

U.S. ECONOMIC OUTLOOK

Oil's well – for now

Summary: Our May 2026 U.S. economic outlook centers on an economy that remains resilient but increasingly constrained by higher prices and thinning buffers. A renewed energy shock is lifting headline inflation and weighing on real incomes, even as underlying domestic demand remains constructive, and the labor market cools in an orderly fashion. Growth has slowed to a more sustainable pace, supported by steady private sector demand, with consumers continuing to spend through savings drawdowns and balance sheet flexibility rather than rising job losses.

At the same time, near-term inflation pressures have firmed, largely reflecting energy pass-through and tariff-related goods pressures – leaving the Federal Reserve firmly in a patient, risk management mode. With labor conditions broadly stable and long-run inflation expectations still anchored, policymakers are prioritizing credibility over preemptive easing as they assess whether recent inflation impulses fade. In this environment, our base case remains continued normalization rather than recession – slower but positive growth, a labor market characterized by defensive stability, and eventual disinflation that opens the door to policy easing once clearer, sustained progress on core inflation reemerges.

- **Growth:** We forecast real GDP growth of 2.2% on a Q4-over-Q4 basis in 2026 (2.3% annual average), with headline growth moderated by the impact of higher energy prices and firmer inflation but underlying domestic demand remaining constructive. Consumer spending slows modestly as real purchasing power is pressured, yet strength in AI-related investment, productivity gains and a rebound in government spending keep the expansion on a stable, albeit slower, footing rather than stalling.
- **Labor Market:** Conditions continue to normalize without unraveling. We expect the unemployment rate to drift modestly higher toward ~4.6% by late 2026, as hiring remains subdued amid slower labor force growth. Recent indicators – volatile payrolls, low hiring rates and historically low jobless claims – continue to point to a 'low-hire, low-fire' equilibrium. This supports near-term stability but leaves the labor market increasingly sensitive to adverse shocks.
- **Inflation:** Inflation pressures have firmed in the near term, reflecting energy pass-through and tariff-related goods pressures, even as underlying disinflationary forces remain intact. We expect core Personal Consumption Expenditures (PCE) inflation to peak in Q2 2026 around 3.3% on a year-ago basis, before easing gradually toward the Fed's 2% goal by the start of 2028, as goods prices normalize, shelter continues to cool and wage growth moderates.

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- **Federal Reserve:** The Fed remains firmly on hold, with recent communications reinforcing a cautious, risk management posture amid firmer inflation and elevated energy-related uncertainty. With labor conditions broadly stable and inflation progress uneven, policymakers are increasingly reluctant to pre-commit to near-term easing. We continue to expect two 25 basis point (bp) rate cuts – in December 2026 and June 2027 – leaving the terminal policy rate unchanged at 3.00%–3.25%.
- **Risks:** Downside risks have moderated, and we have lowered our 12-month recession probability to 30%, reflecting resilient incoming data, continued labor market stability, and easing concerns around Middle East disruptions. While the baseline remains slower growth rather than contraction, risks persist. Sustained energy inflation, thinner household buffers and policy uncertainty could still test the expansion if pressures intensify or conditions deteriorate more abruptly.

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

	Actual 2025	Forecast 2026	Forecast 2027	Forecast 2028
Real GDP	2.1	2.2	2.1	2.2
Consumer Spending	2.6	2.0	1.9	2.0
Investment	1.9	3.7	4.4	3.6
Housing Starts	1.36	1.36	1.31	1.31
Unemployment Rate	4.3	4.5	4.5	4.4
Consumer Price Index	2.7	3.4	2.4	2.1
Core PCE Price Index	2.8	3.2	2.3	2.0
Federal Funds (Upper Target)	4.4	3.7	3.3	3.2

Forecast as of May 4, 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: Energy inflation pass-through: Silence of the core

Core consumer prices were ‘silent’ in March despite the jump in energy prices. Long-term market inflation expectations also appear to be stable. On the flip side, the Fed’s other mandate, maximum employment, is also holding up relatively well with initial jobless claims the lowest in decades. While hiring has slowed with the jobs market cooling, most workers are still holding onto their jobs.

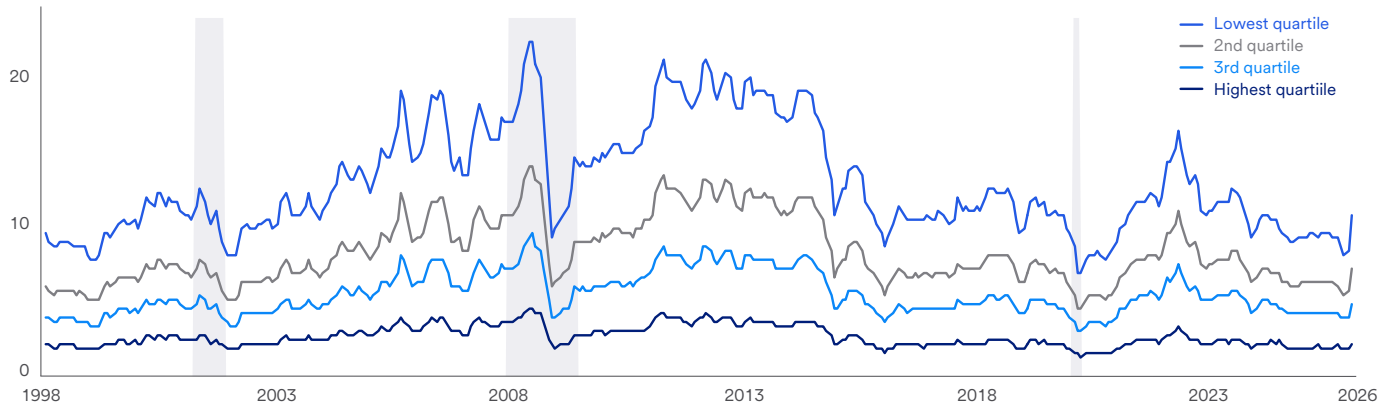
But while retail sales in the U.S. and other markets have shown short-term resilience despite the war’s impact, fatigue will eventually set in as cost pressures mount. A good rule of thumb is that for every \$10 increase in a barrel of West Texas Intermediate crude (WTI), 25 cents is added to a gallon of gas. With oil prices more than \$30 over pre-war prices, those quarters start to add up! And the pain is more acute for lower-wage workers.

The average worker in the U.S. needs to work five hours to pay for the gasoline required to commute to work each month. Given current fuel efficiency, that’s much lower than the nine hours needed in 1976. But workers with lower paying jobs need to work almost 11 hours to pay for their commute today, while workers with higher paying jobs only need to work less than two hours. Higher spending for gasoline means less available for discretionary spending.

No policy action at the Fed’s April meeting was all but ensured from an increasingly divided Committee. Looking at risks today based on the data available, the damage from higher prices currently outweighs job market concerns. But with core inflation modest, wage gains softer and long-term inflation expectations low, I still expect the next cut to be delivered “just in time for the holidays,” at year end.

Average hours of work needed for gas to drive to work each month by hourly wage distribution

Monthly, January 1976-March 2026



Sources: Census, St. Louis FRED, AAA.com, EPA, U.S. Bank Economics calculations

[Read the full commentary here >](#)

Economy: Resilient demand, thinning margins

Real GDP expanded at a 2.0% annualized pace in Q1 2026, rebounding from a sluggish 0.5% pace in Q4 but coming in modestly below expectations. At face value, the headline points to only a middling pickup in momentum. However, the topline likely overstates any loss of underlying strength. Growth was weighed down by a sharp rise in imports, while domestic activity remained constructive, supported in part by a rebound in government outlays following last quarter's shutdown-related drag.

Stripping out trade and other volatile components, underlying demand continues to look healthier than the headline GDP figure alone suggests. Real final sales to private domestic purchasers rose a solid 2.5% annualized in Q1, pointing to steady trend-like growth across the private sector. Business investment was a notable source of support, with strength concentrated in intellectual property and AI-related spending, while consumer outlays continued to advance. At the same time, price pressures firmed over the quarter, pushing nominal GDP growth to a robust 5.6% annualized pace – with roughly 3.6 percentage points of that increase reflecting inflation – and underscoring that aggregate demand remains resilient, even as the composition of growth becomes more uneven beneath the surface.

That unevenness is most evident in the growing tension between resilient spending and pressured real incomes. While nominal income growth has remained positive, higher prices have continued to erode purchasing power, with real disposable income declining in four of the past six months through March. Even so, consumption has yet to slow meaningfully. The result is an economy where demand remains intact, but increasingly dependent on households' willingness and ability to absorb higher costs – suggesting resilience is being sustained through adjustment rather than outright income strength.

Consumer spending has held up in part because households are moving through a familiar sequence of balance sheet buffers. The initial adjustment has been a sustained drawdown in savings, with the personal saving rate falling into the mid-3% range in March – down from nearer 5% at this time last year – and helping cushion consumption as real incomes compress. Importantly, this adjustment has not yet involved a material shift toward borrowing, as revolving credit growth remains relatively modest. Looking ahead, further erosion of savings is likely to lead to greater reliance on credit card use, a transition that would initially be cushioned by historically low debt service burdens and support a more stable near-term outlook. The key risk, therefore, lies not in higher credit use itself, but in a scenario where rising servicing costs or tighter lending conditions begin to strain household cash flows more meaningfully.

Housing wealth represents another – perhaps larger – potential buffer in this process, but it has remained largely inactive. Home equity is abundant by historical standards, with outstanding mortgage debt amounting to only about 25-30% of the value of household real estate – implying that the vast majority of housing value is held as equity. Yet rate lock-in has rendered much of that equity effectively illiquid, as tapping it through refinancing or home equity lines of credit (HELOCs) would require borrowing at materially higher rates. As a result, consumption resilience has thus far been sustained through savings, credit and more liquid financial assets, with housing equity acting as a latent backstop rather than an active source of spending power. While this configuration supports near-term durability in consumer demand, it also implies diminishing buffers over time, leaving spending increasingly sensitive to labor-income dynamics, credit conditions and the persistence of inflation.

U.S. Personal Saving Rate



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

Labor Market: Defensive stability takes hold

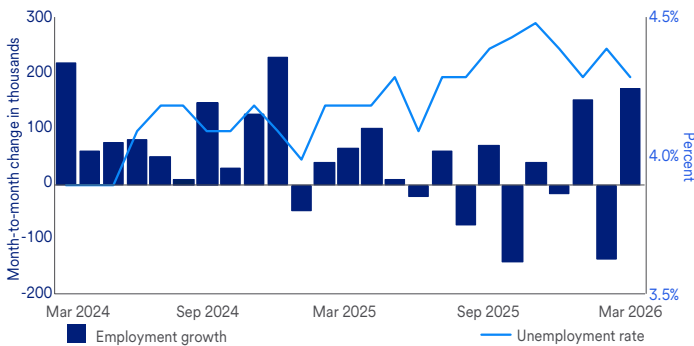
The labor market continues to settle into a slower, more normalized regime – one defined less by rising job losses and more by subdued hiring and limited churn. March’s employment report delivered a notable rebound, with payrolls rising +178,000 and the unemployment rate edging down to 4.3%, partially reversing February’s stall-speed narrative. At face value, the headlines eased near-term concerns about deterioration, with job gains broadening across several service- and goods-producing sectors. Even so, recent payroll prints have been unusually volatile, reflecting temporary factors such as weather normalization and strike reversals. Smoothing through that noise, underlying momentum appears more restrained, consistent with stabilization at a slower pace.

The labor market’s ability to absorb more measured job growth without a material rise in unemployment reflects important structural adjustments. Slower labor force growth – driven by demographics and less supportive immigration flows – has lowered the amount of hiring needed to maintain balance. As a result, modest or even near-flat monthly job gains can coexist with only a gradual increase in unemployment, supporting the view that the economy remains near potential rather than slipping into contraction. At the same time, this configuration leaves a smaller margin for error if hiring fails to hold near current levels.

Labor demand indicators continue to reinforce the picture of a low-churn equilibrium. Job Openings and Labor Turnover Survey (JOLTS) data show hiring rates near cycle lows and quits subdued, signaling limited job-switching opportunities and easing wage pressures. Yet layoffs have not risen meaningfully, a dynamic reinforced by weekly jobless claims holding near the low end of their recent range, including an unexpected late-April drop to a 50-year low of 189,000. Measures outside the official data tell a similar story. Online job postings from Indeed have flattened in recent months after a prolonged decline, suggesting that firms have largely stopped pulling back on labor demand even as they remain cautious about adding headcount. Taken together, these trends point to a labor market that is cooling and recalibrating, not unraveling – exhibiting a form of defensive stability in which employers respond to uncertainty by pausing hiring rather than initiating broad-based job cuts.

Looking ahead, we expect payroll growth to run near stall speed through the first half of 2026, consistent with unemployment drifting modestly higher but remaining in the mid-4% range. The most likely path remains continued normalization, supported by easing wage pressures and ongoing labor hoarding. Risks, however, remain tilted modestly to the downside. In a low-hiring environment, even a modest pickup in layoffs – whether driven by policy uncertainty, tighter financial conditions or sector-specific shocks – could translate more quickly into higher unemployment than in a higher-turnover labor market. For now, the continued absence of broad-based job losses supports a patient outlook, though sustaining this equilibrium will depend on hiring holding steady as the macro backdrop remains uncertain into mid-year.

U.S. Labor Market



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

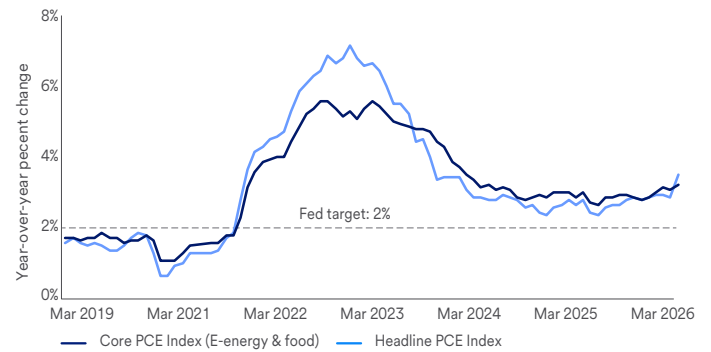
Inflation: An energy shock heard ‘round the world’

Inflation pressures firmed in early 2026, posing another challenge to the disinflation process that has remained uneven. The March PCE inflation report highlighted a jump in airfares, marking the first clear sign that energy pass-through to core prices has begun. Headline PCE rose a sharp 0.7% month-to-month, lifting the year-over-year rate to a three-year high of 3.5%, driven largely by higher energy prices. Core PCE increased a solid 0.3% on the month and 3.2% over the year – still well above the Fed’s 2% target. Sequential inflation measures also accelerated through the first quarter, reflecting a mix of residual seasonality effects, firmer core services pressures and tariff-related goods inflation. Recent trade data reinforce the role of price dynamics, with March’s widening real merchandise trade deficit reflecting higher import values and acting as an additional drag on real activity. While the recent upside does not yet point to a broad reacceleration, it underscores that underlying inflation momentum remains ‘sticky,’ leaving little room for complacency as energy and geopolitical risks persist.

Recognizing increased uncertainty from the war, we continue to expect core inflation to cool gradually once the near-term tariff impulse fades and energy prices moderate – consistent with our assumption that the conflict remains limited. In our baseline, core PCE inflation peaks around 3.3% on a Q2-over-Q2 basis in 2026 before easing to about 2.6% by early 2027, driven by normalization in core goods prices, a contained energy price pass-through, continued moderation in shelter, and only gradual easing in non-housing services as wage growth cools. While the disinflation process is likely to remain slow and uneven, firmer prints early this year do not, in our view, derail the broader trend – supporting expectations

that policy easing becomes more likely once core inflation measures show clearer and more durable progress later this year and into 2027.

U.S. Inflation



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

Monetary Policy: Patience, optionality and a higher bar

The Federal Reserve remains firmly in a holding pattern, with its posture best characterized as cautious patience rather than imminent easing. At the April Federal Open Market Committee (FOMC) meeting, policymakers maintained the federal funds rate target range at 3.50%–3.75% and reaffirmed that inflation remains elevated, in part reflecting higher energy prices and tariff-related pressures, while geopolitical developments continue to add uncertainty to the outlook. In effect, the Committee emphasized that it is comfortable waiting for clearer evidence on whether recent inflation impulses fade or broaden, reinforcing that the current stance reflects deliberate risk management rather than indecision.

What has evolved in recent months is less the policy setting itself than the Fed’s signaling discipline. The April decision featured an unusually wide set of dissents, highlighting growing unease with maintaining an explicit easing bias (over the word “additional” in the statement) in the face of firmer inflation data. Governor Miran again dissented in favor of an immediate rate cut, while regional presidents Hammack, Kashkari and Logan opposed retaining forward-guidance language seen as implying future easing. Chair Powell framed these differences as a debate about timing and uncertainty, not direction – underscoring that “nobody’s calling for a hike,” but that any eventual easing is becoming more conditional. Taken together, the outcome reinforced a Fed increasingly reluctant to pre-commit to rate cuts before inflation progress is clearer.

At the core of the Fed's reaction function remains a strong emphasis on inflation credibility. Policymakers continue to view the anchoring of long-run inflation expectations as the binding constraint after several years of above-target inflation. While near-term expectations have moved higher – largely reflecting energy prices – longer-term expectations remain broadly consistent with the Fed's 2% goal. This combination helps explain the current posture. Officials see no urgency to tighten further, but insufficient confirmation to resume easing. Moreover, the leadership transition now underway seems to reinforce continuity rather than disruption, with incoming Chair nominee Kevin Warsh emphasizing Fed independence, no pre-commitment on near-term rate moves, and potential longer-run refinements to the framework and communications more than any immediate shift in policy direction.

The bottom line is that the Fed's stance reflects confidence in underlying economic momentum, caution on inflation, and a strong preference for preserving policy optionality. With labor market conditions still broadly stable and inflation risks skewed to the upside, officials are comfortable remaining on hold while awaiting clearer signals. We continue to expect policy rates to remain unchanged in the near term, with two additional cuts in our baseline outlook – one in December 2026 and another in June 2027 – contingent on inflation eventually resuming a durable glide toward 2%.

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

	Actual	Forecast							Actual	Forecast	
	2025	2026				2027					
	4Q	1Q	2Q	3Q	4Q	1Q	2Q	3Q	2025	2026	2027

Economic Data¹

Nominal GDP	4.2	5.6	8.5	4.1	3.7	4.1	4.6	4.6	5.0	5.9	4.5
Real GDP	0.5	2.0	2.3	1.9	2.0	2.2	2.3	2.3	2.1	2.2	2.1
Consumer Spending	1.9	1.6	1.7	1.6	1.8	2.0	2.0	2.0	2.6	2.0	1.9
Investment	2.3	8.7	6.3	5.2	4.2	4.3	4.0	3.9	1.9	3.7	4.4
Residential Structures	-1.7	-8.0	-0.1	0.0	0.2	0.2	0.2	0.2	-2.2	-3.6	0.2
Non-Residential Structures	-6.5	-6.7	3.7	4.5	3.8	3.0	2.6	2.5	-5.3	-2.6	3.2
Intellectual Property	5.4	13.0	6.0	5.5	5.0	5.0	5.0	5.0	5.6	7.9	5.1
Equipment	4.3	17.2	8.7	6.9	4.7	5.2	4.4	4.1	8.3	9.0	5.1
Change in Inventory	-16.0	-8.0	0.0	3.0	5.0	8.0	10.0	13.0	29.0	0.0	11.0
Government Spending	-5.6	4.4	1.9	0.8	1.2	1.0	1.4	1.4	1.1	0.8	1.2
Federal	-16.6	9.3	4.2	1.3	2.4	1.7	2.1	2.0	-1.2	-0.1	2.1
State & Local	1.5	1.6	0.5	0.5	0.5	0.5	1.0	1.0	2.5	1.3	0.7
Imports	-1.0	21.4	7.0	3.5	3.0	2.5	2.0	2.0	2.7	3.8	2.8
Exports	-3.2	12.9	7.0	2.5	2.0	2.0	2.0	2.0	1.6	5.3	2.4
Housing Starts	1,323	1,419	1,369	1,337	1,311	1,310	1,313	1,313	1,356	1,359	1,313
Unemployment Rate	4.5	4.3	4.5	4.6	4.6	4.6	4.5	4.4	4.3	4.5	4.5

Prices²

Consumer Price Index	2.7	2.7	3.8	3.6	3.4	3.0	2.1	2.2	2.7	3.4	2.4
Core PCE Price Index	2.9	3.1	3.3	3.2	3.1	2.6	2.4	2.2	2.8	3.2	2.3

Interest rates³

Federal Funds (Upper Target)	4.02	3.75	3.71	3.69	3.63	3.44	3.42	3.19	4.37	3.70	3.31
2-Yr Treasury Note	3.52	3.58	3.71	3.57	3.48	3.43	3.40	3.38	3.81	3.59	3.40
10-Yr Treasury Note	4.10	4.20	4.29	4.29	4.30	4.30	4.30	4.30	4.29	4.27	4.30
30-Yr Freddie Mac Mortgage	6.23	6.11	6.26	6.18	6.13	6.10	6.08	6.07	6.60	6.17	6.08

Forecast as of: May 4, 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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