U.S. ECONOMIC OUTLOOK

Advancing to the next round

Summary: Our July 2026 U.S. economic outlook points to an expansion increasingly defined by divergence rather than broad-based strength. Consumer spending continues to support growth despite ongoing pressure on household purchasing power – with the FIFA World Cup and other summer experiences providing an additional near-term boost – while business investment remains concentrated in technology, AI and digital infrastructure. Revised data suggest households entered the year with somewhat larger savings buffers than previously estimated, providing a modest source of support for consumption. And the labor market has found firmer footing in recent months, though June's employment report suggests hiring momentum remains uneven, and conditions continue to resemble a "low-hire, low-fire" environment.

At the same time, inflation remains elevated, and progress toward the Federal Reserve's 2% objective remains uneven. While broader price pressures have not materially reaccelerated, recent data reinforce that the last mile back to target may be more persistent than previously anticipated. This combination of resilient activity, sticky inflation and a labor market finding firmer footing is likely to keep the Federal Reserve on hold through 2027. However, the June FOMC meeting signaled a more conditional and less transparent policy framework, making additional rate hikes a more credible risk.

- **Growth:** We expect real GDP growth of 2.2% Q4-over-Q4 in 2026 (2.2% annual average) and 2.3% Q4-over-Q4 in 2027 (2.2% annual average) as consumer spending moderates amid ongoing pressure on household purchasing power. Strength in AI-related investment should continue to offset weakness in residential construction, keeping growth mostly intact.
- **Labor market:** The labor market has found firmer footing, with low layoffs, moderate job growth and slower labor-force growth supporting near-term stability. We expect the unemployment rate to average roughly 4.4% in 2026 before edging down to 4.3% in 2027.
- **Inflation:** Inflation remains elevated. While lower energy prices and fading tariff pressures offer some relief, firm shelter and healthcare inflation in May suggest underlying price pressures remain stubborn. We continue to expect core Personal Consumption Expenditures (PCE) inflation to ease from 3.3% in Q2 2026 to near 2% by late 2027, though the path back to target is likely to remain uneven.
- **Federal Reserve:** The Federal Reserve is expected to remain on hold through 2027. With labor market conditions broadly stable and inflation still above target, policymakers appear increasingly focused on the Fed's price stability mandate, making additional rate hikes a more credible risk.
- **Risks:** We have reduced our 12-month recession probability to 25%, reflecting resilient economic activity, a firmer labor market, lower oil prices and easing concerns over this spring's energy shock. Nevertheless, thinning household financial buffers and the potential for renewed inflation pressures remain key downside risks to the expansion.

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U.S. Bank Economics Research Group July 2026 Macro forecast summary

	Actual 2025	Forecast 2026	Forecast 2027	Forecast 2028
Real GDP	2.1	2.2	2.2	2.3
Consumer Spending	2.6	1.8	1.9	2.1
Investment	1.9	4.1	5.8	4.3
Housing Starts	1.36	1.34	1.32	1.32
Unemployment Rate	4.3	4.4	4.3	4.2
Consumer Price Index	2.7	3.6	2.6	2.1
Core PCE Price Index	2.8	3.2	2.3	2.0
Federal Funds (Upper Target)	4.4	3.8	3.8	3.8

Forecast as of: July 1, 2026. Sources: U.S. Bank Economics, Moody's Analytics, and Bloomberg. 1. Projections for real GDP are annual percentage change. Projections for housing starts are 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:

Happy Birthday, America! A 'grand experiment' in resilience

As the United States celebrates its 250th birthday, there are many things I'm proud of. The ingenuity of the American people led to innovations like the automobile and the airplane – transformations that still move people and goods around the world every day. The U.S. also led in transporting ideas across cyberspace, and today it appears to have a front row seat in the AI initiative as well.

That ingenuity and independence is also, I believe, at the heart of the 'grand experiment' at the birth of this nation. The "American experiment" was a bold bet made 250 years ago that regular citizens – not kings, dukes or aristocracy – could govern themselves.

Of course, there are still plenty of economic challenges this 'new' country faces today: the post-pandemic jump in prices, together with a tariff war and the war with Iran, has weakened household purchasing power and is on the minds of many Americans as they enter this summer's vacation season.

And yet, the U.S. has a stubborn habit of absorbing shocks, arguing loudly about them and then muddling through better than expected. U.S. ingenuity has learned to confront shocks, with the U.S. economic expansion quick to recover today. Last week, my team lowered the risk of recession to 25% from 30% – another small reason to celebrate the country's resilience 250 years in. Which brings us back to the quote that still captures the 'grand experiment' best: "Americans will always do the right thing, once they have exhausted all other possibilities."

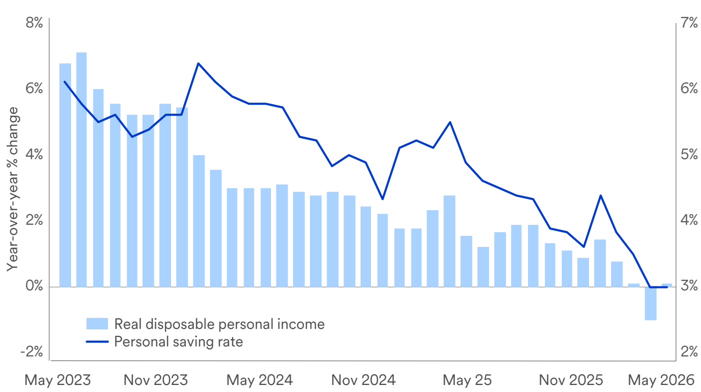
Read the full commentary here >

Consumer spending: Resilient, but still constrained

Consumer spending has remained more resilient than expected, continuing to support overall economic growth despite elevated interest rates and lingering inflation pressures. Recent retail sales data point to firmer demand, particularly for goods, while real personal consumption expenditures (PCE) continue to expand at a moderate pace. Major summer events – including the 2026 FIFA World Cup – may provide an additional, though likely temporary, boost to discretionary spending on travel, entertainment and hospitality-related services in the months ahead. That said, spending growth remains well below the outsized gains seen earlier in the expansion, suggesting consumer activity is increasingly being supported by stability rather than momentum.

At the same time, household purchasing power remains under pressure. While personal income growth improved in May and real disposable income returned to roughly flat on a year-over-year basis, several years of elevated inflation have eroded much of the purchasing power households built up during the postpandemic recovery. The recent retracement in oil prices offers a potential source of relief, particularly if lower gasoline and transportation costs begin to ease pressure on household budgets in the months ahead. However, lower energy prices alone are unlikely to fully offset the cumulative impact of elevated living costs, suggesting any improvement in purchasing power is more likely to be incremental than transformative.

U.S. Household Financial Health

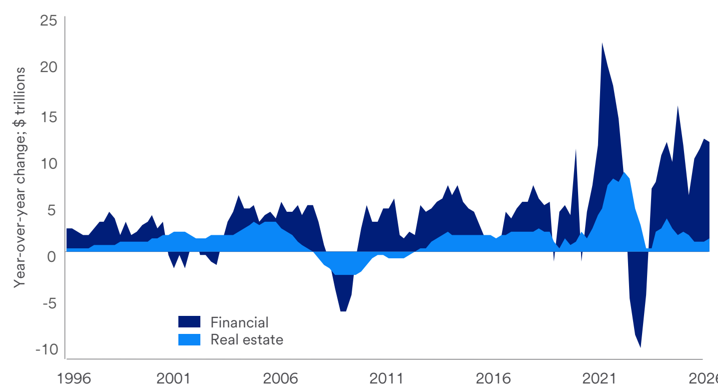


Source: U.S. Bank Economics, U.S. Bureau of Economic Analysis (BEA), Bloomberg

Household balance sheets continue to provide an important source of support. Strong financial asset values and accumulated housing wealth have helped sustain household net worth, while debt service burdens remain relatively manageable despite higher interest rates. Nevertheless, the personal saving rate remains near cycle lows, suggesting many households are either drawing on existing financial buffers or have limited capacity to rebuild them as day-to-day expenses continue to absorb much of their income growth. As a result, balance sheets continue to support consumption, but the margin for absorbing future economic or inflation-related shocks may be limited.

The aggregate picture also masks meaningful divergence beneath the surface. Higher-income households continue to benefit from stronger balance sheets, accumulated wealth gains and greater flexibility in absorbing elevated costs, while lower- and middle-income consumers remain more exposed to inflation and borrowing costs. Signs of stress persist among more credit-constrained borrowers, even as overall spending remains intact. This uneven footing helps explain why consumer activity has remained more resilient than broader sentiment measures might suggest, but it also highlights the limits of that resilience. As a result, the outlook remains one of continued spending growth, albeit at a slower and increasingly uneven pace across households.

U.S. Household Wealth



Source: U.S. Bank Economics, U.S. Bureau of Economic Analysis (BEA), Bloomberg

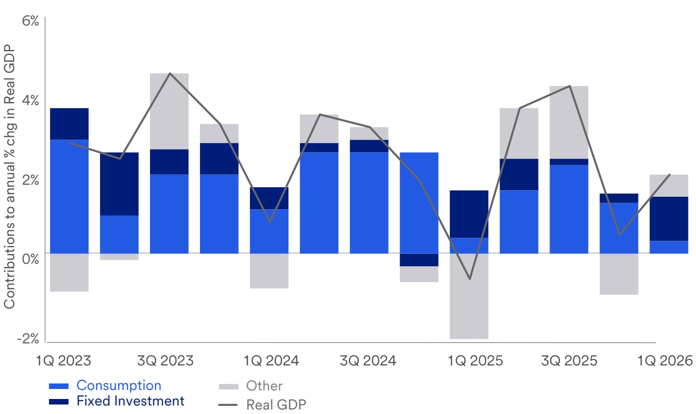
Business investment: Technology leads while housing stabilizes

Business investment continues to underpin economic growth, though momentum remains concentrated in a narrow set of technology-linked categories. Spending tied to artificial intelligence (AI), digital infrastructure and other productivity-enhancing investments is driving much of the activity, while more traditional capital spending remains uneven. This pattern suggests firms are still willing to deploy capital where long-term efficiency gains and strategic advantages are clear, even as elevated borrowing costs and a more uncertain outlook temper broader investment appetite.

Against this backdrop, nonresidential investment should remain supported by the physical buildout required to enable AI and broader digital transformation – particularly in data centers, semiconductors and electrical infrastructure. Incentives embedded in recent tax policy changes may further reinforce spending on equipment, research and modernization efforts, helping offset some of the drag from still-high financing costs. At the same time, businesses appear increasingly focused on demonstrating returns on investment, suggesting that future spending decisions may become more selective as firms balance growth ambitions against profitability and capital discipline.

By comparison, residential investment is beginning to regain footing after several years of pressure from higher financing costs. Activity has stabilized as inventories have improved modestly and buyers and sellers have gradually adjusted to a higher-rate environment. That said, affordability constraints and still-elevated mortgage rates continue to weigh on both transaction volumes and new construction. As a result, while housing is unlikely to reemerge as a primary growth engine in the near term, it is increasingly positioned to transition from a drag to a modest – albeit still limited – source of support as conditions slowly improve.

U.S. Economic Growth



Source: U.S. Bank Economics, U.S. Bureau of Labor Statistics (BLS), Bloomberg

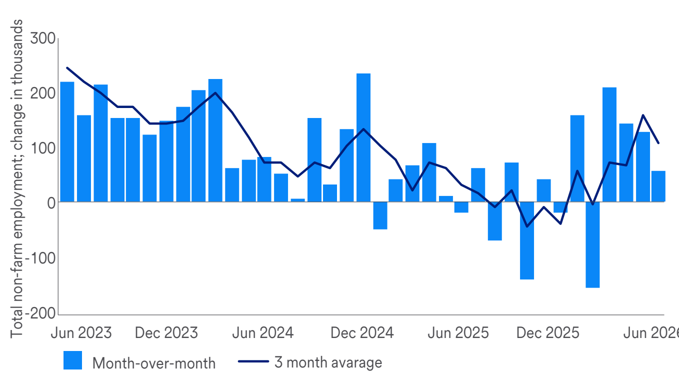
Labor market: Firmer footing, limited tightening

The labor market has shown firmer footing in recent months, though June's employment report suggests hiring momentum has cooled from the stronger pace observed earlier this spring. Nonfarm payrolls rose 57,000 in June, while prior months were revised lower by a combined 74,000, reducing the three-month average pace of job growth to roughly 111,000. Even so, unemployment remains low at 4.2%, layoffs remain contained, and hiring continues to exceed the pace needed to absorb slower labor-force growth. Taken together, the labor market appears stable, though hiring conditions remain uneven across sectors.

Importantly, adjustment continues to occur primarily through restraint rather than retrenchment. Layoffs remain limited, with initial jobless claims still offering little evidence of a meaningful rise in separations. Instead, firms seem to be managing softer conditions by adjusting along the margins. Variability in hours worked and an upward trend in involuntary part-time employment point to some easing in labor demand, while wage growth has continued to trend lower toward 3%, reinforcing that improved hiring conditions have not translated into renewed labor market pressure. Slower labor-force growth is also reducing the pace of job creation needed to maintain balance, while emerging technologies such as AI appear to be influencing employment primarily through productivity and efficiency gains rather than outright displacement.

Looking ahead, we expect the labor market to remain in a state of cautious stability. Payroll growth may show some near-term variability following firmer readings, but the broader trend should remain consistent with moderate hiring and a gradual drift higher in the unemployment rate. While the underlying 'low-hire, low-fire' dynamic leaves the labor market sensitive to any increase in layoffs, the recent pickup in hiring helps reduce downside concerns. At the same time, steady employment alongside moderating wage growth suggests the labor market's contribution to inflation pressures continues to ease. For policymakers, this reinforces a backdrop in which labor conditions are not re-tightening but remain sufficiently resilient to support a patient, higher-for-longer policy stance.

U.S. Labor Market



Source: U.S. Bank Economics, U.S. Bureau of Labor Statistics (BLS), Bloomberg

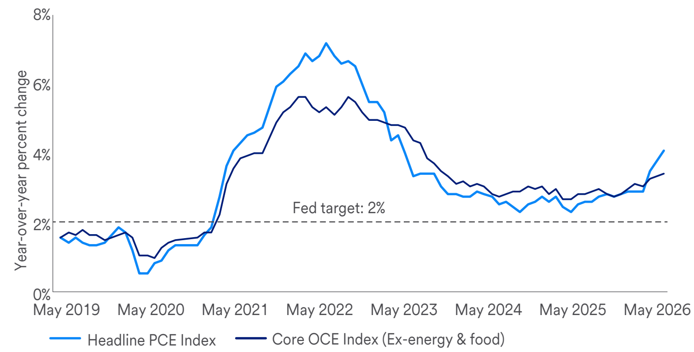
Inflation: Sticky, but narrowing

Inflation remains elevated and has shown only limited progress toward the Federal Reserve's 2% target in recent months. May's Personal Consumption Expenditures (PCE) report underscored that challenge, with headline prices rising 0.4% month-over-month and 4.1% year-over-year, while core PCE increased 0.3% on the month and accelerated to 3.4% year-over-year. Specifically, core services prices excluding housing – often viewed as a gauge of underlying, labor-intensive inflation pressures – rose 0.5% month-over-month, reinforcing that services inflation remains a primary source of stickiness. On a shorter-term basis, core inflation continues to run at a pace well above target, suggesting that the challenge has shifted from renewed acceleration to lingering persistence.

At the same time, the composition of inflation has become more favorable. Much of the tariff-related impulse that lifted goods prices earlier this year now appears to be behind us, with pass-through effects fading and modest goods disinflation reemerging. Likewise, the inflationary impact from this spring's energy shock has remained relatively contained, with spillovers largely limited to transportation-related categories such as airfares. Strong summer travel demand and events such as the FIFA World Cup may contribute to temporary firmness in select service categories, but housing inflation continues to cool gradually, while several measures of underlying services inflation have shown tentative improvement. Taken together, the recent data highlight sticky inflation, but with signs of reprieve from the spring highs.

Looking ahead, inflation is likely to remain elevated, but with greater volatility and a less predictable path than expected earlier this year. Importantly, oil prices have retraced sharply from their spring highs as concerns over global supply disruptions have eased, removing what had become one of the most significant upside risks to the inflation outlook. Lower energy costs should help ease pressure on both headline inflation and household purchasing power in the months ahead, particularly if crude prices remain near current levels. Even so, consumer demand remains resilient and policymakers are unlikely to interpret a few softer inflation readings as evidence that the job is finished. Our baseline still anticipates some easing in underlying price pressures during the second half of 2026 as temporary distortions fade and goods disinflation resumes. However, progress is likely to remain uneven, leaving the Fed cautious and increasingly sensitive to upside inflation surprises.

U.S. Inflation



Source: U.S. Bank Economics, U.S. Bureau of Labor Statistics (BLS), Bloomberg

Monetary policy: Deliberate ambiguity

While the Federal Reserve remains firmly on hold, the June FOMC meeting marked a meaningful shift in both how policy is communicated and how future decisions will be framed. The federal funds rate was left unchanged at 3.50% to 3.75%, but the more important development was a transition from a conditional – yet still somewhat guided – framework to one that is more explicitly open-ended. Under new Chair Kevin Warsh, the post-meeting statement was substantially shortened, eliminating much of its forward-looking language while placing greater emphasis on the Fed's price stability objective. At the same time, officials stressed that projections should be viewed as conditional rather than directional, reinforcing a more data-dependent and less prescriptive approach to policy.

The meeting also reinforced a firmer tilt in the Fed's underlying reaction function. Updated projections showed higher expected inflation and a modestly higher policy path, with the median federal funds rate rising to 3.8% by year-end and a growing share of participants penciling in potential rate increases. More broadly, policymakers appear less focused on preparing for eventual easing and more concerned with ensuring inflation returns sustainably to target. Stronger recent inflation readings – driven in part by energy and tariff dynamics, but increasingly evident across core components – continue to leave inflation as the binding constraint on policy.

Importantly, this increased emphasis on inflation is occurring alongside an economy that has not weakened enough to compel a policy response. Growth has moderated but remains positive, while labor market conditions remain broadly stable, reinforcing the Fed's willingness to remain patient. At the same time, financial conditions and real policy rates may be less restrictive than headline measures suggest as inflation firms. This creates a subtle tension, where holding nominal rates steady may effectively ease policy at the margin, complicating the Fed's effort to maintain sufficient restraint to bring inflation back to target.

Taken together, these dynamics point to a policy framework that is not only conditional, but increasingly asymmetric and less transparent. Holding rates steady remains our base case, but the balance of risks has shifted, with the threshold for easing rising further while the possibility of renewed tightening, though still a tail risk, has become more credible. With forward guidance scaled back and the signaling value of tools like the dot plot diminished, the range of potential outcomes has widened and market pricing is likely to play a greater role in shaping expectations. Our July baseline remains largely unchanged, and we continue to expect the Federal Reserve to remain on hold through 2027. While a path back to easing could eventually emerge as inflation pressures recede and labor market softening unfolds, those conditions remain incomplete, reinforcing a higher-for-longer stance for now.

U.S. Bank Economics Research Group July 2026 Macro forecast summary

	Actual		Forecast						Actual	Forecast	
	2025	2026	2026			2027					
	4Q	1Q	2Q	3Q	4Q	1Q	2Q	3Q	2025	2026	2027
Economic Data[1]											
Nominal GDP	4.2	5.8	7.3	5.5	4.3	4.1	4.2	4.2	5.0	6.0	4.5
Real GDP	0.5	2.1	2.2	2.4	2.0	2.2	2.4	2.5	2.1	2.2	2.2
Consumer Spending	1.9	0.5	2.3	1.6	1.6	2.0	2.0	2.2	2.6	1.8	1.9
Investment	2.3	7.9	7.0	8.1	5.9	5.6	5.4	5.0	1.9	4.1	5.8
Residential Structures	-1.7	-7.8	-1.0	0.1	0.8	1.7	2.0	1.8	-2.2	-3.7	1.2
Non-Residential Structures	-6.5	-4.7	-1.4	0.5	1.7	2.0	2.5	2.3	-5.3	-3.6	1.7
Intellectual Property	5.4	13.8	6.4	6.1	6.3	6.2	6.5	6.3	5.6	8.4	6.3
Equipment	4.3	15.8	10.5	9.3	9.0	9.0	6.9	5.7	8.3	9.6	7.9
Change in Inventory	-15.6	-16.7	-0.3	27.8	30.0	26.8	26.2	27.6	28.5	10.2	27.3
Government Spending	-5.6	4.4	1.9	0.5	1.9	1.1	1.5	1.5	1.1	0.8	1.3
Federal	-16.6	9.4	3.7	1.5	2.2	1.4	2.1	2.2	-1.2	-0.2	2.0
State & Local	1.5	1.6	0.9	-0.1	1.6	0.9	1.1	1.2	2.5	1.4	0.9
Imports	-1.0	11.8	11.0	3.4	5.7	5.1	4.9	4.8	2.7	2.6	5.2
Exports	-3.2	10.9	6.0	2.4	3.5	3.0	4.0	4.3	1.6	4.7	3.6
Housing Starts	1.32	1.42	1.32	1.32	1.31	1.32	1.33	1.33	1.36	1.34	1.32
Unemployment Rate	4.5	4.3	4.3	4.4	4.4	4.3	4.3	4.3	4.3	4.4	4.3
Prices[2]											
Consumer Price Index	2.7	2.7	4.0	3.9	3.7	3.5	2.4	2.3	2.7	3.6	2.6
Core PCE Price Index	2.9	3.1	3.3	3.2	3.1	2.6	2.5	2.3	2.8	3.2	2.3
Interest rates[3]											
Federal Funds (Upper Target)	4.02	3.75	3.75	3.76	3.76	3.76	3.76	3.76	4.37	3.76	3.76
2-Yr Treasury Note	3.52	3.58	3.97	4.01	3.90	3.87	3.86	3.85	3.81	3.87	3.86
10-Yr Treasury Note	4.10	4.20	4.43	4.49	4.50	4.50	4.50	4.50	4.29	4.40	4.50
30-Yr Freddie Mac Mortgage	6.23	6.11	6.41	6.36	6.28	6.26	6.25	6.25	6.60	6.29	6.25

Forecast as of July 1, 2026. 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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