

U.S. ECONOMIC OUTLOOK

# Mounting risks beneath a surface of resilience

- Our October 2025 U.S. economic outlook highlights mounting risks beneath a surface of resilience. A government shutdown adds fiscal uncertainty to an economy already contending with tariffs and political gridlock. Consumer spending remains surprisingly strong, but gains are concentrated among high-income households and may prove unsustainable. The labor market shows a “low-hire, low-fire” dynamic – stable for now, yet fragile if layoffs rise. Meanwhile, inflation sends mixed signals: producer margins are squeezed even as consumer prices climb, leaving the Fed caught between sticky inflation pressures and a softening jobs market.
- We raised our third quarter real GDP tracking estimate by 1.4% to +2.5% annualized, marking an acceleration from the +1.6% pace in the first half of 2025 amid tariff-driven swings in imports and inventories. The cleaner Q3 figure largely reflects stronger consumer spending in July and August.
- With tariff-related price pass-through continuing to erode purchasing power, we expect firm inflation, further labor market softening, and slower growth ahead. Real GDP is forecast to grow just 0.5% annualized in Q4, reflecting both the drag from the government shutdown and weaker consumer demand, before rebounding modestly in early 2026 as the reopening and One Big Beautiful Bill Act (OBBBA) fiscal impulse kicks in. Core PCE inflation peaks at 3.2% year-over-year (YoY) by 4Q25, while the unemployment rate drifts up to 4.5% over the winter.

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**U.S. Bank Economics Research Group October 2025 Macro forecast summary**

	Actual 2024	Forecast 2025	Forecast 2026	Forecast 2027
Real GDP	2.8	1.9	1.7	2.0
Consumer Spending	2.9	2.5	1.6	2.0
Investment	3.0	2.3	1.6	3.0
Housing Starts	1.37	1.36	1.37	1.40
Unemployment Rate	4.0	4.3	4.5	4.4
Consumer Price Index	3.0	2.9	3.0	2.2
Core PCE Price Index	2.9	2.9	2.9	2.1
Federal Funds (Upper Target)	5.3	4.4	3.6	3.3

Forecast as of October 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.

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**Mounting risks beneath a surface of resilience – continued from previous page**

- The Fed delivered its first rate cut of 2025 at the September Federal Open Market Committee (FOMC) meeting, lowering the target range to 4.00–4.25% after months of holding steady amid inflation concerns. The move reflects a clear pivot toward labor market support, with downside employment risks now prioritized. We continue to expect three 25-basis point (bp) rate cuts by the Fed this year – each in September, October and December – and another 50bp next year, for a terminal rate of 3.00–3.25%.
- The risk to our baseline outlook remains skewed to the downside, at 35%, driven by the rapid change in policies across several dimensions: trade, immigration and fiscal. These factors will keep general uncertainty about the future path of economic activity elevated.

**From the desk of the Chief Economist:**

**When gridlock turns to rigor mortis**

Heightening divisions among policymakers made a U.S. government shutdown almost inevitable. At midnight on September 30, the government closed its doors — its 10th shutdown with furloughs since 1981. While the debt ceiling is not part of this drama, thanks to the OBBBA, the shutdown still matters.

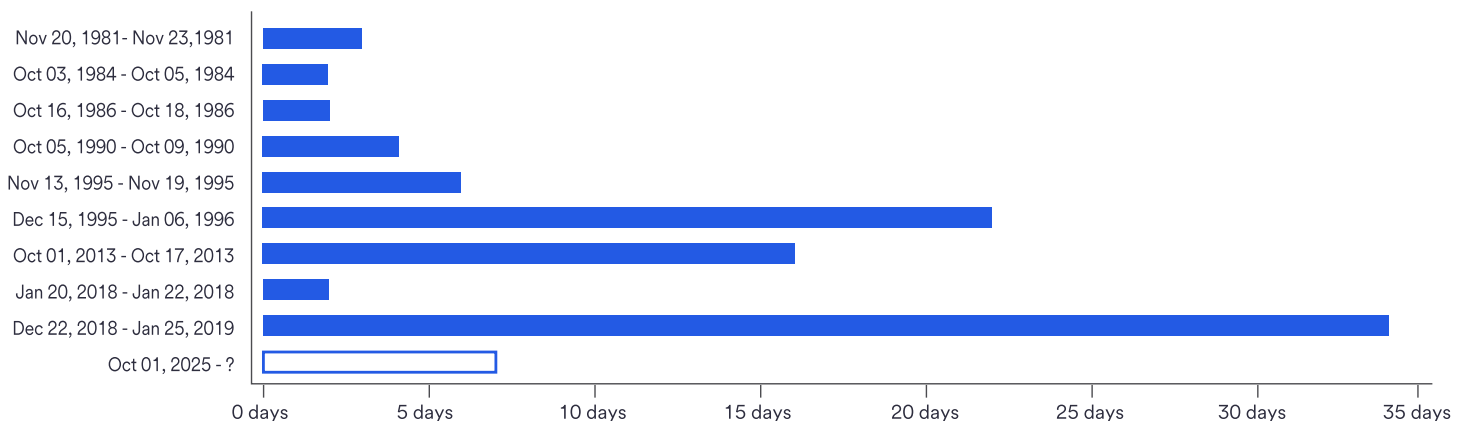
With no agreement reached, the federal government halts about \$26 billion of overall federal spending known as “discretionary.” For a \$20 trillion economy, this direct impact should be modest. But lost productivity from furloughed workers is permanent. Thus, if back pay is granted, federal spending rises without output, adding to inflation.

Nearly half of the already slimmed down federal workforce is furloughed, shaving an estimated 0.1 percentage points (ppts) off GDP for every week the shutdown lasts. Indirect costs – cancelled contracts, closed parks and reduced household spending – could push that figure closer to 0.2 ppts per week. Historically, much of this loss is recouped once government reopens, provided workers receive back pay. Contractors, however, rarely do.

This time may be worse. The White House has instructed agencies to prepare Reduction in Force notices for programs deemed “inconsistent with the president’s priorities.” If implemented, layoffs would hit regions like D.C. hard, compounding earlier DOGE-related cuts. And, unlike attrition, these job losses would be immediate.

Shutdowns have long reflected political gridlock – S&P Global Ratings, my alma mater, downgraded U.S. debt in 2011 for that very reason, and Fitch followed in 2023. Now, layer on tariffs feeding into consumer prices and a weakening labor market, and conditions are deteriorating. A shutdown – normally a small hit – could be the straw that breaks the camel’s back.

**U.S. government shutdowns**



**Consumer spending: Resilience with caveats**

Recent data underscores the resilience of the American consumer. Second quarter personal consumption expenditures (PCE) were stronger than initially estimated and appear to have accelerated in the first two months of Q3.

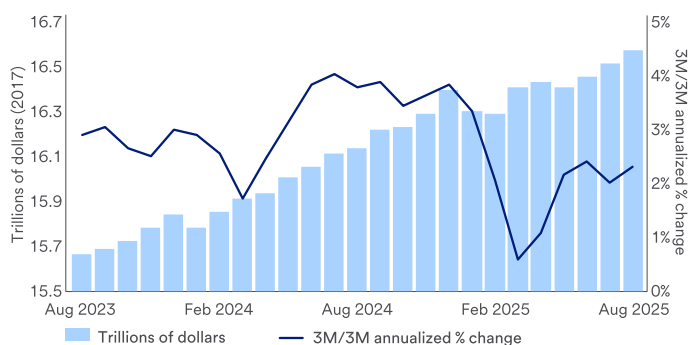
The latest Q2 GDP estimate showed consumption growth at a robust 2.5% annualized, well above earlier estimates. And momentum has carried into Q3. According to Bureau of Economic Analysis (BEA) and Census Bureau data, real consumption grew at a stronger 4.5% annualized rate in July and August, while real retail sales (excluding autos) rose 2.7%. Our analysis of company-level data confirms similar strength.

That said, there are caveats. Consumption growth has outpaced income, and gains have been concentrated among high-income households – raising sustainability concerns. While spending surged, real personal income (excluding transfers) grew only 2.0% annualized in the first two months of Q3, pushing the saving rate down to 4.6% in August. Analysis shows spending growth over the past two years has been driven largely by the top 10% of earners, while the bottom 20% has lost ground.

Taken together, consumers have proven more resilient than expected, lifting Q3 GDP tracking forecasts. But this pace is unlikely to last. Looking ahead, consumption growth is likely to align closer with slower real income growth. Tighter credit conditions and a softening labor market could also weigh on household spending as we move into Q4 and 2026. This dynamic may reinforce a cautious approach to rate cuts by the Fed.

**Consumer spending**

*Personal Consumption Expenditures (PCE)*



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

**Labor market: Stability on the surface, fragility beneath**

The U.S. labor market has entered what Fed Chair Jerome Powell calls a “low-hire, low-fire” phase. Payroll growth has slowed to just 29,000 per month over the summer – even before expected downward revisions – yet unemployment remains relatively low at 4.3% in August. This paradox reflects a sharp pullback in both labor demand and supply, leaving the market less dynamic and increasingly vulnerable.

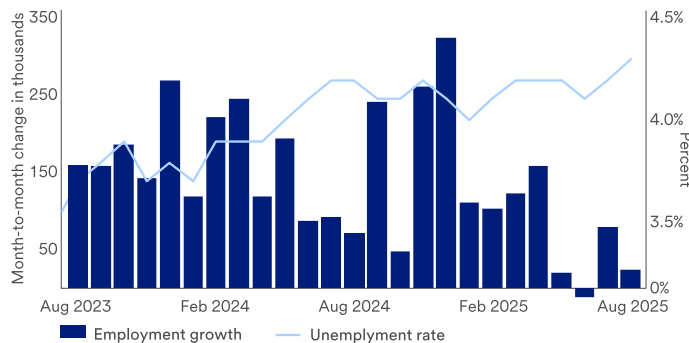
A key to this paradox is the decline in ‘breakeven’ job growth – the monthly pace needed to keep unemployment steady. Once estimated at 250,000+, breakeven is now closer to 75,000 or less as population growth slows and participation stalls. This explains why unemployment can hold steady despite minimal job creation and underscores a loss of labor market dynamism. Job openings have fallen, quits are at cycle lows, and hiring is near recessionary levels – all classic low-churn conditions.

Several forces are driving this slowdown: immigration policy shifts, tariffs, fiscal tightening (including DOGE-related layoffs) and softer consumer spending among lower- and middle-income households. AI adoption may also be reducing demand for entry-level tech roles. And an extended government shutdown risks amplifying these headwinds by disrupting operations and confidence.

For now, layoffs remain subdued. Initial claims are below 250,000, and continuing claims have eased from summer highs. Employers appear to be hoarding labor, wary of repeating the costly rehiring scramble of the pandemic. But the firewall is thin: if layoffs rise even modestly, the very low hiring rate means displaced workers may struggle to find jobs, pushing unemployment higher.

We still lean toward a soft landing, supported by low layoffs, moderating wage growth, and a more neutral Fed stance. But the margin for error is razor-thin. A prolonged shutdown, a sharper consumer pullback, or another confidence shock could tip the balance. One early complication: the September employment report has been delayed by the shutdown, leaving us (and the Fed) ‘data blind’ at a critical juncture. In the meantime, we’re watching alternative private sources to gauge momentum.

**U.S. Labor market**



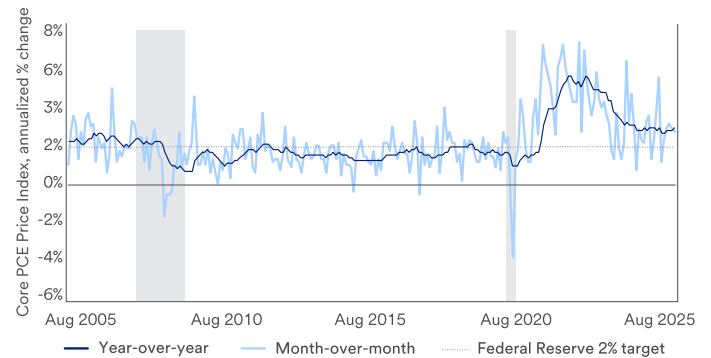
Source: U.S. Bank Economics; U.S. Bureau of Labor Statistics (BLS); Bloomberg

**Inflation: Mixed signals, sticky risks**

Recent inflation readings have sent policymakers a mixed message. On the producer’s side, prices eased in August after a sharp July spike, largely because businesses absorbed more of the tariff burden. That suggests margins are under pressure – but not necessarily that inflation is fading. Core producer prices, which strip out food, energy, and trade services, still rose at a solid 0.3% MoM (2.8% YoY) pace, signaling that underlying cost pressures remain.

Consumers, meanwhile, felt the opposite. The headline Consumer Price Index (CPI) accelerated in August, driven by rebounds in energy and food, and the Fed’s preferred gauge – core PCE – rose 0.2% MoM (2.9% YoY) – still well above its 2% target. Services inflation is proving sticky, with “supercore” measures hitting a six-month high. Tariff-sensitive goods like vehicles and apparel are also seeing price pass-through, while shelter costs picked up again. In short, the inflation story is far from over.

**U.S. Inflation**



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

The challenge for the Fed is clear: producer margins are being squeezed while consumer prices are climbing. And with new tariffs on pharmaceuticals, furniture and heavy trucks now in play, more upward pressure is likely. Fed Chair Powell recently acknowledged the tension between the Fed’s dual mandate, noting that near-term risks tilt toward higher inflation even as employment risks grow.

Fed officials remain deeply divided – some warn against cutting rates too aggressively, while others fear moving too slowly could deepen labor market strain. For now, we expect two additional 25bp cuts by year-end. But with inflation momentum building and job growth slowing, the Fed’s next steps will hinge on how these competing forces evolve in the months ahead.

## U.S. Bank Economics Research Group October 2025 Macro forecast summary

	Actual		Forecast						Actual	Forecast	
	2025		2025		2026						
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	2024	2025	2026
<b>Economic Data<sup>1</sup></b>											
Nominal GDP	2.9	6.0	5.8	3.5	4.5	3.4	4.4	4.7	5.3	4.6	4.4
Real GDP	-0.6	3.8	2.5	0.5	1.6	1.3	1.9	2.2	2.8	1.9	1.7
Consumer Spending	0.6	2.5	3.0	0.8	1.3	1.3	1.8	2.0	2.9	2.5	1.6
Investment	23.3	-13.8	3.9	0.1	3.7	1.8	4.1	4.8	3.0	2.3	1.6
Residential Structures	-1.0	-5.1	-3.4	-0.6	0.8	2.7	4.5	2.9	3.2	-1.6	0.5
Non-Residential Structures	-3.1	-7.5	-1.6	-0.1	0.7	2.2	2.2	2.2	1.1	-4.5	0.3
Intellectual Property	6.5	15.0	3.9	3.7	2.0	2.2	1.6	2.8	3.5	5.3	3.3
Equipment	21.4	8.5	2.1	0.0	3.3	3.4	4.2	3.6	3.5	7.6	3.0
Change in Inventory	172.0	-18.3	10.0	-2.0	15.9	5.9	17.9	37.3	43.5	40.4	19.2
Government Spending	-1.0	-0.1	0.4	0.8	-0.4	0.2	0.2	0.6	3.8	1.3	0.2
Federal	-5.6	-5.3	-3.2	-1.6	-0.5	0.0	0.0	0.1	3.8	-0.9	-1.2
State & Local	1.9	3.1	2.7	2.3	-0.4	0.2	0.2	0.9	3.8	2.7	1.0
Imports	38.0	-29.3	0.0	0.4	-1.6	0.6	2.3	3.4	5.8	3.4	-1.9
Exports	0.2	-1.8	-2.7	-1.6	-0.9	0.7	2.1	3.1	3.6	0.2	-0.4
Housing Starts	1.40	1.35	1.34	1.35	1.35	1.36	1.37	1.38	1.37	1.36	1.37
Unemployment Rate	4.1	4.2	4.3	4.6	4.6	4.5	4.4	4.3	4.0	4.3	4.4
<b>Prices<sup>2</sup></b>											
Consumer Price Index	2.7	2.5	3.1	3.3	3.3	3.2	3.0	2.7	3.0	2.9	3.0
Core PCE Price Index	2.8	2.7	3.0	3.2	3.2	3.1	2.9	2.6	2.9	2.9	2.9
<b>Interest rates<sup>3</sup></b>											
Federal Funds (Upper Target)	4.5	4.5	4.5	4.0	3.8	3.7	3.5	3.4	5.3	4.4	3.6
2-Yr Treasury Note	4.1	3.9	3.7	3.6	3.5	3.5	3.4	3.4	4.4	3.8	3.4
10-Yr Treasury Note	4.5	4.4	4.3	4.2	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	6.3	6.3	6.2	6.1	6.1	6.7	6.6	6.2

Forecast as of: October 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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