Economic view December 5, 2025

From the desk of Chief Economist Beth Ann Bovino

Ring out the old, ring in the new

As we 'ring out the old', one thing that I'm grateful for is the surprising strength of the American economy despite the many headwinds this year. As expected, the 'Big Three' policy initiatives – taxes & regulation, tariffs and immigration – were initiated to a lesser, or sometimes much greater, degree this year. I said in January that tariffs and tighter immigration policy would offset the Trump administration's looser regulations and tax cuts this year, but both policies were much larger than expected with a much bigger bite. (The Fed gave one more cut than we thought, assuming a December move).

Tariff policy stung U.S. households and businesses. The launch of tariffs across the world on Liberation Day (April 2) was initially estimated to push the effective tariff rate (ETR) to around 20% (eight times higher than 2024). Tighter immigration policies and deportations this year were much larger than expected, with reports that both undocumented and some documented workers were impacted, shrinking labor supply and slowing business production for some industries than earlier thought.

Still, throughout 2025 we kept our stance for a soft landing in the U.S. Why was that?

We thought tariffs would push up prices and slow the economy, but not as bad as markets feared. This was in large part because U.S. economic activity is largely domestically driven. The share of U.S. trade as a percentage of GDP is around 25 percentage points (ppts) less than half world trade as a percentage of GDP (60 ppts), so less dependent on trade. Similar to the 2018 tariff war, U.S. households kept spending, despite the tariffs, largely because U.S businesses initially absorbed the costs, hesitant to pass these onto consumers and lose market share. (We were worried that the escalation between the U.S. and China would lead to a hard landing, but that was quickly reversed.)

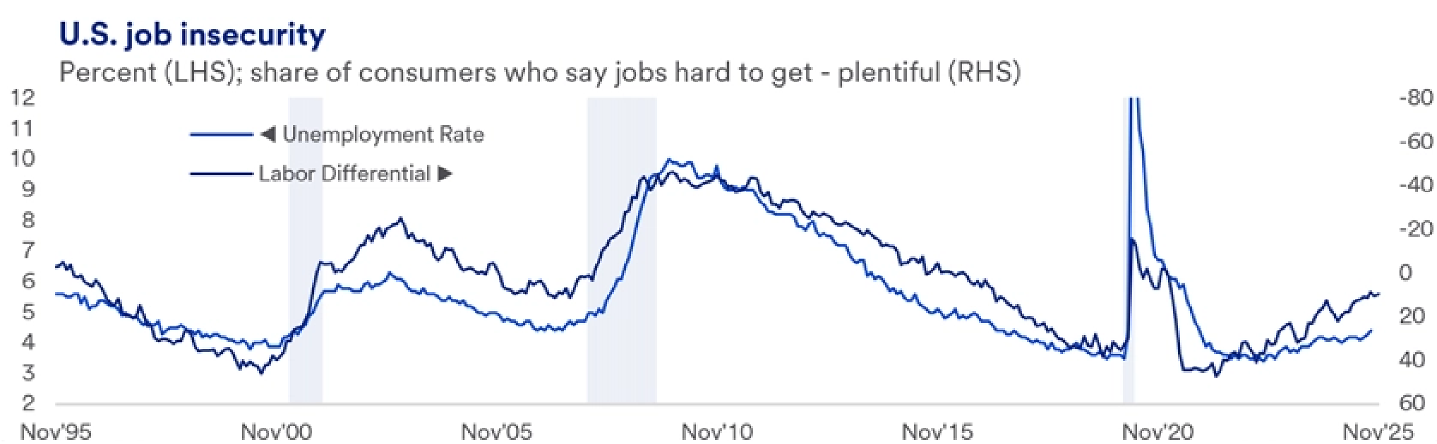
As the U.S. nears 2026, most of our 2025 forecasts at the start of the year appear to be ringing true. GDP for 2025 is closing in on our January forecast of 2.1%. Consumer spending, so far, is also near our January forecast, helped by businesses earlier eating the tariff costs, and now because people need a little 'retail therapy' to manage the higher prices as businesses are now pushing through costs to consumers. Those costs were larger than we anticipated with overall and core consumer prices much larger than we anticipated at the start of the year. The housing market also appears to be weaker than we anticipated, with stubbornly high home prices and building costs, and borrowing costs keeping many out of the market.

How we're doing			
2025		Jan '25- forecast	Dec '25- forecast
Real GDP	%	2.1	2.0
Consumer Spending	%	2.6	2.5
Investment	%	2.3	2.1
Housing Starts	Million	1.45	1.36
Unemployment Rate	Rate	4.2	4.3
Consumer Price Index	%	2.5	2.8
Core PCE Price Index	%	2.4	2.9
Federal Funds (Upper)	%	4.35	4.40
Real GDP	%	2.1	2.0

Source: U.S. Bank Economic Research Group's U.S. Baseline Forecasts. Indicators are current through December 5. Shutdown has delayed government data.

But that's behind us. As we ring in the New Year, we continue to anticipate moderate growth supported by consumer spending and stable investment to keep the economy landing softly. Tension between the two Fed mandates will continue through most of 2026 with inflation elevated on persistent tariff pressures while the labor market remains fragile in its "low-hire, low-fire" world. The Federal Reserve is expected to slowly cut rates this year amid mandate tensions, executing a soft landing for the first time since 1995.

Landing and takeoff are the hardest parts of flying. The same is true for central bankers when navigating a safe path for the economic 'plane.' And while the U.S dodged that bullet in 2025, downside risks remain. The Fed has turned its attention to the weaker jobs market despite sticky inflation. Once a cushion for the economy, the jobs market is now fragile, with meager job gains and job postings as businesses shy away from new hires. While the unemployment rate is low, recent Challenger layoff announcements suggest that it will pick up this year, pulling the rug out of a worker's job security, as seen with the Conference Board's job insecurity metric rising (see chart). With that gone, consumers won't just be cautious, they may keep their wallets shut.



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

My biggest worry stems from a monetary policy mistake, on our radar for a long time. It got worse when tension between their two mandates widened and more recently when economic data was delayed. Consumer inflation is sticky and still far from their 2% inflation target and we believe businesses are still passing through tariff costs to their customers, with consumer prices reaching the peak this year. But despite high inflation, the Fed is focused on the jobs mandate. If the wrong move, it would only mean higher prices and more job loss for the Fed to fight next year and beyond. In this ‘lose-lose’ outcome, I certainly don't envy their jobs!

Disclosures