Economic Research Group
SEPTEMBER 2026

U.S. ECONOMIC OUTLOOK

A new engine

Summary: Our September 2026 U.S. economic outlook continues to point to an economy expanding at a solid pace despite a range of geopolitical, structural, and policy-related headwinds. While second-quarter GDP growth remained at a modest 1.5% annualized rate, upward revisions to consumer spending and continued strength in business investment suggest underlying demand remains firmer than the headline figure implies. AI-related investment and productivity gains continue to provide an increasingly important source of support, offsetting weakness in more interest-rate-sensitive sectors and helping keep the expansion on track. With economic activity proving more resilient than many anticipated, the focus has increasingly turned from growth risks to whether inflation can continue moving sustainably toward the Federal Reserve's 2% objective.

Looking ahead, our baseline forecast continues to call for growth near its long-run potential pace. The central question is no longer whether the economy can withstand higher interest rates, but whether inflation can continue moving lower while demand, investment and productivity remain unusually resilient. Although inflation has eased considerably from its peak, recent developments suggest the final stretch back to price stability may prove slower and less predictable than previously anticipated. As a result, we continue to expect the Federal Reserve to raise the policy rate by 25 basis points in September and remain focused on preserving price stability until inflation shows clearer signs of returning sustainably toward target.

- **Growth:** Real GDP growth will likely be 2.1% fourth-quarter-over-fourth-quarter (Q4/Q4) in 2026 (2.2% annual average) and 2.1% Q4/Q4 in 2027 (2.2% annual average). While slowing labor-force growth and restrictive monetary policy continue to present headwinds, resilient consumer demand, strong AI-related investment, and improving productivity will keep economic growth near its long-run potential.
- **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. Historically low layoffs and slower labor-force growth should help keep unemployment relatively stable.
- **Inflation:** Inflation has shown recent 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 in the second half of 2026 before moderating to 2.1% by the end of 2027, though the final stretch back to target may prove bumpier than previously expected.
- **Federal Reserve:** Resilient economic activity and lingering inflation pressures have reinforced policymakers' focus on price stability. As a result, our baseline forecast still includes a 25-basis-point rate hike in September, followed by an extended pause as officials assess incoming data.
- **Risks:** We maintain a 25% probability of recession over the next 12 months. While resilient consumer spending, strong AI-related investment, and a stable labor market continue to support growth, they may also slow the return of inflation to target. As a result, persistently higher inflation, additional monetary policy tightening, rising long-term interest rates tied to federal debt concerns, and a retrenchment in AI-related investment remain key risks to the outlook.

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

	Actual 2025	Forecast 2026	Forecast 2027	Forecast 2028
Real GDP	2.1	2.2	2.2	2.0
Consumer Spending	2.6	2.1	2.1	1.9
Investment	1.9	3.5	5.4	3.1
Housing Starts	1.36	1.36	1.35	1.35
Unemployment Rate	4.3	4.3	4.3	4.2
Consumer Price Index	2.7	3.4	2.6	2.3
Core PCE Price Index	2.8	3.3	2.4	2.0
Federal Funds (Upper Target)	4.4	3.8	4.0	4.0

Forecast as of: September 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 $40 trillion question: What would Janet Yellen think?

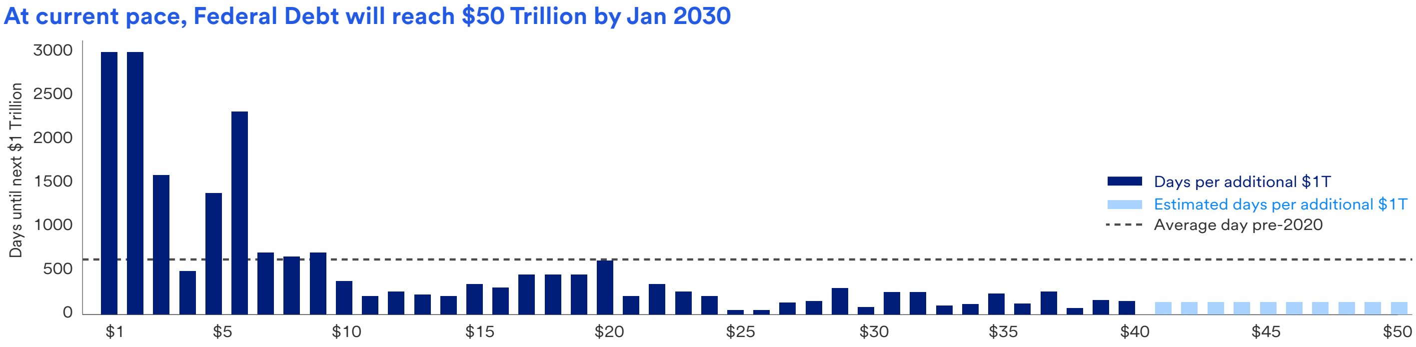
It wasn't news that the U.S. government's total gross federal debt reached $40 trillion last month. It wasn't even that, as a percentage of GDP, it's in triple digits. What caught my attention is how quickly $1 trillion can be added to the sum.

The pace is the bigger worry. From 1982 to 1999, it took an average of 635 days, or just under two years, for debt to rise by another $1 trillion. Since 2020, that timeline has shrunk to about 152 days – and 124 days since government debt hit $38 trillion. At this pace, federal debt will reach $50 trillion in January 2030, or 3 years and three months. In other words, the debt clock is not just ticking; it is moving a lot faster.

I keep coming back to former U.S. Treasury Secretary Janet Yellen's warning when the federal debt passed the $38 trillion "threshold." She warned that rising debt relative to GDP "are clearly strengthening" preconditions for fiscal dominance, where government financing needs begin to limit the Fed's ability to run monetary policy cleanly and independently.

The debt level alone is not the whole story. The real issue is the combination of faster debt growth, rising interest costs, and investor patience that may not last forever. Markets had mostly shrugged off the debt buildup so far. But are now paying closer attention. If confidence slips, higher term premiums, inflation expectations, and long-term rates could follow.

At current pace, Federal Debt will reach $50 Trillion by Jan 2030



Source: U.S. Bank Economics, Bloomberg, U.S. Treasury Department, ECMSource.com

You can always find Beth Ann Bovino's commentaries here >

Consumer spending: Holding up, but no longer driving the story

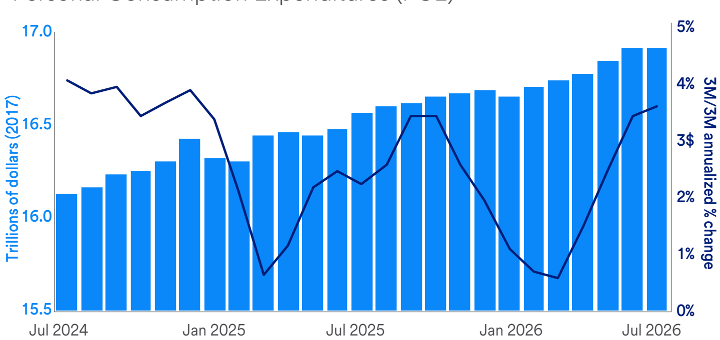
Consumer spending continues to provide an important foundation for economic growth, though it is no longer the primary force behind the expansion. Revised second-quarter GDP data showed household spending increased at a 3.4% annualized pace, stronger than initially reported and consistent with underlying demand that remains firmer than headline growth suggests. Labor market conditions also remain supportive, with historically low layoffs helping sustain income growth and consumer confidence. Even so, spending appears increasingly supported by stability rather than momentum, reflecting a consumer sector that remains resilient but is no longer accelerating.

Household finances continue to present a mixed picture. Income growth has improved from the slower pace seen last winter, but several years of elevated inflation have limited gains in purchasing power. While inflation has shown renewed signs of easing, higher living costs continue to absorb a meaningful share of household budgets. Household balance sheets remain a source of support, particularly among higher-income consumers benefiting from strong equity markets and rising wealth. However, low saving rates suggest many households have less flexibility to absorb future shocks, while higher borrowing costs continue to weigh on interest-rate-sensitive spending.

The consumer outlook therefore remains constructive, but increasingly uneven. Higher-income households continue to benefit from stronger balance sheets and asset values, while many lower- and middle-income consumers remain more exposed to inflation and borrowing costs. Looking ahead, we expect consumer spending to expand at a moderate, roughly 2% annualized pace through 2027. While that should remain sufficient to support economic growth, the expansion is likely to depend increasingly on business investment and productivity gains rather than stronger household spending.

U.S. Real Consumer Spending

Personal Consumption Expenditures (PCE)



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

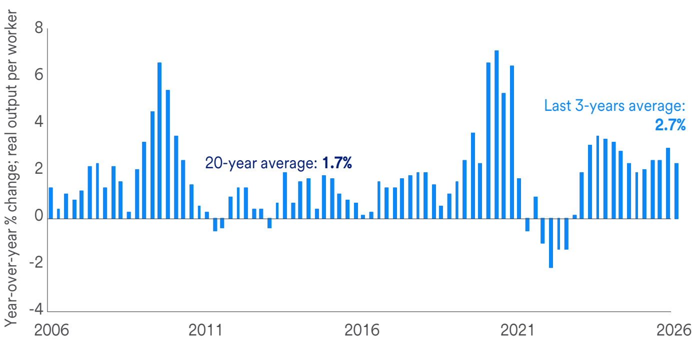
Business investment: AI continues to reshape the expansion

Business investment remains one of the strongest areas of the U.S. economy, though momentum continues to be concentrated in a relatively narrow set of technology-related categories. Spending on artificial intelligence (AI), cloud computing, data centers, semiconductors, software, and other productivity-enhancing technologies continues to expand despite elevated interest rates and tighter financial conditions. Increasingly, these investments are contributing meaningfully to overall economic activity, with AI-related spending now estimated to be adding nearly a full percentage point to U.S. economic growth. As a result, business investment has become an increasingly important counterweight to slower activity in more interest-rate-sensitive sectors of the economy.

The significance of this investment cycle extends beyond the direct spending itself. One of the more encouraging developments in recent years has been a noticeable improvement in productivity growth, with businesses increasingly generating more output without a commensurate increase in labor inputs. While it remains too early to draw definitive conclusions, growing adoption of AI, automation, and other advanced technologies appears to be contributing to those gains. This development is particularly important given slowing labor-force growth, as stronger productivity may help offset demographic headwinds and support economic growth near its long-run potential pace in the years ahead.

At the same time, the increasing importance of AI-related investment creates both opportunities and risks for the outlook. Continued technological adoption and productivity gains could support stronger growth than currently anticipated, particularly if the benefits of these investments broaden beyond the technology sector. However, a growing share of economic momentum is now tied to a relatively limited number of industries and large-scale investment projects. Moreover, the same forces helping sustain growth may also slow the return of inflation to target by supporting demand and economic activity at a time when policymakers remain focused on price stability. As a result, the durability of the current expansion increasingly depends on continued business investment and the productivity gains it is expected to generate.

U.S. Productivity



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

Housing: Frozen, not broken

Despite the summer heat, the housing market remains in hibernation. Existing-home sales continue to run roughly 25% below pre-pandemic levels, home-price appreciation has slowed considerably, and new construction is beginning to show signs of fatigue. Yet unlike prior housing downturns, today's market remains broadly stable. Housing remains one of the clearest examples of where higher interest rates continue to restrain economic activity, even as the broader economy remains on relatively solid footing.

Existing-home sales have remained range-bound near 4.0 to 4.25 million units annually for the past four years, well below the 5.0 to 5.5 million pace common before the pandemic. Earlier this year, a brief decline in mortgage rates below 6% raised hopes for a rebound. However, resilient economic growth, persistent inflation pressures, and higher long-term Treasury yields pushed mortgage rates back above 6.5%, quickly ending any meaningful improvement in activity. The market continues to be constrained by the lock-in effect, as many homeowners remain reluctant to exchange low-rate mortgages for significantly higher borrowing costs. While the influence of lock-in should gradually fade over time, it remains a meaningful obstacle to turnover today.

At the same time, housing conditions have become more balanced. Inventories have improved, affordability has stabilized, and home-price appreciation has slowed sharply. The S&P Cotality Case-Shiller 20-City Index is up just 2.1% over the past year, below the pace of inflation. Adjusted for inflation, home prices are approximately 3.5% below their mid-2022 peak. Combined with rising real wages, these trends have modestly improved affordability, helping prevent further deterioration in demand even as mortgage rates remain elevated.

Residential construction has held up better than the resale market, but builders are becoming more cautious. Recent housing-starts data have softened, with weakness emerging in both single-family and multifamily construction. While permits suggest activity is unlikely to collapse, elevated financing costs, affordability constraints, and slower demand growth should keep residential investment subdued through the remainder of the year. As a result, housing is likely to remain a modest drag on economic growth rather than a meaningful source of support.

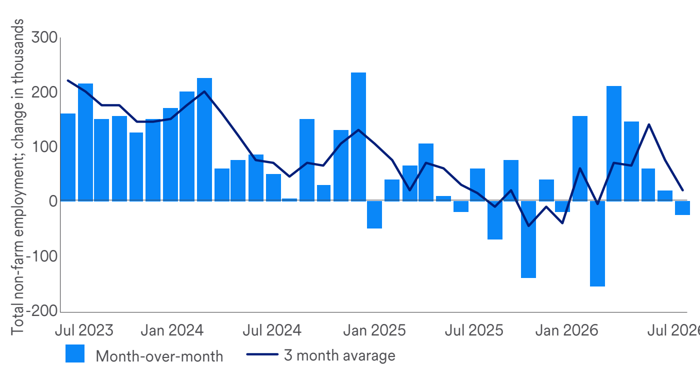
Labor market: Supply constraints take center stage

The labor market continues to cool, but there is little evidence of a material deterioration in overall conditions. Job growth has slowed from the exceptionally strong pace seen earlier in the expansion, yet layoffs remain historically low, unemployment continues to hold in the low-4% range, and wage growth has moderated without a meaningful increase in labor-market stress. Rather than signaling weakness, these developments are broadly consistent with a labor market moving toward a more sustainable balance between labor supply and labor demand.

A key reason for that stability is slower labor-force growth. Demographics, retirements, lower fertility rates, reduced migration, and softer participation gains have all contributed to a workforce that is expanding more slowly than in prior years. As a result, the economy no longer requires the same pace of job creation to maintain a stable unemployment rate, helping explain why unemployment has remained relatively steady despite more moderate hiring.

Looking ahead, we expect labor-market conditions to remain broadly balanced. Slower labor-force growth will increasingly place the burden of economic expansion on productivity gains, which have strengthened in recent years and may reflect ongoing investment in AI, automation, and other efficiency-enhancing technologies.

U.S. Labor Market



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

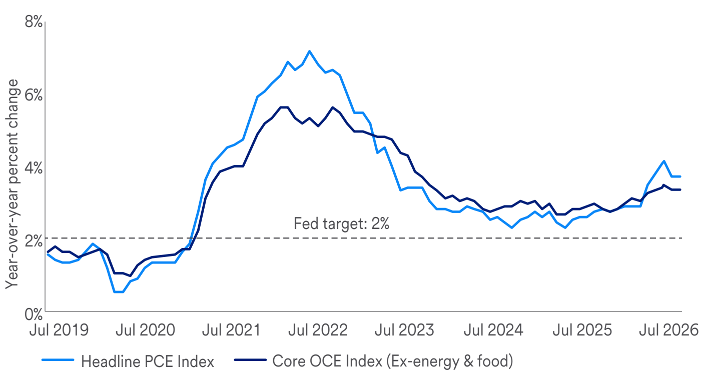
Inflation: The final stretch gets harder

Inflation continues to move in the right direction, but progress is becoming increasingly uneven. Recent reports have shown renewed signs of moderation, particularly in some goods and housing-related categories, helping ease concerns that inflation was reaccelerating earlier this year. Even so, underlying inflation remains well above the Federal Reserve's 2% target, with core PCE inflation running 3.3% over the year through July. More broadly, recent data suggest the easiest phase of the disinflation process may now be behind us.

A key challenge is that many of the same forces supporting economic growth are also slowing the return to price stability. Consumer spending remains positive, business investment continues to expand, and labor-market conditions remain broadly balanced despite slower hiring. At the same time, goods prices have moved back into positive territory, services inflation remains elevated, and higher energy prices have introduced a renewed source of uncertainty. As a result, inflation is unlikely to return to target in a straight line, particularly if economic activity remains resilient.

Looking ahead, we expect inflation to continue moderating, but only gradually. Cooling housing inflation, easing supply-chain pressures, and slower wage growth should help reduce price pressures over time. However, persistent services inflation and continued resilience in economic activity are likely to keep inflation above target through much of the forecast period. The result is an environment in which inflation continues to improve, but not quickly enough to shift policymakers' focus away from price stability, helping explain why the Federal Reserve remains inclined to maintain a restrictive policy stance for longer than previously anticipated.

U.S. Inflation



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

Monetary policy: The arrival of the Warsh Fed

Federal Reserve Chair Kevin Warsh has signaled that the most significant change at the Fed may not be the level of interest rates, but how monetary policy is communicated and implemented. Since taking the gavel in May, Warsh has deemphasized explicit forward guidance, shortened policy statements, and encouraged markets to focus more on economic data than Fed signaling. That shift was on full display at Jackson Hole in late August, where he spent little time discussing the next policy move and far more time explaining how policymakers should evaluate a rapidly changing economic environment.

A central theme of the new approach is that policymakers should remain open to the possibility that the economy is evolving in important ways. Advances in AI, stronger productivity growth, changing labor-force dynamics, demographic shifts, and evolving financial conditions may all affect how economic data should be interpreted. The Fed's recent reviews and task forces examining communications, productivity, labor markets, inflation measurement, and alternative data sources reflect a broader willingness to reassess assumptions that have guided monetary policy for much of the past decade.

Importantly, a more flexible framework should not be confused with a more accommodative one. Warsh has consistently described economic activity as resilient while emphasizing that inflation remains above target and recent progress has been encouraging, but not yet conclusive. The result is a Fed that appears less committed to policy roadmaps and more focused on responding to incoming data. Consistent with that framework, our baseline forecast continues to include a 25-basis-point rate hike in September, followed by an extended pause as policymakers assess whether inflation is returning sustainably toward target.

U.S. Bank Economic Research Group September 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	8.0	5.2	4.8	4.5	4.5	4.1	5.0	6.1	4.8
Real GDP	0.5	2.1	1.5	2.7	2.2	2.1	2.3	2.0	2.1	2.2	2.2
Consumer Spending	1.9	0.5	3.4	2.5	1.7	1.8	2.0	1.9	2.6	2.1	2.1
Investment	2.3	7.9	2.7	8.5	7.6	5.3	4.4	3.5	1.9	3.5	5.4
Residential Structures	-1.7	-7.8	1.3	-0.5	0.4	1.4	2.0	2.0	-2.2	-3.4	1.2
Non-Residential Structures	-6.5	-4.7	-1.8	-0.7	0.5	1.7	2.0	2.0	-5.3	-3.9	1.1
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	13.6	10.6	8.0	6.0	4.3	3.3	8.3	10.3	6.5
Change in Inventory	-15.6	-16.7	-53.1	-20.0	10.0	20.0	25.0	25.0	28.5	-19.9	23.8
Government Spending	-5.6	4.4	-1.0	1.6	1.4	1.3	1.3	1.2	1.1	0.4	1.2
Federal	-16.6	9.4	-4.2	2.5	2.4	2.3	2.1	2.0	-1.2	-1.5	1.8
State & Local	1.5	1.6	0.9	1.0	0.8	0.8	0.8	0.8	2.5	1.5	0.8
Imports	-1.0	11.8	12.5	7.5	5.5	4.0	3.0	3.0	2.7	3.3	4.8
Exports	-3.2	10.9	4.5	3.0	2.5	2.0	2.5	2.7	1.6	4.4	2.6
Housing Starts	1.32	1.42	1.34	1.35	1.35	1.35	1.35	1.35	1.356	1.363	1.352
Unemployment Rate	4.5	4.3	4.3	4.2	4.3	4.4	4.4	4.3	4.3	4.3	4.3
Prices[2]											
Consumer Price Index	2.7	2.7	3.8	3.5	3.5	3.3	2.5	2.4	2.7	3.4	2.6
Core PCE Price Index	2.9	3.1	3.4	3.4	3.3	2.8	2.5	2.3	2.8	3.3	2.4
Interest rates[3]											
Federal Funds (Upper Target)	4.02	3.75	3.75	3.80	4.01	4.01	4.01	4.01	4.37	3.83	4.01
2-Yr Treasury Note	3.52	3.58	3.97	4.21	4.15	4.12	4.10	4.10	3.81	3.98	4.11
10-Yr Treasury Note	4.10	4.20	4.42	4.64	4.57	4.52	4.51	4.50	4.29	4.46	4.51
30-Yr Freddie Mac Mortgage	6.23	6.11	6.42	6.53	6.37	6.29	6.26	6.25	6.60	6.36	6.26

Forecast as of September 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.