to Hormuz-driven fertiliser and shipping cost shocks compared to a heavily import-dependent economy like the UK. Nonetheless, Federal Reserve (Fed) officials see the conflict as a channel keeping both total and core inflation elevated relative to last year. Energy was the dominant driver of inflation in the Spring, but it's now easing, with energy prices falling 1.5% month-on-month in July, though they're still up nearly 15% year-on-year, so the level effect from the war hasn't fully washed out even as the momentum has turned disinflationary. Although a recent spike in oil could turn this back to a headwind.

Outside of this, there are a range of factors feeding through to the inflation story, including tariff concerns as well as tech-related spending. AI is also an upward pressure on inflation given the strong demand on materials for Data Centres, and the shortage of supply of chips and steel which is adding to consumer related items such as smartphones, computer equipment etc. Housing or shelter inflation had been a major concern in the US but we are now beginning to see disinflation, although this is partly being offset by non-housing services such as insurance and medical care.

FactSet economist expectations are for headline US inflation to drift towards 3.5% by the end of the year, with geopolitics being the main upside risk. Core CPI (stripping out volatile food and energy) is expected to be 2.8%. Expectations are for these to ease to 2.4% and 2.5% respectively. With this being above the Federal Funds target (or main bank rate) and the risk to the upside alongside other inflation expectations (food is discussed further below), the market is currently pricing in circa 2-3 rate hikes in the year ahead, pushing the policy rate closer to 4.25% from its current 3.75% level:

Implied US policy rate (green) based on number of hikes priced in (blue bar)



Source: FactSet

The market has also faced a new unknown, as new Fed Chair Warsh has avoided providing forward guidance to the market. The lack of communication has led to increased market volatility, with the bond market focusing closely on the real time oil price. In fact, the 30-day correlation between daily 10-year yield changes and WTI Oil has risen from circa 0.10 in 2022 to 0.69. (Correlation measures the strength and direction of a linear relationship between two variables. A correlation of 0.69 is considered moderately strong).

Kevin Warsh's speech at an economic forum in Jackson Hole at the end of August broke tradition and failed to signal a rate path, and instead characterised inflation as the Fed's primary concern over unemployment. The market perceived this as a hawkish signal and has since priced in more of a chance of a US rate hike in September (up from 40% to 50%).

Elsewhere, the UK is a net gas importer, and North Sea production has been in long-term decline, so a growing share of UK gas comes from LNG imports and pipeline gas from Norway/Europe. That LNG supply chain runs partly through routes exposed to the Hormuz disruption (Qatari LNG in particular transits the Strait).

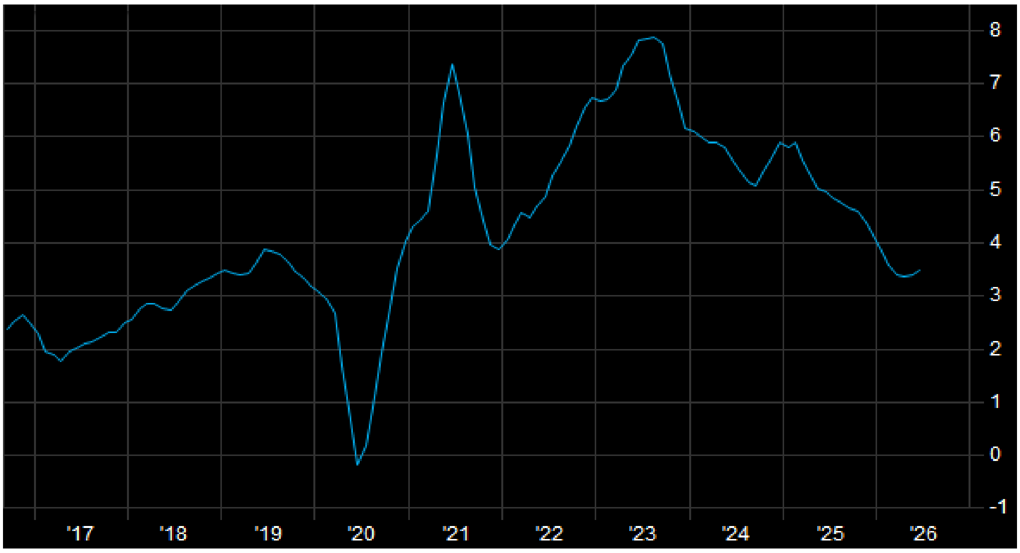
Retail electricity and gas prices are set by a regulator-administered cap that resets periodically based on wholesale costs, meaning the mechanism acts fast and near-automatic. For example, the 13% Ofgem cap rise from 1st July pushed headline CPI to 2.9% in July. UK (and broader European) electricity markets are priced on a marginal-cost basis where gas-fired plants are very often the price-setter, even when gas supplies only a fraction of total generation. That means a gas price spike directly drags the electricity price up with it, regardless of the source, even as renewables contributed significantly to the UK power grid over a number of days throughout the summer. For example, the UK reported its highest ever solar output of 15,158MW (as reported by the UK's NESO).

More recently, the latest figures in the UK have shown a decline in inflation through Q2, which was largely due to owner-occupier housing costs and general housing/household services easing, alongside food inflation cooling steadily through the quarter. Food and non-alcoholic beverages fell to 2.2% in May, its lowest reading since December 2024, before easing further to 1.3% in July. Having said this, the full extent of the Iran War on food is yet to be felt.

The Bank of England's (BoE) central projections at its July meeting for inflation were seeing it peak at around 3.2% in Q4 2026. They also noted that they see "risks to the inflation outlook are tilted to the upside". Given this, the market is pricing in circa 2-3 rate hikes in the next twelve months, with rates set to be around 0.50%-0.75% higher by this time next year.

As with all other policy setters, the BoE will be paying close attention to second round effects of higher wages, although the trend since 2023 (as detailed in the below graph), has seen wage rises mediate in regions such as the US, UK and Europe. So far there is limited data to suggest that a wage price spiral is taking hold, which has been some relief for policy setters, although some suggest this is starting to turn as seen below:

UK Average Earnings (%, 3 Month Average)



Source: FactSet

Whilst markets have years of experience when it comes to oil, which is well documented and understood, food is a different story. Food inflation is highly material, according to the Economist,[1] US consumers are paying 25% more for their groceries now than in 2020. Additionally, the UN Food and Agriculture Organisation's Food Price Index is 30% higher. The effect is not only material to the already hard-pressed consumer, but it can invoke disturbing political reactions, ranging from attempts at price controls to trade bans.

The oil price itself has an impact, through both farming and transport costs and the price of diesel. According to the Financial Times the cost for diesel for Nebraska farmers has risen from US$3.81 before the war to US$5.45.[2]

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[1] The Economist "Who's to blame for rising food prices?" podcast August 25th 2026.
[2] FT "U.S. grain farmers face worst crisis in decades as Iran war sends costs spiralling." 25th 2026.

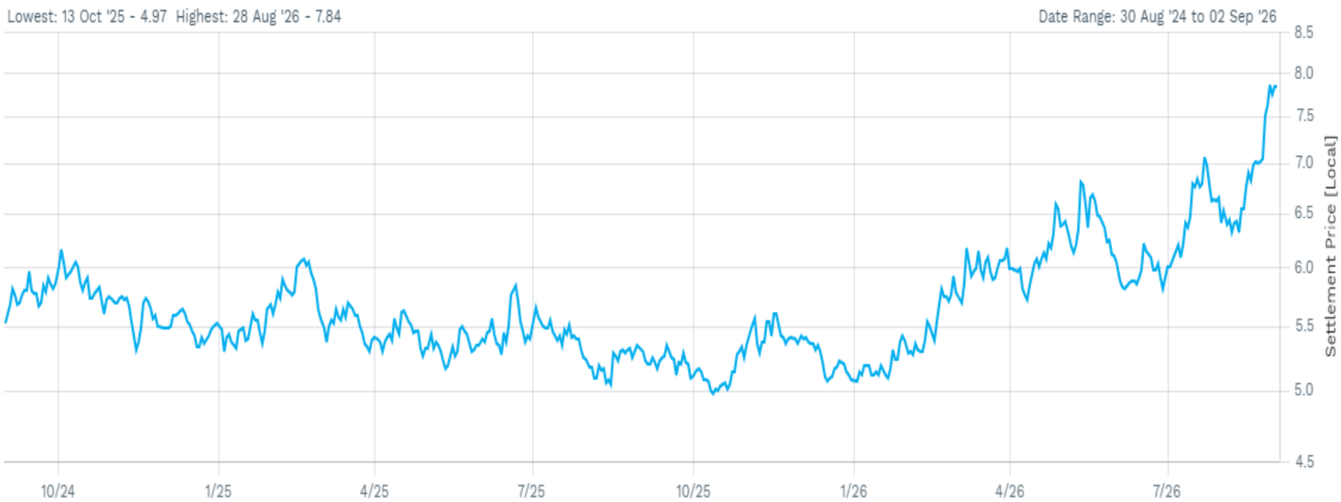
A more significant impact on crop prices and yields for this and next year has been fertiliser prices, and this is not just in terms of costs to the farmer, but more relevant in terms of application. The higher costs mean less fertiliser has been used, reducing yields in both this year and the next. The Agricultural and Food Economics Journal revealed that a 10% rise in fertiliser costs equates to a 7% drop in yield.[3] Whilst this is a broad-brush statistic it indicates the scale of the problem.

Urea (a key nitrogen fertiliser) almost doubled in price on the onset of the Iran war. Whilst easing seasonal demand in the Northern Hemisphere and China's lifting of its export ban have softened pressure, prices remain resiliently elevated. This comes alongside other fertilisers exported from the Gulf, such as Phosphate. In general, fertiliser use is notably lower and this will remain an issue for next year as well. Africa and South Asia have been flagged most at risk from food security crisis as they are less able to absorb higher prices, resulting in supply diverting to wealthier countries who are able to pay a premium to import more expensive commodities.

The next unfortunate event, the drought of 2026, has then made matters even worse and widened the problem even further. As the FT pointed out not only are wheat harvests below the 5-year average, but milk production sank 4.5% in July due to stressed cows and curtailed grass growth.[4]

Coceral, the European trade association covering cereals, rice, animal feed, oilseeds, olive oil, oils and fats, and agricultural supplies, warned in a July report that this year's cereal harvests are set to come in weaker. Output across the EU's 27 members plus the UK is forecast to slip from 311.3 million tonnes to 295.5 million tonnes, with barley production alone expected to fall from 63.8 million to 58.8 million tonnes.[5] In the US, the USDA has forecast the smallest wheat crop in more than 60 years, reporting the lowest planted area since records began. The following graph plots the rise of Wheat since the crisis:

Wheat Prices (CBT $/bu)



Source: FactSet

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[3] Syfert.net "Why fertiliser prices are rising in 2026" March 16th 2026.
[4] FT "UK Government considers aid for drought hit farmers" August 13th 2026
[5] Coceral Crop Forecast July 2026

The UK's Food and Drinks Federation (FDF) warned that soaring temperatures in the UK and Europe are pushing up fruit, vegetable, and grain supply costs, which will feed into supermarket prices. Meanwhile, Oxford Economics have concluded that heatwaves will be “a stronger driver of food prices next year than the war”, which is not going unnoticed by policy makers. ECB Chief Economist Lane explicitly flagged food prices as a key driver of inflation into 2027, warning of additional upward pressure in summer 2027 from weather events including El Nino.

Research from the ECB has shown that the El Nino weather pattern has driven around a fifth of historical swings in global commodity-price inflation, typically lifting real commodity inflation by roughly 3% over the following six to twelve months.

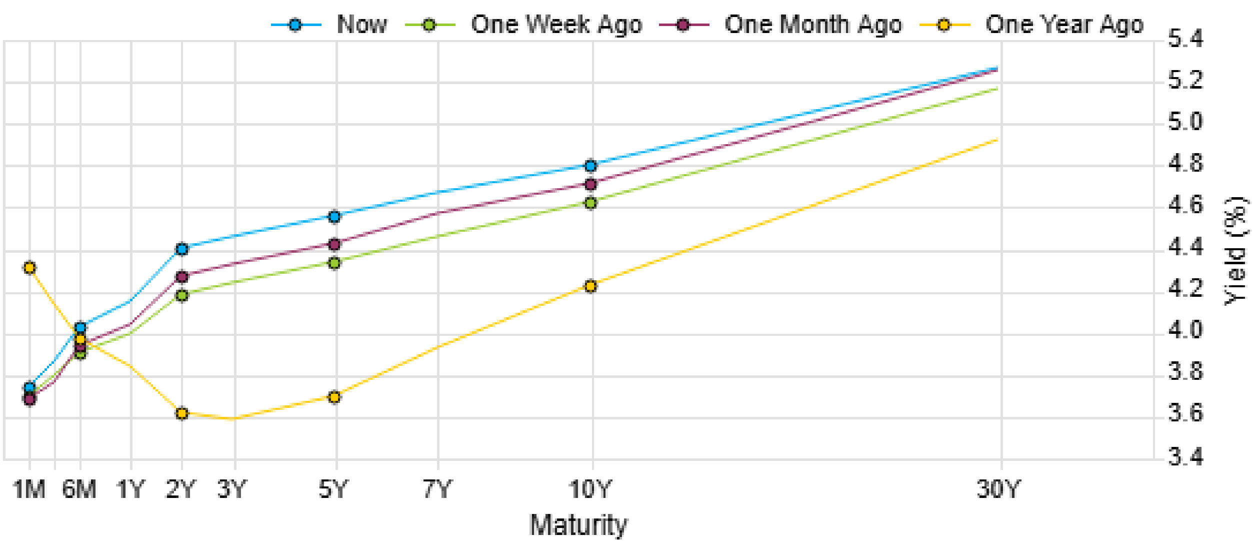
Forecasts vary, but at the moment there is a consensus that recent events (war, weather etc) will add 2-4% to US food prices and a little more to European food prices. There is also no room to be complacent as this will not be just a one-year issue, next year’s prices will be impacted as well, and older issues such as Russia and Ukraine (the world’s largest and 5th largest grain exporters) have not gone away.

This is a classic example of physical risk, as both geopolitical and climate risks impact one of the world’s most critical resources, food, something the West has taken so long for granted. It’s also more than inflationary, it will keep inflation higher in the West, but for other parts of the world its life and death, and the risks here become more political. As the Economist points out, supermarkets are super-efficient and are not price gouging, the response to this challenge will require far more intellect and effort.

Portfolio positioning

Inflation persistence has forced a broad pivot towards tighter monetary policy globally and markets have positioned accordingly. Volatility since the Iran war has heightened, most notably in rate expectations and therefore bond yields. With inflation expectations rising, alongside the ongoing concerns over government deficits, we have seen yield curves steepen, with the blue and yellow lines showing the divergence between now and this time last year, with notably steeper curves seen across major developed markets.

US Yield Curve at various points (Now being 02/09/2026)



Source: FactSet

A steeper yield curve happens when the gap (spread) between long-term and short-term interest rates gets wider. Long-term bond yields have gone up faster than short-term yields, as investors demand a greater premium to hold longer debt.

Prior to the war, one of our main concerns when looking at debt was over government deficits and the impact this would have on the yield curve, with investors likely to demand a greater premium to hold longer dated debt. In terms of asset allocation, we are positioned above neutral levels for debt, however, this is positioned below neutral levels in terms of duration (or interest rate sensitivity).

When it comes to US Treasuries, portfolios have limited exposure, and there are a few reasons for this. This includes concerns over the Trump regime, which has pulled out of the Paris Climate Agreement, concerns over international policy, and general anti-sustainability rhetoric. Despite this, we are able to gain exposure to proxy Treasuries through Sustainable Development Banks, who are highly rated from a credit standpoint (AA-AAA) and large issuers of US denominated debt. Development banks are government-backed financial institutions that provide long-term, low-cost loans and expert advice to fund economic and social projects. They aim to reduce poverty, build infrastructure, and support sustainable growth. Our holding here also sits at the lower end of duration, with the HSBC Sustainable Development Bank Fund, sitting at 3.6yrs duration, aligning in our desire to be below neutral in our rate sensitivity.

At our rebalance in June, across our different MPS ranges, we have also taken a slightly more defensive stance by increasing more value focussed investments and/or companies operating in infrastructure and real assets (such as real estate, utilities etc.), which tend to hold up better in inflationary environments for a few structural reasons. This includes infrastructure projects, in many cases, being explicitly linked to inflation, in a similar way that rent leases are reset with inflation. They also have a lower correlation to financial assets, which was another rationale for adding given we sought some defensive elements that would help diversify from certain AI related themes.

Within portfolios core allocations, at our rebalance in June, we lowered some of our UK exposure given our concerns over the UK economy. The UK economy is highly susceptible to rising energy and food prices, particularly given the UK consumer is already under pressure. This is a similar story to Emerging Markets, although our main rationale for reducing exposure was the increased risk related to concentration in particular AI names.

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Appendix

Inflation — A sustained increase in the general price level of goods and services over time, which reduces the purchasing power of money.

QE (Quantitative Easing) — A monetary policy tool where central banks inject money into the economy, typically by purchasing assets, to stimulate growth.

Strait of Hormuz — A key global shipping chokepoint for oil, gas, and fertiliser trade; its closure (following Israel/US strikes on Iran in Feb 2026) disrupted roughly a third of global seaborne fertiliser trade and about a fifth of LNG flow.

Brent Crude Oil — A major global benchmark price for oil.

Dutch Gas (TTF) — A benchmark price for European natural gas.

Headline Inflation — The total inflation rate for an economy, including all goods and services (e.g., food and energy), without stripping out volatile components.

Core CPI (Core Inflation) — Inflation measured after stripping out volatile components such as food and energy, giving a clearer view of underlying price trends.

Ofgem — The UK's energy regulator, which sets the periodic price cap on retail gas and electricity.

Correlation — A statistical measure of the strength and direction of a linear relationship between two variables, typically ranging from -1 to +1; a reading of 0.69 (as cited for 10-year yields vs. WTI oil) is considered moderately strong.

WTI Oil — West Texas Intermediate, a US benchmark crude oil price.

Yield Curve — A line plotting interest rates (yields) of bonds with different maturities; it "steepens" when the gap between long-term and short-term yields widens.

Bond Yield — The return an investor earns on a bond; yields rise when bond prices fall (sell off).

Duration — A measure of a bond or bond fund's sensitivity to interest rate changes; higher duration means greater sensitivity.

Development Banks (Sustainable Development Banks) — Government-backed financial institutions providing long-term, low-cost loans and advice to fund economic/social projects, often used as a highly-rated (AA–AAA) proxy for exposure to government bonds like US Treasuries.

Urea — A key nitrogen-based fertiliser, whose price nearly doubled following the onset of the Iran conflict.

Coceral — The European trade association representing cereals, rice, animal feed, oilseeds, olive oil, oils and fats, and agricultural supplies.

USDA — The United States Department of Agriculture.

El Niño — A recurring climate pattern linked (per ECB research) to roughly a fifth of historical swings in global commodity-price inflation.

Physical Risk — A term (used here regarding food security) referring to risk arising from direct physical/environmental and geopolitical events impacting critical resources.