

U.S. ECONOMIC OUTLOOK

Higher for longer... and long-term

Summary: Our October 2026 U.S. economic outlook continues to point to an economy that has proven remarkably resilient despite still-elevated price pressures, higher interest rates, and a range of geopolitical challenges. Consumer spending remains healthy, business investment continues to benefit from strong AI-related activity, and labor market conditions remain consistent with ongoing economic expansion. At the same time, inflation has become increasingly influenced by rising energy costs and other supply-related pressures, raising the risk that progress toward price stability becomes slower and more uneven than anticipated. Many of the same forces supporting growth and complicating the inflation outlook are also contributing to higher long-term borrowing costs. Fiscal borrowing, duration risk, and stronger economic activity have pushed real rates and term premiums higher, suggesting borrowing costs may remain elevated even as inflation gradually improves.

Looking ahead, our baseline forecast continues to call for growth near its long-run potential pace. The central question is no longer whether higher interest rates will materially slow activity, but whether inflation can return sustainably to target while demand and investment remain strong. Although inflation has eased significantly from its peak, recent developments suggest the final stretch back to the Federal Reserve's objective may prove more challenging. As a result, we now expect the Fed to continue gradually tightening policy through early 2027, bringing the cumulative increase in the federal funds rate to 75 basis points between September 2026 and March 2027.

- **Growth:** Real GDP growth is forecast to be 2.8% fourth-quarter-over-fourth-quarter (Q4/Q4) in 2026 (2.4% annual average) and 2.1% Q4/Q4 in 2027 (2.4% annual average). While tighter monetary policy and higher interest rates continue to present headwinds, resilient consumer demand, strong AI-related investment, and improving productivity look to keep economic growth near its long-run potential.
- **Labor market:** We expect the unemployment rate to average 4.2% in 2026 and 4.3% in 2027, reflecting a broadly balanced labor market despite slower hiring. Historically low layoffs and slower labor-force growth should help keep unemployment relatively stable.
- **Inflation:** Rising energy costs and other supply-related pressures threaten to slow progress toward the Fed's 2% objective. We expect core personal consumption expenditures (PCE) inflation to average 3.0% year-over-year in the second half of 2026 before moderating to 2.2% by the end of 2027.
- **Federal Reserve:** The combination of resilient demand, persistent inflation pressures, and a more challenging path back to price stability has strengthened the case for additional policy tightening. We now expect a cumulative 75 basis points of rate increases between September 2026 and March 2027, bringing the federal funds rate to a peak range of 4.25% to 4.50%.
- **Risks:** We maintain a 25% probability of recession over the next 12 months. While economic activity remains resilient, persistent inflation pressures, additional monetary-policy tightening, elevated long-term interest rates, and a retrenchment in AI-related investment remain the primary risks to the outlook.

Economics Research Group contributors

Beth Ann Bovino

Chief Economist
bethann.bovino@usbank.com

Ana Luisa Araujo

Senior Economist
analuisa.araujo@usbank.com

Matt Schoeppner

Senior Economist
matthew.schoeppner@usbank.com

Adam Check

Economist
adam.check@usbank.com

Andrea Sorensen

Economist
andrea.sorensen@usbank.com

Investment products and services are:

NOT A DEPOSIT • NOT FDIC INSURED • MAY LOSE VALUE • NOT BANK GUARANTEED • NOT INSURED BY ANY FEDERAL GOVERNMENT AGENCY

U.S. Bank Economic Research Group October 2026 Macro Forecast Summary

	Actual 2025	Forecast 2026	Forecast 2027	Forecast 2028
Real GDP	2.3	2.4	2.4	2.0
Consumer Spending	2.6	2.5	2.4	1.9
Investment	3.1	4.1	5.7	3.3
Housing Starts	1.36	1.4	1.4	1.4
Unemployment Rate	4.3	4.2	4.3	4.2
Consumer Price Index	2.7	3.4	2.6	2.3
Core PCE Price Index	2.8	3.0	2.4	2.0
Federal Funds (Upper Target)	4.4	3.8	4.5	4.5

Forecast as of: October 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:
AI promises come with a price tag

While researching our latest report, *AI bubble or the next industrial revolution*, we were struck by the timing mismatch: the costs come upfront, while the payoff comes later. With AI, the buildout costs are significant while the size of the payoff is unclear. Businesses are buying chips, building data centers, expanding power systems, upgrading software, and training workers to ‘supervise’ their AI agents. That spending supports growth even as higher interest rates weigh on other sectors. Companies must buy the ingredients, build the kitchen, and train the cooks, at a cost, before the pie gets bigger.

These upfront costs happen before AI helps firms produce more with less. That lag explains the bubble talk: new technologies often attract too much money and optimism before their lasting value is clear. Some projects will prove more Betamax than breakthrough, but a few bad recipes do not make the kitchen useless.

Broad adoption could lift output per worker and offset slower labor-force growth in the U.S. economy. Stronger productivity could eventually contain costs, encourage investment and new business. The labor-market story will probably be less “robots took my job” and more “the job got remodeled.” So far, AI seems more likely to curb hiring and reorganize tasks than cause mass layoffs. Machines can handle routine analysis, while people devote more time to judgment, relationships, and context. I expect a similar partnership with the AI revolution.

The challenge is getting the mix right. Workers who complement AI should become more productive and valuable, while firms that invest wisely in this partnership can turn expensive tools into durable gains. Yet a bigger pie does not guarantee equal slices. Who benefits will depend on skills, competition, wage flexibility, and who owns the technology.

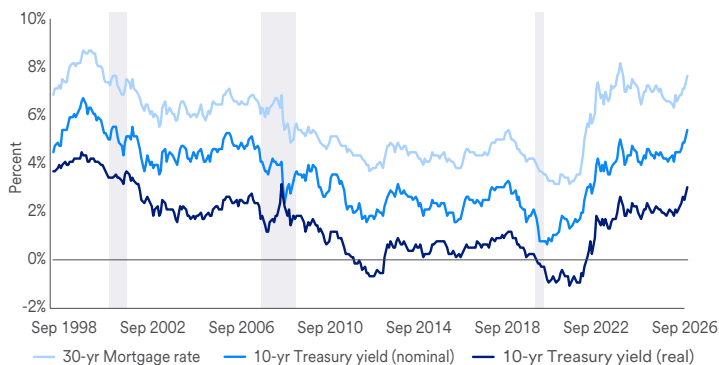
Get investment, training, and the human-machine partnership right, and AI can support better work and broader prosperity. Get them wrong, and we may still get a bigger pie – but fewer served at a very small table.

You can always find Beth Ann Bovino’s commentaries [here >](#)

Interest rates: The new cost of capital

The sharp rise in Treasury yields has become one of the defining economic stories of the past month. The 10-year Treasury yield recently climbed above 5.30% for the first time in over two decades, reflecting a growing reassessment of both the economic outlook and the trajectory of monetary policy. Stronger-than-expected growth, resilient consumer spending, and persistent inflation have challenged expectations that higher borrowing costs would meaningfully slow the economy, increasing the likelihood that Federal Reserve policy remains restrictive for longer.

U.S. Treasury rate



Source: U.S. Bank Economics, Mortgage Bankers Association (MBA), Bloomberg

Yet the rise in long-term yields appears to reflect more than expectations for the Fed's next few decisions. Investors are increasingly reassessing where long-term interest rates ultimately settle once current economic and policy uncertainties fade. Strong demand for capital, particularly from AI-related investment, has coincided with rising Treasury borrowing needs and increased debt issuance. As a result, investors are demanding greater compensation to commit funds for longer periods, pushing the term premium higher and contributing to the rise in Treasury yields.

Structural forces may also be contributing to this shift. Slower labor-force growth, years of underinvestment in key sectors, and recurring supply disruptions have left the economy operating with less spare capacity than in the past. The combination of stronger capital demand and more limited supply suggests the economy may now require somewhat higher interest rates than it did during the decade prior to the pandemic.

None of this necessarily means rates will continue rising indefinitely. But it does suggest that investors and businesses should prepare for a world in which long-term borrowing costs

remain "higher for longer ... and longer." Even if inflation returns to target and the Fed eventually begins easing policy, long-term rates may settle above the levels experienced during much of the 2010s. The challenge may no longer be navigating a higher-for-longer environment, but adjusting to the possibility that the baseline level of interest rates has shifted permanently higher.

Consumer spending: Resilient, but facing new pressures

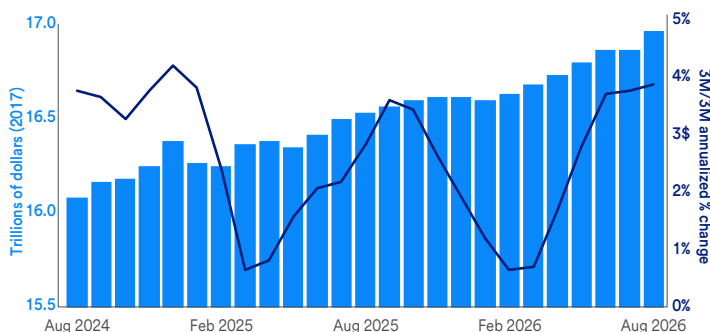
Consumer spending remains an important source of economic resilience. August retail sales exceeded expectations, with gains broadly distributed across both goods and services categories, suggesting the temporary slowdown observed earlier this summer was not the beginning of a broader pullback. As a result, we are currently tracking third-quarter real consumer spending growth near a 3.6% annualized pace, following a strong 3.8% increase in the second quarter and well above the 2.5% average pace recorded over the year. Labor-market conditions also remain supportive, with historically low layoffs and steady income growth helping sustain household spending. While consumption is no longer the primary driver of U.S. economic growth, households continue to spend at a healthy pace despite persistent inflation and higher borrowing costs.

Household finances, however, continue to present a mixed picture. Several years of elevated inflation have limited gains in purchasing power, while rising energy costs are placing renewed pressure on household budgets. Although household balance sheets remain supportive overall, particularly among higher-income consumers benefiting from strong equity markets and rising wealth, low saving rates and elevated borrowing costs leave many households with less flexibility to absorb future shocks, especially for interest-rate-sensitive purchases such as homes and vehicles.

The consumer outlook therefore remains constructive, but increasingly exposed to rising energy costs, elevated interest rates, and thinner financial cushions. We expect consumer spending to moderate toward a more trend-like 2% pace through 2027, supported by stable labor-market conditions and continued income growth. Nevertheless, households are likely to become more selective in how they allocate spending, leaving economic growth increasingly reliant on business investment and productivity gains rather than consumer-led expansion.

U.S. Real Consumer Spending

Personal Consumption Expenditures (PCE)



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

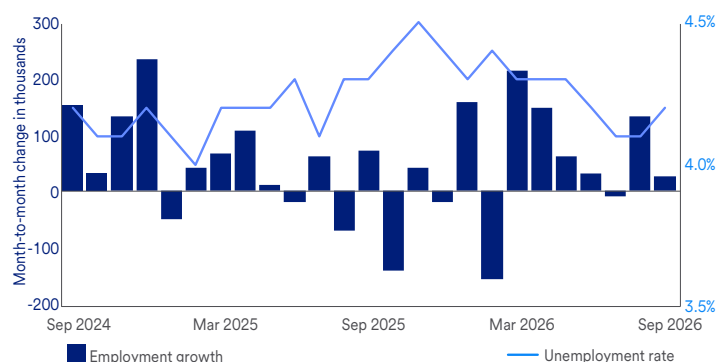
Labor market: Stable, but still slow

The labor market remains broadly stable despite slower hiring activity. September payroll growth came in below expectations, and recent revisions suggest hiring has lost some momentum over the past several months. Even so, layoffs remain historically low, the unemployment rate continues to hold in the low-4% range, and wage growth has moderated without a meaningful increase in labor-market stress. Taken together, these developments are consistent with a labor market settling into a sustainable balance between labor supply and demand.

A key factor supporting that stability has been continued economic resilience. Healthy consumer spending and strong business investment continue to support labor-market conditions, even as hiring remains subdued. Recent employment gains have become increasingly concentrated in industries such as health care, construction, manufacturing, and other investment-related sectors, mirroring the broader trend of growth becoming more dependent on a narrower set of drivers. At the same time, labor-force participation has improved over the past few months, helping offset demographic headwinds and expand the available workforce.

Looking ahead, we expect labor-market conditions to remain broadly balanced. While hiring is likely to remain modest, historically low layoff activity and slower labor-force growth constrain the supply of available workers, limiting upward pressure on unemployment. As a result, we expect the unemployment rate to remain in the low-4% range through much of the forecast period, consistent with a labor market that is cooling gradually rather than deteriorating.

U.S. Labor Market



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

Inflation: Progress continues, but risks have shifted

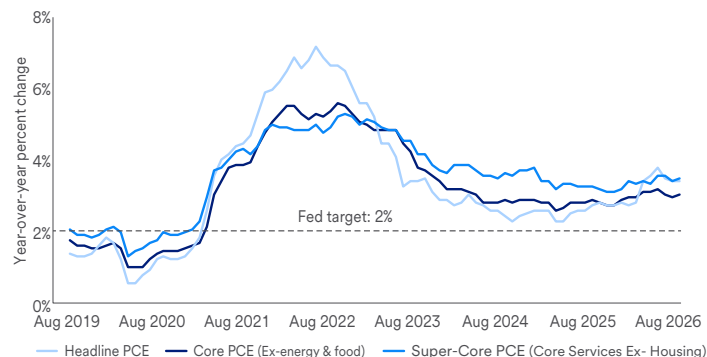
Inflation continues to move gradually toward the Federal Reserve's 2% objective, though the path remains uneven. August's inflation data showed further improvement in underlying price pressures, with annual revisions lowering previously reported inflation rates and helping confirm that inflation has moderated more than initially believed. At the same time, core inflation remains above target and progress continues to vary significantly across categories. While some goods and housing-related measures have continued to improve, many service-sector prices remain elevated, suggesting the final stage of disinflation is likely to take time.

A growing challenge is that the sources of inflation risk have increasingly shifted away from the labor market and toward energy and other supply-related factors. Recent increases in oil and fuel prices contributed meaningfully to August's headline inflation reading and have begun affecting transportation-related categories more broadly. Geopolitical uncertainty and higher commodity prices have introduced a renewed source of price pressure, even as underlying demand conditions remain relatively stable. As a result, inflation risks now appear more connected to the possibility that supply-driven cost increases slow or interrupt the broader disinflation trend.

Looking ahead, we continue to expect inflation to moderate over time, supported by cooling housing costs, slower wage growth, and improving underlying inflation trends. However, the process is likely to remain gradual and occasionally uneven as higher energy costs and other supply-related pressures offset some of the progress occurring elsewhere in the economy. We expect core PCE inflation to average

3.0% year over year during the second half of 2026 before moderating to 2.2% by the end of 2027. Although inflation remains on a path back toward target, recent developments suggest the final stretch will continue to prove challenging and less predictable.

U.S. Inflation



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

Monetary policy: Inflation remains priority

The Federal Reserve's rate increase at the September Federal Open Market Committee (FOMC) meeting marked an important shift in the policy outlook. The FOMC raised the federal funds rate by 25 basis points to a target range of 3.75% to 4.00%, citing resilient economic activity and inflation that remains above its 2% objective. Updated projections reinforced the view that policymakers believe the economy can withstand additional tightening, with participants modestly raising their growth forecasts, lowering their projected unemployment rate, and signaling that further policy firming will likely be needed. Most importantly, the Committee emphasized that the goal of the increase was to support a more timely return of inflation to target rather than respond to any deterioration in economic conditions.

Chair Warsh's characterization of the decision as removing "a dose of accommodation" provided additional insight into how policymakers view the current environment. While borrowing costs have risen meaningfully, officials appear unconvinced that overall financial conditions are sufficiently restrictive to guarantee a sustained return to price stability. At the same time, policymakers have become increasingly focused on the risk that higher energy costs, geopolitical developments, tariffs, and other supply-related pressures could prolong the inflation process if they begin spreading more broadly through the economy. Subsequent comments from Fed officials consistently reinforced this theme, emphasizing that the labor market remains in solid condition while inflation continues to warrant the Committee's primary attention.

As a result, our monetary-policy outlook has become modestly more hawkish. We continue to expect policymakers to proceed gradually, allowing time between rate increases to evaluate incoming economic and inflation data. However, the combination of resilient economic activity, persistent price pressures, and the Committee's own policy projections supports our expectation for two additional 25-basis-point rate increases in December and March. That would bring cumulative tightening to 75 basis points between September 2026 and March 2027 and leave the federal funds rate in a 4.25% to 4.50% target range. From there, we expect the Fed to remain on hold through 2027 as policymakers assess whether inflation is moving sustainably back toward target and whether the economy can continue expanding at a pace consistent with long-run price stability.

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

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

Economic Data¹

Nominal GDP	3.7	5.8	8.5	6.7	5.2	4.7	4.6	3.8	4.2	5.0	6.2	5.1
Real GDP	0.2	2.5	2.2	3.5	2.8	2.1	2.1	2.0	2.0	2.3	2.4	2.4
Consumer Spending	1.9	0.7	3.8	3.6	2.8	1.9	2.0	1.9	1.9	2.6	2.5	2.4
Investment	1.1	7.2	4.6	13.0	7.0	4.9	3.7	3.4	3.3	3.1	4.1	5.7
Residential Structures	-1.8	-7.6	2.8	0.0	0.3	1.4	2.0	2.0	2.0	-2.7	-2.8	1.3
Non-Residential Structures	-9.8	-9.4	0.1	1.0	0.5	1.7	2.0	2.0	2.0	-2.2	-5.4	1.4
Intellectual Property	4.4	15.6	9.2	7.0	6.4	5.1	5.0	4.8	4.7	6.8	9.3	5.8
Equipment	6.9	15.5	13.4	11.2	8.0	6.0	4.3	3.3	2.8	8.8	11.1	6.6
Change in Inventory	-45.9	-34.7	-63.4	5.4	25.0	30.0	27.2	25.0	25.0	6.7	-16.9	26.8
Government Spending	-5.7	4.7	-0.1	1.6	1.4	1.3	1.3	1.2	1.2	1.6	0.7	1.3
Federal	-15.7	10.9	-2.4	2.5	2.4	2.3	2.1	2.0	1.9	-1.3	-0.6	2.0
State & Local	0.5	1.4	1.2	1.0	0.8	0.8	0.8	0.8	0.8	3.3	1.4	0.9
Imports	-1.5	11.5	12.6	11.6	5.5	4.0	3.0	3.0	3.1	3.6	4.4	5.3
Exports	-4.2	13.9	5.0	1.5	1.5	2.0	2.5	2.7	3.0	2.1	4.8	2.3
Housing Starts	1.32	1.42	1.35	1.36	1.36	1.35	1.36	1.37	1.37	1.36	1.37	1.36
Unemployment Rate	4.5	4.3	4.3	4.1	4.2	4.2	4.3	4.3	4.2	4.3	4.2	4.3

Prices²

Consumer Price Index	2.7	2.7	3.8	3.4	3.5	3.3	2.5	2.4	2.3	2.7	3.4	2.6
Core PCE Price Index	2.8	3.0	3.1	3.0	3.0	2.8	2.4	2.3	2.2	2.8	3.0	2.4

Interest rates³

Federal Funds (Upper Target)	4.02	3.75	3.75	3.79	4.07	4.29	4.51	4.51	4.51	4.37	3.84	4.46
2-Yr Treasury Note	3.52	3.58	3.97	4.34	4.77	4.65	4.62	4.61	4.60	3.81	4.17	4.62
10-Yr Treasury Note	4.10	4.20	4.42	4.74	5.02	4.87	4.82	4.81	4.80	4.29	4.59	4.83
30-Yr Freddie Mac Mortgage	6.23	6.11	6.42	6.69	6.85	6.65	6.58	6.56	6.55	6.60	6.52	6.59

Forecast as of October 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 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 Economic Research Group.



The views expressed in this commentary represent the opinion of the author and do not necessarily reflect the official policy or position of U.S. Bank. The views are intended for informational use only and are not exhaustive or conclusive. The views are subject to change at any time based on economic or other conditions and are current as of the date indicated on the materials. It is not intended to be a forecast of future events or guarantee of future results. It is not intended to provide specific advice. It is issued without regard to any particular objective or the financial situation of any particular individual. It is not to be construed as an offering of securities or recommendation to invest. It is not for use as a primary basis of investment decisions. It is not to be construed to meet the needs of any particular investor. It is not a representation or solicitation or offer for the purchase or sale of any particular product or service.

Investors should consult with their investment professional for advice concerning their particular situation. The factual information provided has been obtained from sources believed to be reliable, but is not guaranteed as to accuracy or completeness. U.S. Bank is not affiliated or associated with any organizations mentioned.

U.S. Bank and its representatives do not provide tax or legal advice. Each individual's tax and financial situation is unique. You should consult your tax and/or legal advisor for advice and information concerning your particular situation.