U.S. ECONOMIC OUTLOOK

Resilience has consequences

Summary: Our August 2026 U.S. economic outlook points to an economy that continues to expand at a solid pace despite a range of structural and policy-related headwinds. While second-quarter GDP growth slowed to a 1.5% annualized pace, the underlying details painted a considerably stronger picture of activity. Consumer spending accelerated, business investment remained solid and a key measure of private sector demand posted its strongest increase in more than a year. At the same time, businesses and supply chains have continued to adapt to higher trade barriers, helping limit the economic drag from tariffs. The labor market also remains broadly balanced despite a slower pace of hiring, as historically low layoffs continue to support stability.

Looking ahead, we expect the economy to remain on firm footing, with growth continuing near its long-run potential pace. While that resilience remains supportive of the outlook, it is also one reason inflation is proving slow to return to target. With consumer spending, business investment and labor market conditions continuing to support demand, policymakers are likely to remain focused on price stability. As a result, our baseline forecast now includes a 25-basis point rate hike in September, though we view it as an incremental adjustment rather than the start of a broader tightening cycle.

- **Growth:** We expect real GDP growth of 2.0% Q4-over-Q4 (Q4/Q4) in 2026 – a 2.1% annual average – and 2.1% Q4/Q4 in 2027 (2.1% annual average). While slowing labor-force growth and higher trade barriers present headwinds, resilient consumer demand, solid business investment and improving productivity should keep economic growth near its long-run potential pace.
- **Labor market:** We expect the unemployment rate to average 4.3% in both 2026 and 2027, reflecting a broadly balanced labor market despite slower hiring. Slower labor-force growth, strong prime-age participation and historically low layoffs should help maintain overall stability.
- **Inflation:** Inflation has shown renewed signs of improvement, but progress toward the Federal Reserve's 2% objective remains gradual and uneven. We expect core Personal Consumption Expenditures (PCE) inflation to average 3.3% year-over-year (YoY) in the second half of 2026 before moderating to 2.2% by the end of 2027 – as easing goods and housing inflation are only partially offset by persistent services inflation.
- **Federal Reserve:** Continued economic resilience and only gradual progress on inflation have shifted policymakers' focus more squarely toward price stability. As a result, our baseline forecast includes a 25-basis point rate hike in September, though we do not expect the move to mark the start of a broader tightening cycle.
- **Risks:** We maintain a 25% probability of recession over the next 12 months. While the economy has proven resilient to higher interest rates, elevated trade barriers and slower labor-force growth, it also slows the return of inflation to target. As a result, higher energy prices, additional monetary policy tightening, and a retrenchment in AI-related investment remain key risks to the outlook.

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U.S. Bank Economic Research Group August 2026 Macro forecast summary

	Actual 2025	Forecast 2026	Forecast 2027	Forecast 2028
Real GDP	2.1	2.1	2.1	2.0
Consumer Spending	2.6	2.0	1.9	1.9
Investment	1.9	3.4	5.3	3.2
Housing Starts	1.36	1.37	1.35	1.35
Unemployment Rate	4.3	4.3	4.3	4.2
Consumer Price Index	2.7	3.5	2.6	2.3
Core PCE Price Index	2.8	3.3	2.5	2.0
Federal Funds (Upper Target)	4.4	3.8	4.0	4.0

Forecast as of: August 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 Economic Research Group.

From the desk of the Chief Economist:

The tariff shock fades, but the trade map shifts

While it seems that the tariff war is largely behind us, longer-term ramifications need to be considered. The tariff war has nudged other countries to find different partners. The UK and India signed a trade agreement in July 2025, the EU and India reached a free trade agreement this January and the EU also signed a landmark deal with Mercosur, a South American trade bloc, creating a free-trade zone covering about 700 million consumers. We are watching whether this becomes a one-off scramble or a more durable shift away from U.S.-centered trade design.

As others deepen trade ties, the U.S. government is pursuing other options to increase tariffs, such as Section 301 of the Trade Act of 1974 to reimpose tariffs of up to 12.5% around 60 economies, offsetting the 10% tariff the Supreme Court deemed unlawful. Dependence on U.S. technological innovation will likely keep foreign markets open to trade with the U.S. for some time. But the U.S. could be on shaky ground in the future, with China's technological advancements on its heels.

Read the full commentary here >

Economy: Growth remains on firm footing

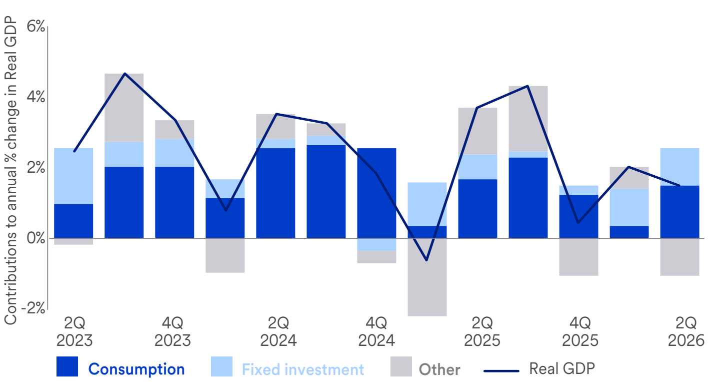
Real GDP increased at a 1.5% annualized pace in the second quarter, slowing from 2.1% in the first quarter and falling short of expectations. However, the headline figure understated the economy's underlying momentum. Trade, inventories and government spending all weighed on overall growth, obscuring continued strength across key areas of private sector demand. Consumer spending accelerated to a robust 3.2% annualized pace, while both nonresidential and residential investment contributed positively to growth. Perhaps most notably, real final sales to private domestic purchasers, a key measure of underlying demand, surged 3.9% annualized, more than double its first quarter pace and indicative of a considerably stronger economy than the headline GDP figure alone would suggest.

The details of the second-quarter GDP report reinforced our view that economic activity remained on relatively firm footing through mid-2026. Despite elevated interest rates, tighter financial conditions and ongoing affordability pressures, households and businesses continue to spend and invest at rates consistent with sustained expansion. More broadly, growth appears to be running near, and potentially modestly above, the economy's long-run potential pace. While slowing labor-force growth has become a more meaningful constraint on potential output, stronger productivity growth, supported in part by ongoing technological investment, may be helping offset that drag. Importantly for policymakers, an economy growing near potential is not necessarily inflationary. However, it does suggest price pressures are unlikely to dissipate solely through weaker demand, leaving the Federal Reserve focused more squarely on inflation than growth concerns.

Looking ahead, we continue to expect consumer spending to expand at a moderate pace of roughly 1.8% to 2.0% through the remainder of 2026 and into 2027. Affordability challenges, subdued real income growth and a personal saving rate near cycle lows will likely continue to constrain household spending. At the same time, however, strong household balance sheets, elevated financial and housing wealth, and a still-solid labor market should provide sufficient support to keep consumption growing. Business investment also remains a constructive part of the outlook, particularly in areas tied to artificial intelligence (AI), digital infrastructure and other productivity-enhancing technologies. These investments should continue to support growth while helping offset some of the economy's demographic headwinds over time.

Taken together, the outlook remains one of continued expansion rather than meaningful acceleration or contraction. We expect real GDP growth to remain slightly above 2% through the second half of 2026 and into 2027, broadly consistent with growth near the economy's potential rate. That backdrop should help limit the risk of broader economic overheating, even as underlying demand remains firm. Nevertheless, inflation remains above the Federal Reserve's target, and progress toward price stability has been slow and uneven. As a result, we now anticipate one 25-basis point rate hike in September, though we view it as an incremental adjustment rather than the beginning of a broader tightening cycle.

U.S. Economic Growth



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

Trade policy and tariffs: Adaptation over disruption

Trade policy remains an important force shaping the economic outlook, but recent economic data suggest the U.S. economy has proven more resilient to higher trade barriers than markets expected. Earlier concerns centered on whether escalating tariffs and policy uncertainty might materially slow growth or tip the economy toward recession. Instead, consumer spending has remained resilient, labor market conditions have held relatively steady and businesses have increasingly adapted to operating in an environment of elevated tariffs. As a result, the discussion has shifted from whether tariffs will derail economic growth to how businesses and supply chains are adjusting to a world where enhanced trade barriers are likely to persist.

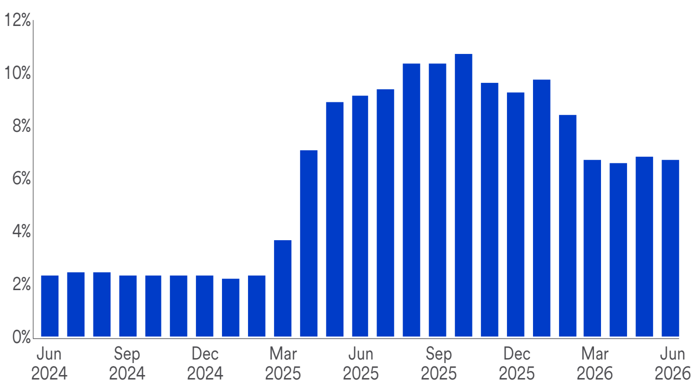
A large reason tariffs have taken only a modest bite out of economic activity is that the U.S. economy remains primarily driven by domestic demand. Consumer spending alone accounts for roughly two-thirds of economic activity, while services make up a far larger share of output than manufacturing or trade. As a result, trade shocks tend to have a more muted effect on overall growth than in smaller, more trade-dependent economies such as Singapore or the United Kingdom. This helps explain why tariffs have altered the composition of activity more than the overall pace of growth.

Another reason the impact has proven more manageable is that businesses have adapted rather than retrenched. While imports from China have declined meaningfully, firms have increasingly shifted sourcing toward alternative suppliers across Asia and North America. Higher tariffs have therefore reshaped supply chains and redirected trade flows rather than materially reducing trade activity. This adjustment has helped cushion the impact on growth while reinforcing broader trends toward supply chain diversification, resilience and nearshoring. As a result, trade continues to influence how and where economic activity occurs, but thus far has had a smaller effect on overall growth than initially feared.

The inflation story has also become clearer. Higher tariffs continue to raise costs and put upward pressure on prices, but the effect increasingly resembles a one-time adjustment in the price level rather than a self-reinforcing inflation cycle. Our estimates suggest tariffs have added roughly one-half percentage point to inflation since early 2025, with most of the pass-through concentrated in goods prices. Consequently, while tariffs remain a headwind to the disinflation process, the resulting inflation shock has been more manageable than assumed at the outset.

Looking ahead, we expect the effective U.S. tariff rate to average roughly 7.5% over our forecast horizon. Under this baseline, tariffs should continue to create modest headwinds for growth and contribute to inflation pressures, but not enough to materially alter the broader economic outlook. The economy has thus far demonstrated a notable ability to absorb higher trade costs through supply chain adjustments, sourcing diversification and continuing private sector demand. Risks, however, remain skewed to the upside. Recent policy developments suggest trade barriers are becoming a more durable feature of the policy landscape, while escalating tariff discussions involving Canada, potential sector-specific actions, and future USMCA negotiations could push effective tariff rates higher than currently assumed. As a result, trade policy remains an important upside risk to inflation and a continuing source of uncertainty in the second half of 2026.

Effective Tariff Rate Paid on U.S. Imports



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

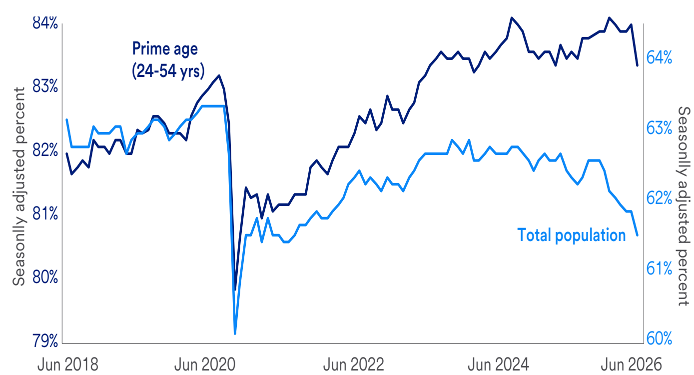
Labor market: A smaller workforce, not a weaker one

The labor market remains on relatively solid footing, supported by a prime-age labor force participation rate that continues to run above prepandemic levels. Strong participation among core working-age workers (ages 25-54) suggests much of the postpandemic labor market recovery is complete, leaving limited scope for further gains through worker re-entry. At the same time, labor-force growth has slowed as an aging population, retirements, lower fertility rates and reduced net migration increasingly constrain labor supply. As a result, demographic trends are becoming a more important determinant of both labor market conditions and the economy's long-run growth potential.

A key implication of slower labor-force growth is that the economy no longer needs the same pace of job creation to maintain balance. Payroll growth averaged just under 100,000 per month during the first half of 2026, well below the exceptionally strong gains seen earlier in the expansion. Yet the unemployment rate has remained remarkably steady, fluctuating within a narrow 4.2% to 4.4% range and remaining consistent with a labor market that remains broadly balanced. Rather than signaling weakness, slower hiring largely reflects a more gradually expanding workforce, while layoffs remain historically low. This 'low-hire, low-fire' dynamic has helped preserve overall stability.

Looking ahead, we expect the labor market to remain characterized by moderate hiring and only a gradual lift in unemployment. As labor-force growth slows, productivity gains will play an increasingly important role in sustaining economic expansion. Ongoing investment in AI, digital infrastructure and other productivity-enhancing technologies may help offset some of the drag from demographic headwinds, supporting growth near the economy's potential pace. The result is a labor market that continues to move toward a slower-growth equilibrium over time.

U.S. Labor Force Participation Rate



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

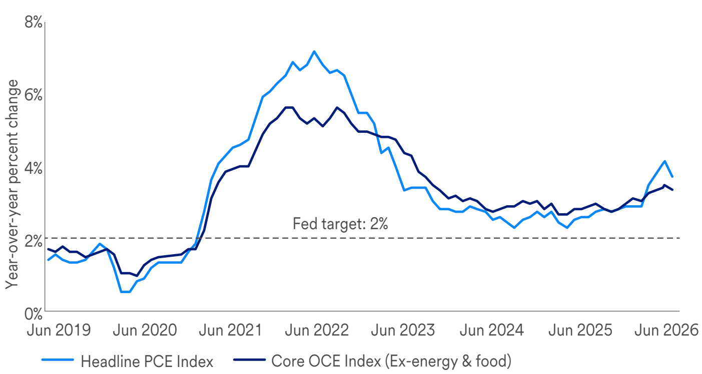
Inflation: Progress, but not enough

Inflation delivered some encouraging news at the start of the summer, but not enough to convince policymakers that the job is finished. June's PCE report showed further progress, with core prices rising just 0.1% over the month and the year-over-year rate easing to 3.3%. Headline inflation declined 0.1% MoM and slowed to 3.7% from a year earlier, helped in part by lower energy prices. More broadly, several underlying measures suggest inflation has moderated from the firmer readings seen earlier this spring, providing tentative evidence that some temporary sources of price pressure may be fading.

Even so, inflation remains well above the Federal Reserve's 2% target, and the path back to price stability is likely to remain uneven. Recent gains in crude oil prices following renewed tensions in the Middle East raise the possibility that some of June's energy-driven improvement could prove short-lived. While much of the tariff-related adjustment appears to be behind us, an economy that continues to grow near its potential pace is unlikely to generate rapid disinflation. Resilient consumer demand, stable labor market conditions and continued investment spending suggest policymakers will want additional evidence that price pressures are moving sustainably lower before declaring victory.

Looking ahead, we expect inflation to continue moving lower, but the path is likely to remain gradual and uneven. Goods inflation should ease as tariff-related pressures fade, and housing inflation should continue to cool, though more slowly than earlier in the cycle. Services inflation is likely to remain the primary source of persistence, keeping core PCE inflation above the Fed's 2% objective for much of the forecast period. That backdrop is consistent with a continued, but gradual, disinflation process and helps explain why Federal Reserve officials remain focused on inflation despite an economy that continues to expand near its potential pace.

U.S. Inflation



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

Monetary policy: A more hawkish Fed

The combination of resilient economic growth, stable labor market conditions and only gradual progress on inflation helps explain the Federal Reserve's growing readiness to respond to inflation risks. The Federal Open Market Committee (FOMC) left the federal funds rate unchanged at 3.50% to 3.75% in July, extending the policy pause that has been in place since January. The post-meeting statement changed little from June and offered few clues regarding the timing of future policy moves. However, the apparent stability of the decision masked an important shift in the policy discussion. Three policymakers dissented in favor of a 25-basis point rate increase, marking the first time since 2016 that three Committee members voted against the majority in the same direction. The dissents highlighted growing concern that inflation progress is occurring too slowly and that policy may no longer be as restrictive as previously believed.

Chair Kevin Warsh's press conference reinforced that message. Warsh described the economy as showing 'impressive resilience' and emphasized that inflation remains above the Fed's objective. At the same time, he avoided signaling any predetermined path for policy, reiterating that future decisions will depend on incoming economic and financial data. The result is a Fed that remains firmly data-dependent but increasingly focused on inflation risks, with the economy's continued resilience providing flexibility to tighten policy if necessary.

Looking ahead, policymakers are unlikely to place significant weight on a single month of encouraging inflation data, particularly with energy prices moving higher and new tariffs presenting potential upside risks to prices. More importantly, an economy that continues to grow near its potential pace reduces the urgency for policy easing while allowing officials to remain focused on price stability. With inflation still above target and broader economic conditions remaining resilient, we believe the balance of risks has shifted modestly toward additional tightening. Our baseline forecast anticipates a 25-basis point rate increase at the September FOMC meeting, followed by an extended period of unchanged policy rates.

U.S. Bank Economic Research Group August 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	7.9	5.4	5.1	3.9	4.9	3.7	5.0	6.1	4.7
Real GDP	0.5	2.1	1.5	2.2	2.3	2.1	2.3	2.0	2.1	2.1	2.1
Consumer Spending	1.9	0.5	3.2	1.8	1.7	1.8	2.0	1.9	2.6	2.0	1.9
Investment	2.3	7.9	3.0	7.8	7.6	5.1	4.4	3.5	1.9	3.4	5.3
Residential Structures	-1.7	-7.8	1.5	-0.7	0.4	1.4	2.0	2.0	-2.2	-3.3	1.2
Non-Residential Structures	-6.5	-4.7	-5.0	-2.3	0.5	1.7	2.0	2.0	-5.3	-4.7	0.7
Intellectual Property	5.4	13.8	8.8	5.4	5.3	5.1	5.0	4.8	5.6	8.7	5.3
Equipment	4.3	15.8	15.2	9.8	8.0	5.3	4.3	3.3	8.3	10.4	6.3
Change in Inventory	-15.6	-16.7	-50.8	-20.4	10.0	20.0	25.0	25.0	28.5	-19.5	23.8
Government Spending	-5.6	4.4	-0.8	1.7	1.6	1.4	1.3	1.3	1.1	0.4	1.3
Federal	-16.6	9.4	-4.1	2.7	2.5	2.4	2.3	2.1	-1.2	-1.5	2.0
State & Local	1.5	1.6	1.1	1.2	1.0	0.8	0.8	0.8	2.5	1.6	0.9
Imports	-1.0	11.8	11.5	7.0	5.5	4.0	3.0	3.0	2.7	3.1	4.7
Exports	-3.2	10.9	4.5	3.0	2.5	2.0	2.5	2.7	1.6	4.5	2.6
Housing Starts	1.32	1.42	1.35	1.35	1.35	1.35	1.35	1.35	1.36	1.37	1.35
Unemployment Rate	4.5	4.3	4.3	4.3	4.3	4.4	4.3	4.3	4.3	4.3	4.3
Prices[2]											
Consumer Price Index	2.7	2.7	3.8	3.7	3.6	3.2	2.6	2.4	2.7	3.5	2.6
Core PCE Price Index	2.9	3.1	3.3	3.3	3.3	2.8	2.6	2.4	2.8	3.3	2.5
Interest rates[3]											
Federal Funds (Upper Target)	4.02	3.75	3.75	3.79	4.00	4.00	4.00	4.00	4.37	3.82	4.00
2-Yr Treasury Note	3.52	3.58	3.97	4.19	4.13	4.11	4.10	4.10	3.81	3.97	4.10
10-Yr Treasury Note	4.10	4.20	4.42	4.62	4.54	4.51	4.50	4.50	4.29	4.44	4.50
30-Yr Freddie Mac Mortgage	6.23	6.11	6.42	6.49	6.33	6.27	6.26	6.25	6.60	6.34	6.26

Forecast as of August 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 Def ator, 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 Economic Research Group.