

U.S. ECONOMIC OUTLOOK

Deck next year's halls with caution! (Fa la la la la!)

- **Summary:** Our U.S. economic outlook as we head into 2026 highlights resilient but slowing consumer spending, a labor market stuck in a “low-hire, low-fire” pattern, and inflation that remains stubbornly above target and expected to peak next year as tariff-costs filter through to consumers. With inflation progress stalled and growth risks rising, we expect the Fed to cut another 25 bp in December which should bring good cheer to the New Year. Given significant tension between their two mandates, the Fed will struggle to avoid stagflation, with a more cautious approach to accommodation next year.
- **Growth:** Economic activity to moderate. Q3 GDP is estimated at 3.1% (q/q annualized), supported by resilient retail sales and healthy capital spending, with full-year 2025 growth now at 2.0%. We expect somewhat softer but steady growth of 1.9% in 2026, as still-high prices and job concerns slow, not topple, expansion.
- **Labor Market:** Stability on the surface, fragility underneath. Hiring has slowed but unemployment rate is still low at 4.4% in September and is projected to peak at 4.7% by early 2026 – driven by reduced labor market dynamism, restrictive immigration, and business caution amid policy uncertainty shaping next year's business plans.
- **Consumer:** Resiliency challenges ahead. Spending remained solid through 3Q as strength in services helped offset slower goods consumption – pressured by tariff-related pricing pressure and high borrowing costs. Real-time October retail data point to continued moderation into fall, concentrated in essential ‘must have’ items – particularly among lower-income consumers. High income households continue to drive a disproportionate share of overall spending, particularly in discretionary categories, supported by record-high equity prices.
- **Inflation:** Price pressures remain elevated. Core PCE inflation, currently at 2.8% year-over-year, is expected to climb to 3.1% in the first half of 2026 driven by tariff-related goods inflation and firm non-housing services costs, before gradually easing toward the Fed's 2% target.
- **Fed:** Monetary policy remains cautious and divided. Following October's rate cut to 3.75-4.00%, the Fed is signaling another likely reduction in December amid concerns over labor market softness despite sticky inflation. The disappointing November ADP report may temper hawkish dissent. We expect a gradual path toward a neutral rate of 3.25% by the end of 2026.
- **Risks:** Risks remain skewed to the downside amid elevated uncertainty from fiscal, immigration, and trade policy changes. Trade war risk has eased slightly with the effective tariff rate lowered to 14.5% (from 16%), though we see little impact on trade costs regardless of the Supreme Court's review of tariff authority. Our 12-month recession risk holds at 35%.

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U.S. Bank Economics Research Group December 2025 Macro forecast summary

	Actual 2024	Forecast 2025	Forecast 2026	Forecast 2027
Real GDP	2.8	2.0	1.9	2.0
Consumer Spending	2.9	2.5	1.7	2.0
Investment	3.0	2.1	1.3	2.6
Housing Starts	1.37	1.36	1.37	1.42
Unemployment Rate	4.0	4.3	4.6	4.4
Consumer Price Index	3.0	2.8	3.0	2.2
Core PCE Price Index	2.9	2.9	2.9	2.2
Federal Funds (Upper Target)	5.3	4.4	3.6	3.2

Forecast as of December 3, 2025. Sources: U.S. Bank Economics, Moody's Analytics, and Bloomberg. 1. Projections for real GDP are annual percent change. Projections for housing starts in millions, annualized. Projections for the unemployment rate represent annual averages. 2. Projections for the CPI and Core PCE are annual percent change; 3. Interest rate projections represent annual averages, and are the views of the U.S. Bank Economics Research Group.

From the desk of the Chief Economist:
Ring out the old, ring in the new

As we ‘ring out the old’, one thing that I’m grateful for is the surprising strength of the American economy despite the many headwinds this year. As expected, the ‘Big Three’ policy initiatives – taxes & regulation, tariffs and immigration – were initiated to a lesser, or sometimes much greater, degree this year. I said in January that tariffs and tighter immigration policy would offset the Trump administration’s looser regulations and tax cuts this year, but both policies were much larger than expected with a much bigger bite.

Tariff policy stung U.S. households and businesses, but not as much as markets feared. The launch of tariffs across the world on Liberation Day (April 2) was initially estimated to push the effective tariff rate (ETR) to around 20% (eight times higher than 2024). Tighter immigration policies and deportations this year were much larger than expected, with reports that both undocumented and some documented workers were impacted, shrinking labor supply and slowing business production for some industries than earlier thought.

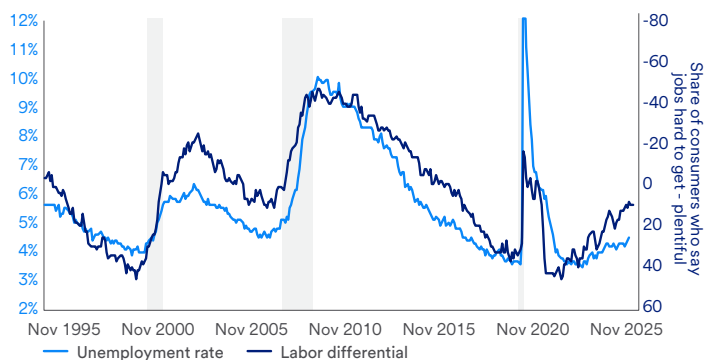
How we’re doing			
2025		Jan-'25 forecast	Dec-'25 forecast
Real GDP	%	2.1	2.0
Consumer spending	%	2.6	2.5
Investment	%	2.3	2.1
Housing starts	Million	1.45	1.36
Unemployment rate	Rate	4.2	4.3
Consumer Price Index	%	2.5	2.8
Core PCE Price Index	%	2.4	2.9
Federal funds (upper)	%	4.35	4.40

Source: U.S. Bank Economic Research Group's U.S. Baseline Forecasts. Indicators are current through December 5. Shutdown has delayed government data.

But that’s behind us. As we ring in the New Year, we continue to anticipate moderate growth supported by consumer spending and stable investment to keep the economy landing softly. Tension between the two Fed mandates will continue through most of 2026 with inflation elevated on persistent tariff pressures while the labor market remains fragile in its “low-hire, low-fire” world. The Federal Reserve is expected to slowly cut rates this year amid mandate tensions, executing a soft landing for the first time since 1995.

Landing and takeoff are the hardest parts of flying. The same is true for central bankers when navigating a safe path for the economic ‘plane.’ And while the U.S. dodged that bullet in 2025, downside risks remain. The Fed has turned its attention to the weaker jobs market despite sticky inflation. Once a cushion for the economy, the jobs market is now fragile, with meager job gains and job postings as businesses shy away from new hires. While the unemployment rate is low, recent Challenger layoff announcements suggest that it will pick up this year, pulling the rug out of a worker’s job security, as seen with the Conference Board’s job insecurity metric rising (see chart). With that gone, consumers won’t just be cautious, they may keep their wallets shut.

U.S. Job insecurity



Source: U.S. Bank Economics; Bureau of Labor Statistics (BLS); Conference Board

My biggest worry stems from a monetary policy mistake, on our radar for a long time. It got worse when tension between their two mandates widened and more recently when economic data was delayed. Consumer inflation is sticky and still far from their 2% inflation target and we believe businesses are still passing through tariff costs to their customers, with consumer prices reaching the peak this year. But despite high inflation, the Fed is focused on the jobs mandate. If the wrong move, it would only mean higher prices and more job loss for the Fed to fight next year and beyond. In this ‘lose-lose’ outcome, I certainly don’t envy their jobs!

[Read the full commentary here >](#)

Consumer spending: It’s a “Ho-Ho-Hum” holiday for retailers

Consumer spending has held up despite the prolonged government shutdown and limited visibility into official data. September retail sales, the last major release, rose 0.2% month-over-month (MoM), down in real terms according to our calculations but following strong goods consumption

earlier in the summer. Restaurant spending – the lone services proxy in the report – jumped 0.7% MoM, reinforcing the theme of services resilience. Control group sales, which exclude more volatile categories (like auto, gas, building materials, and restaurants) and feeds into the personal consumption expenditures (PCE) component of GDP, fell by -0.1% MoM. Taken together, Q3 consumption growth should remain solid, but September’s softness hints at a more cautious backdrop heading into year-end.

High-frequency indicators echo this mixed picture. USB Economics’ Consumer Dashboard shows card-based retail spending, ex-autos, up 2.3% year-over-year in October, a slight improvement from September’s 2.1% pace but well below early-year growth near 5%. Spending on essentials such as food and gasoline continue to rise, while discretionary categories – clothing, furniture, and sporting goods – remain flat or negative, reflecting shifting consumer priorities amid higher borrowing costs, tariff-driven price pressures. Coupled with growing job insecurity, people are becoming increasingly cautious.

Confidence remains fragile, but its predictive power for spending is limited. Inflation concerns dominate consumer surveys, with one-year expectations still high and sentiment among lower-income households weak. In contrast, higher-income groups – especially those earning over \$200K – continue to report improved outlooks and drive aggregate spending growth. Early holiday indicators, including card data, point to steady seasonal outlays, with higher-income households driving luxury spending on travel and entertainment.

Bottom line: Consumer spending is resilient but faces headwinds from labor market softening and persistent price pressures, particularly at the low-end of the income spectrum. We expect goods spending to moderate further, while services outlays should remain a stabilizing force through year-end – assuming the jobs market cushion doesn’t erode. Income-based divergence will likely persist, leaving aggregate consumption growth positive but slower as we move into 2026.

Labor market: Silent hires, holy furloughs

The labor market continues to operate under a “low-hire, low-fire” equilibrium – a dynamic we highlighted in October and which remains intact despite recent headlines. September’s employment report, finally published after weeks of disruption caused by the government shutdown, offered a welcome

surprise: nonfarm payrolls rose by +119,000, more than double consensus expectations and the strongest monthly gain since April. Gains were broad-based, led by healthcare and leisure & hospitality, while construction posted its best reading in over a year. Yet, revisions to prior months tempered the headline enthusiasm, and the three-month average remains subdued at +62,000 – far below early-year norms above 200,000. Meanwhile, the household survey showed the unemployment rate ticking up to 4.4%, its highest since mid-2023 – but while people got jobs even more joined the labor force, a good combination. In short, the rise in joblessness reflects more workers seeking jobs, not a collapse in hiring.

With official October and November payrolls still delayed, attention remains on alternative labor market indicators – including ADP’s report derived from payroll records. Here, private-sector employment unexpectedly declined (by -32,000) in November, following only modest gains in October, marking the softest two-month stretch since early 2023. Losses were concentrated in smaller firms and spanned both goods-producing and services sectors, with notable declines in manufacturing and professional services. While education and health services posted gains, the overall picture suggests hiring momentum remains subdued heading into year-end.

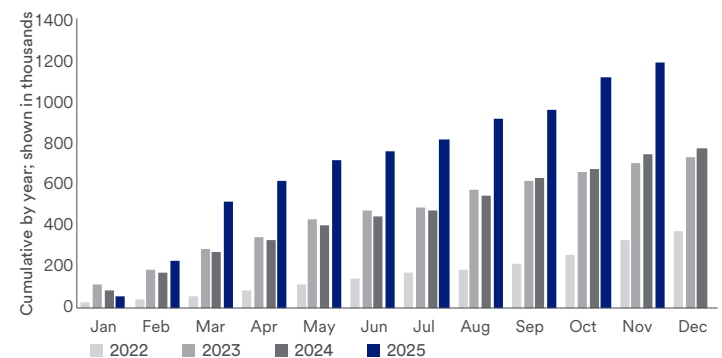
This softness is echoed in other signals. Weekly jobless claims remain mostly contained within a 220,000–235,000 range, suggesting broad-based layoffs are limited even as corporate announcements have surged. November’s Challenger, Grey & Christmas report showed employers have announced over 1.17 million job cuts year-to-date – a more than 50% increase from the same period last year and the highest level since 2020. However, the trend appears structural, rather than cyclical, with DOGE impacts on the federal workforce a key driver. Planned reductions in the private sector have been concentrated in tech and warehousing, and largely strategic, tied to restructuring and AI adoption rather than widespread demand weakness – with many phased-in or involving redeployment. Note that the report measures layoffs by U.S.-based companies, including planned cuts at overseas subsidiaries.

Still, continuing claims have climbed back to cyclical highs – levels not seen in roughly four years – pointing to slower hiring and longer job searches. This aligns with our framework: employers are reluctant to shed workers aggressively, but equally cautious about adding staff, leaving churn at historically low levels making it harder for the unemployed to find work.

Bottom line: The firewall against sharply rising unemployment – subdued layoffs – remains intact for now, even as hiring stays weak. We expect the ‘low-hire, low-fire’ pattern to persist near term, but with continuing claims drifting higher as job searches lengthen. While we expect initial claims to drift higher, it will likely stay contained unless corporate reductions broaden beyond concentrated pockets. The labor market remains a critical swing factor for the Fed – and for the soft-landing narrative heading into 2026.

U.S. Labor Market

Job cut announcements



Source: U.S. Bank Economics; Challenger

Inflation: All I want for Christmas is 2%

Inflation remains stubbornly above the Fed’s 2% target, even as official data releases have slowed to a trickle. The Bureau of Labor Statistics (BLS) confirmed there will be no October Consumer Price Index (CPI) report, and the November CPI – set for release on December 18 – will come after this month’s Federal Open Market Committee (FOMC) meeting. This unusual reporting cadence, combined with survey gaps, means inflation data through year-end will be harder to interpret and subject to quality distortions. September’s Producer Price Index (PPI), published in mid-November, pointed to continued firmness in non-housing services costs – particularly airfares – while goods inflation tied to tariffs remained present but muted. Based on CPI and PPI components, we estimate core PCE inflation at roughly 2.9% YoY through September, still well above target.

Alternative indicators reinforce this picture of sticky price pressures. The Cleveland Fed’s nowcast continues to track core inflation at just under 3% through late November and Purchasing Managers’ Index (PMI) surveys show input costs rising sharply in services, with the Institute for Supply Management (ISM) prices-paid index still trending among its

highest levels since late 2022. Manufacturing cost pressures remain elevated as well, reflecting tariff-related uncertainty and supply chain adjustments. These dynamics suggest that while inflation is not accelerating, progress toward 2% remains stalled.

Consumers feel the strain too. One-year inflation expectations were unchanged in November at 5.7% – according to the Conference Board – and confidence surveys show growing caution around discretionary spending, particularly among lower income households. Tariffs remain a key driver of goods prices, but we continue to view their impact as a one-time level adjustment rather than a sustained inflation impulse. Excluding tariff effects, underlying inflation is likely running closer to 2.3-2.4%, indicating that the Fed is not far from its goal once these distortions fade.

Bottom line: Inflation is sticky but not spiraling. We expect core PCE to edge higher into early 2026 – peaking near 3.1% – before gradually converging toward the non-tariff trend nearer 2% late next year. Risks remain two-sided: persistent services inflation could delay normalization, while fading tariff effects and softer demand should support disinflation.

U.S. Inflation

Nowcast (Daily Estimate of current rates)



Source: U.S. Bank Economics; Federal Reserve Bank of Cleveland

Federal Reserve: It's beginning to look a lot like a December cut

While the division at the FOMC will likely persist, we think a December cut is all but certain.

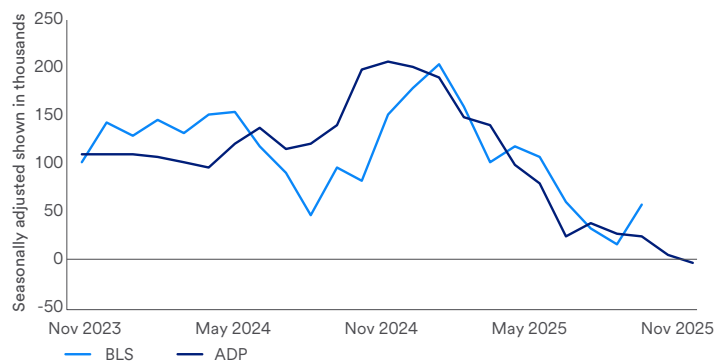
The Federal Reserve enters its December 9-10 meeting amid one of the most divided policy backdrops in recent memory. Following October's 25bp cut, which brought the target range to 3.75%-4.00%, Chair Jerome Powell emphasized that another reduction was "far from a foregone conclusion." That message set the tone for a month of contrasting signals from policymakers.

The October meeting minutes, released in mid-November, initially raised the odds of a pause, underscoring uncertainty. While participants broadly agreed policy remains restrictive, "many" favored holding rates steady in December, even as "several" acknowledged that further easing could be warranted if labor market conditions weaken. Inflation concerns remained central, with progress toward the 2% target appearing to stall amid tariff-related price pressures. These dynamics have only reinforced the Fed's data-dependent posture – complicated by the government shutdown, which has delayed or canceled official employment and inflation reports.

Despite earlier caution, recent remarks from Powell's closest allies suggest momentum is now firmly building for another cut. New York Fed President John Williams and San Francisco's Mary Daly have joined Governor Christopher Waller, both signaling openness to "near-term" adjustments and in our view, laying the groundwork for Powell to steer the committee toward additional easing. This shift reflects growing concern over stagnating job growth and the risk of a "two-speed economy," even as inflation remains uncomfortably elevated. Market-implied odds for a December cut have jumped to over 90% – up from ~30% just after the release of the October minutes – underscoring how sensitive market pricing remains to Fed communication. We believe the balance of risks – and Powell's preference for consensus given increasingly dovish Fed talk – tilts toward another 25bp reduction in December, but lingering divisions suggest the decision won't be unanimous. If delivered, the accompanying messaging will likely emphasize a higher bar for further cuts, aiming to preserve flexibility.

U.S. Labor Market

Private employment, 3M moving average of net change



Source: US Bank Economics; Bureau of Labor Statistic (BLS); Automatic Data Processing (ADP)

Looking ahead, the Fed's challenge extends beyond December. In 2026, the committee will need to navigate crosscurrents of slowing labor demand, sticky inflation and heightened uncertainty around fiscal policy. We expect the Fed to continue aligning its stance toward a long-run neutral estimate of 3.25% over the next year, but the path will be gradual and contingent on clearer signals from the data. Risks remain two-sided: a sharper slowdown in the labor market could accelerate easing, while persistent inflation might force a prolonged hold, leaving the Fed struggling to avoid stagflation.

Bottom line: We earlier believed that the Fed could hold rates at the December FOMC meeting, given sticky inflation and just okay BLS data. But Friday's disappointing ADP report and job growth narrowing to its tipping point has made us a believer that an "insurance" rate cut is the safest bet and will likely bring good cheer as we enter the New Year!

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	Actual		Forecast						Actual	Forecast	
	2025		2025		2026						
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	2024	2025	2026
Economic Data¹											
Nominal GDP	2.9	6.0	7.6	2.6	5.1	3.7	3.8	4.2	4.3	4.8	4.5
Real GDP	-0.6	3.8	3.1	0.9	1.7	1.8	1.8	1.9	2.0	2.0	1.9
Consumer Spending	0.6	2.5	3.0	1.0	1.4	1.6	1.8	2.0	2.9	2.5	1.7
Investment	23.3	-13.8	2.5	0.7	2.0	3.7	3.1	3.1	3.0	2.1	1.3
Residential Structures	-1.0	-5.1	-4.9	-0.9	0.1	1.0	2.5	2.5	3.2	-1.9	-0.5
Non-Residential Structures	-3.1	-7.5	-2.7	-2.0	0.9	2.2	2.2	2.2	1.1	-4.7	-0.2
Intellectual Property	6.5	15.0	4.0	2.8	2.1	2.8	2.8	2.8	3.5	5.3	3.5
Equipment	21.4	8.5	2.7	0.4	3.1	3.4	2.9	2.5	3.5	7.7	2.9
Change in Inventory	172.0	-18.3	-2.0	-1.6	-0.7	10.3	14.7	20.6	43.5	37.5	11.2
Government Spending	-1.0	-0.1	0.7	-2.0	2.1	0.2	0.2	0.6	3.8	1.2	0.3
Federal	-5.6	-5.3	-2.9	-8.0	4.7	0.0	0.0	0.1	3.8	-1.2	-1.1
State & Local	1.9	3.1	3.0	1.8	0.6	0.3	0.3	0.9	3.8	2.7	1.2
Imports	38.0	-29.3	-2.8	-2.1	1.4	0.6	2.0	3.0	5.8	2.9	-2.1
Exports	0.2	-1.8	0.0	0.5	1.3	0.7	2.0	2.6	3.6	0.7	0.9
Housing Starts	1.40	1.35	1.34	1.35	1.35	1.36	1.38	1.39	1.37	1.36	1.37
Unemployment Rate	4.1	4.2	4.3	4.5	4.7	4.7	4.6	4.5	4.0	4.3	4.6
Prices²											
Consumer Price Index	2.7	2.5	2.9	3.1	3.2	3.1	2.9	2.7	3.0	2.8	3.0
Core PCE Price Index	2.8	2.7	2.9	3.0	3.1	3.1	2.9	2.6	2.9	2.9	2.9
Interest rates³											
Federal Funds (Upper Target)	4.5	4.5	4.5	4.0	3.7	3.7	3.5	3.4	5.3	4.4	3.6
2-Yr Treasury Note	4.1	3.9	3.7	3.5	3.5	3.4	3.4	3.4	4.4	3.8	3.4
10-Yr Treasury Note	4.5	4.4	4.3	4.1	4.2	4.2	4.3	4.3	4.2	4.3	4.2
30-Yr Freddie Mac Mortgage	6.8	6.8	6.6	6.2	6.2	6.1	6.1	6.1	6.7	6.6	6.1

Forecast as of: December 3, 2025. Sources: U.S. Bank Economics, Moody's Analytics, and Bloomberg.

1. Projections for real GDP are quarter-on-quarter percent change at annual rate. Projections for housing starts in millions, annualized. Projections for the unemployment rate represent quarterly/annual averages.

2. Projections for the CPI, GDP Deflator, and Core PCE are year-over-year percent change.

3. Interest rate projections represent quarterly/annual averages, and are the views of the U.S. Bank Economics Group.



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