

U.S. ECONOMIC OUTLOOK

# Trendlines and tumbleweeds

- Our September 2025 U.S. economic outlook highlights the fiscal policy effects from recent legislation, a labor market showing signs of reduced dynamism, a housing market subdued by high costs, and a mixed business investment climate led by AI. These factors collectively shape the near-term economic trajectory amidst ongoing uncertainties.
- Economic momentum has slowed this year. Headline real GDP rebounded by a revised 3.3% annualized in Q2, after contracting by -0.5% in Q1. But volatility has been created by tariff policy changes, whipsawing components like imports and inventories. Through the sharp quarterly swings, 1H 2025 real GDP grew only 1.4%, or about half of last year's growth of 2.8%.
- With the uncertainty shock likely fading but the realities of tariffs intensifying, we continue to expect slower growth, a further loss of labor market momentum, and firm inflation in 2H 2025. Real GDP is now forecast to grow at a near 1% pace in Q3, before picking up a little steam in Q4 and into 2026 as the fiscal impulse from the One Big Beautiful Bill Act (OBBBA) kicks in. The unemployment rate drifts up to 4.6% over the winter. And Core PCE inflation peaks at 3.2% year-over-year by Q4 2025.

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

	Actual 2024	Forecast 2025	Forecast 2026	Forecast 2027
Real GDP	2.8	1.7	1.6	2.2
Consumer Spending	2.8	1.9	1.2	2.0
Investment	4.0	2.5	1.8	3.8
Housing Starts	1.37	1.40	1.40	1.40
Unemployment Rate	4.0	4.3	4.4	4.2
Consumer Price Index	3.0	2.8	2.9	2.2
Core PCE Price Index	2.8	2.9	2.9	2.0
Federal Funds (Upper Target)	5.3	4.4	3.6	3.3

Forecast as of: September 5, 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 Group.

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**Trendlines and tumbleweeds** – *continued from previous page*

- Disappointing jobs market data give the Fed reason to act now, but with inflation well above their mandate, this supports the case for sequential, rather than staggered, easing of monetary policy. We now 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%.
- Our risk to the 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:****A beautiful bill, briefly**

We have updated our baseline to reflect the modest near-term boost to U.S. economic growth resulting from the recently passed OBBBA. Specifically, the legislation primarily supports corporate cash flows and provides targeted household tax relief. On the business side, provisions such as upfront R&D expensing and bonus depreciation are set to accelerate tax savings and incentivize investment in equipment and structures. For households, new tax cuts – including SALT cap relief, deductions for tips, overtime and seniors – will offer some support to consumption, though the impact is smaller, particularly when weighed against headwinds from trade and immigration policy. It is also worth noting that, while the income tax cuts in OBBBA are extraordinarily large in budgetary terms, the economic benefit is more limited, as much of the cost stems from extending provisions that were already in place under current policy.

Otherwise, we expect the fiscal impulse from OBBBA on economic/consumption growth to be short-lived. The structure of the bill frontloads new tax relief while backloading spending cuts, particularly to Medicaid, SNAP and student loan programs. These contractionary measures – typically affecting lower income households – carry higher fiscal multipliers, meaning they are likely to exert a stronger drag on economic activity over time. As a result, we expect the bill to begin to weigh on GDP growth by 2027. We also caution that the bill's long-term implications include elevated deficits and a rising debt-to-GDP ratio, potentially reaching 125% within a decade. This could exert upward pressure on interest rates and dampen future growth.

**Labor market: Slack to the future**

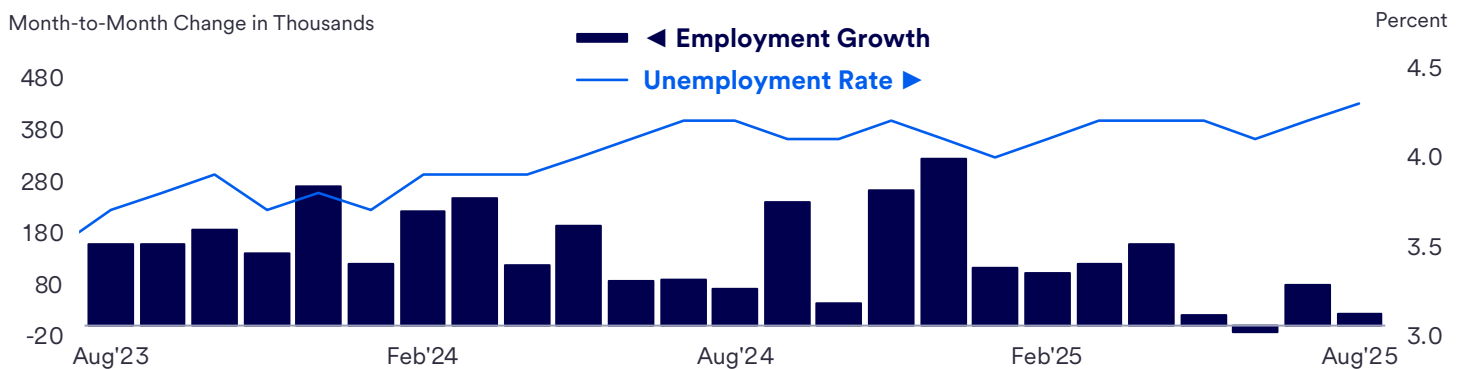
The August employment report confirmed a visible deceleration in labor market momentum. Nonfarm payrolls rose by just 22,000 – well below already meager consensus expectations and U.S. Bank Economics’ forecast – with downward revisions to prior months subtracting another 21,000 jobs. The three-month average gain now sits at a paltry +29,000, a stark contrast to the near +200,000 pace seen at the start of the year. While healthcare and leisure/hospitality posted modest gains in August, job creation remained narrow as goods-producing and government sectors contracted and broader services showed signs of fatigue. This ongoing slowdown in job growth aligns with our expectation that the trend in employment gains will decelerate to near-zero in the second half of the year, as persistent economic uncertainty and labor supply constraints continue to act as major headwinds.

The results of the household survey similarly pointed to rising slack, with the unemployment rate ticking up to 4.3% in August. Some of the increase reflects a rebound in the labor force after stagnating throughout the first half of the year – although the participation rate, at 62.3%, remains subdued. Long-term unemployment rose to over 1.9 million, now accounting for more than a quarter of all unemployed individuals. Youth unemployment (ages 16–24) climbed to a four-year high of 10.5%, underscoring the disproportionate impact of hiring slowdowns on new labor market entrants. And immigration-related labor supply constraints are compounding the slowdown, with foreign-born participation continuing to trend lower amid restrictive policies and enforcement actions. These dynamics are reducing the breakeven pace of job growth needed to stabilize the unemployment rate – which is now estimated to be below 100,000 per month.

Overall, the August employment report did little to ease concerns about the underlying health of the labor market. While we don’t believe the floor has fallen out – as layoffs remain low – the outlook is increasingly ominous. We expect the Fed to respond with a 25bp rate cut in September, with the door now open for more aggressive easing through year-end, depending on the potential inflationary impacts of higher tariffs.

Beyond the employment report, other indicators of labor market dynamism also point to a gradual loss of momentum. Jobless claims have been trending upward, raising the risk that layoffs could pick up in the coming months. Job openings have moved sideways to down this year, suggesting hiring demand is at its lowest point since the pandemic. Meanwhile, the quits rate has moderated, indicating workers are less confident in their ability to find new opportunities. Together, these trends suggest that while the labor market remains relatively resilient, it is becoming less dynamic – with fewer opportunities for job seekers and a more cautious stance from employers amid ongoing economic uncertainty. This may represent another cause for concern for the Fed, as it could hinder progress toward its dual mandate.

**U.S. Labor Market**



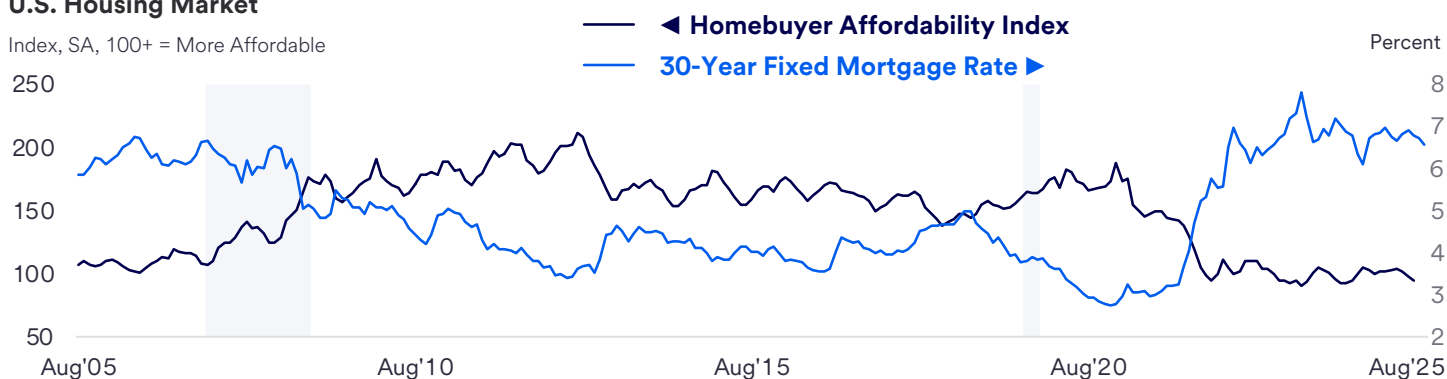
Source: US Bank Economics; US Bureau of Labor Statistics (BLS); Bloomberg

### Housing: The great hibernation

The dual pressures of high mortgage rates and elevated home prices have put the housing market into a deep slumber. Prospective sellers are locked-in, with over 70% of outstanding mortgages carrying a rate of 5% or less, according to the Federal Housing Finance Agency (FHFA). Prospective buyers are priced-out, with the Atlanta Fed calculating that a mortgage payment on the median-priced home would account for 48% of median household income – an all-time high dating back to 2005. This has resulted in sluggish resale activity, with existing home sales coming in at a seasonally adjusted annual rate of 4.01 million units in July, about 1.5 million units below the prepandemic average.

#### U.S. Housing Market

Index, SA, 100+ = More Affordable



Source: US Bank Economics; National Association of Realtors (NAR); Freddie Mac

That said, prospective sellers can only stay put for so long. Major life events – such as marriage or job changes – are gradually prompting some to list their homes. This has pushed up the inventory of houses – measured in both units and months’ supply – to more sustainable levels. This increase in supply has slowed price gains, with Case-Shiller and the National Association of Realtors (NAR) reporting home prices up only around 1% year-on-year. If this trend continues, we could see a year-on-year decline in national housing prices later this year or in 2026. Importantly, such a decline would likely be orderly, as household balance sheets remain strong. According to the Federal Reserve Board of Governors, aggregate mortgage debt-to-equity stands at 39% – a historically low level, and far healthier than the 60% seen prior to the 2007–08 housing collapse. Correspondingly, only 2.5% of homeowners currently have negative or near-negative equity, according to CoreLogic and the Urban Institute.

Residential construction has held up better than the resale market, but signs of weakness are beginning to emerge. U.S. residential construction activity exceeded expectations in July, with total housing starts rising 5.2% month-over-month to a seasonally adjusted annual rate of 1.428 million units. The increase was driven by a nearly 12% jump in multifamily starts – which tend to be volatile and subject to large revisions – while single-family starts rose a more modest 2.8% following four months of subdued performance.

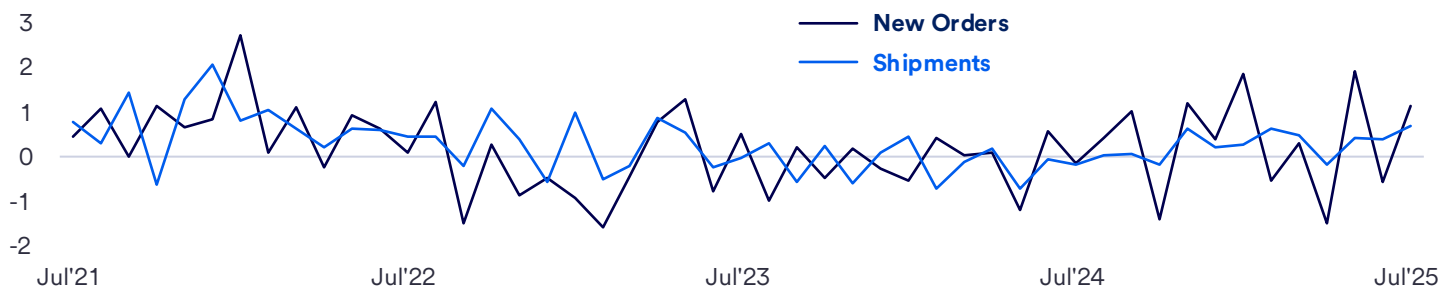
Despite this strength, building permits – a leading indicator – fell 2.8% to 1.354 million units, the lowest level since mid-2020. The divergence between starts and permits suggests that homebuilders remain cautious amid ongoing supply-side constraints and persistent affordability challenges. This caution is reflected in the National Association of Home Builders (NAHB) Housing Market Index, which edged down one point to 32 in August – well below the 50-point threshold indicating favorable building conditions. Overall, muted permitting activity and soft builder sentiment point to continued sluggishness in residential construction in the near term.

**Business investment: AI leads the waltz, manufacturing follows**

Business equipment investment has shown signs of improvement this summer. Core capital goods orders – a key leading indicator of business investment, as they typically translate into shipments that contribute to GDP – rose 1.1% in July, following a revised 0.6% decline in June. Similarly, core capital goods shipments, which feed directly into current GDP calculations, increased 0.7% after a 0.4% gain in June. These better-than-expected figures suggest firms are moving forward with some capital expenditure plans, despite widespread anecdotal reports of project delays.

**U.S. Core Capital Goods Orders & Shipments**

Nondefense Excluding Aircraft; Month-Over-Month Percent Change



Source: US Bank Economics; U.S. Census Bureau

Nonetheless, the broader investment climate remains mixed, reflecting a tug-of-war between strong AI-driven demand and ongoing policy uncertainty. Q2 GDP revisions underscored the scale of technology investment, with software spending growing at a more than 26% annualized rate while spending on computers and peripheral equipment surged by 60%, following double that gain in Q1. Upward revisions to intellectual property products were driven by increases in both software and R&D, with AI-related infrastructure contributing significantly to the strength.

This technology boom stands in contrast to survey-based indicators. The Institute for Supply Management (ISM) Manufacturing PMI registered 48.7 in August, marking a sixth consecutive month of contraction. While new orders showed a modest rebound, production and employment continued to decline, signaling persistent weakness in the sector. Encouragingly, the prices paid component eased some in August, suggesting tariff-induced cost pressures may be moderating slightly, though they remain elevated.

Looking ahead, the investment landscape is likely to remain turbulent through the rest of 2025. While core capital goods data points to sustained demand – particularly for AI and productivity-enhancing technologies that help offset higher tariff costs – the broader manufacturing sector continues to face challenges. ISM survey respondents remained notably downbeat despite the modest headline improvement. We expect business equipment investment to encounter headwinds in the final months of 2025 as the initial wave of tariff front-loading subsides and cost pressures squeeze profit margins. However, the potential for more favorable business provisions in 2026 under the OBBBA, coupled with ongoing AI-driven capital expansion, should offer some support for investment activity heading into the new year.

## U.S. Bank Economics Research Group September 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	3.2	5.3	3.8	4.5	5.0	3.6	4.1	4.9	5.3	4.5	4.4
Real GDP	-0.5	3.3	1.1	1.3	1.4	1.7	2.0	2.2	2.8	1.7	1.6
Consumer Spending	0.5	1.6	1.0	0.6	0.9	1.5	1.8	2.0	2.8	1.9	1.2
Investment	23.8	-13.8	1.8	2.1	3.3	3.4	3.7	3.8	4.0	2.5	1.8
Residential Structures	-1.3	-4.7	0.1	0.5	1.5	2.5	3.3	3.2	4.2	-0.9	1.3
Non-Residential Structures	-2.4	-8.9	0.1	0.5	1.2	1.8	2.1	2.5	3.5	-2.4	0.6
Intellectual Property	6.0	12.8	3.0	2.0	1.5	2.2	2.6	2.9	3.9	4.6	2.8
Equipment	23.7	7.4	0.0	1.0	3.0	3.0	3.0	3.0	3.4	7.1	2.5
Change in Inventory	160.5	-32.9	-25.0	-15.0	0.0	10.0	20.0	30.0	39.0	21.9	15.0
Government Spending	-0.6	-0.2	0.0	-0.3	0.1	0.4	0.4	0.5	3.4	1.2	0.1
Federal	-4.6	-4.7	-2.4	-1.2	0.0	0.4	0.5	0.6	2.6	-0.4	-0.6
State & Local	2.0	2.6	1.5	0.3	0.1	0.3	0.4	0.5	3.9	2.2	0.6
Imports	38.0	-29.8	-1.0	-4.0	-1.0	0.0	0.0	0.0	5.3	2.5	-3.4
Exports	0.4	-1.3	-0.9	-0.6	-0.4	0.0	0.0	0.0	3.3	0.9	-0.4
Housing Starts	1.40	1.30	1.30	1.40	1.40	1.40	1.40	1.40	1.40	1.40	1.40
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	2.9	3.2	3.2	3.0	2.8	2.5	3.0	2.8	2.9
Core PCE Price Index	2.8	2.7	2.9	3.2	3.2	3.0	2.8	2.5	2.8	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	4.2	3.9	3.7	3.5	3.4	3.4	3.4	3.4	4.4	3.8	3.4
10-Yr Treasury Note	4.5	4.4	4.2	4.1	4.1	4.2	4.2	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: September 5, 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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