

U.S. ECONOMIC OUTLOOK

Near trend, not trouble

Our March 2026 U.S. economic outlook highlights an economy that remains near trend, though recent data point to a more fragile balance between growth and labor market momentum than earlier in the year. Late-2025 GDP weakness largely reflects temporary shutdown effects rather than a deterioration in underlying private demand, and consumers continue to support growth. However, February's employment report introduced meaningful downside risk to the recent "stable but slow" labor market narrative, with hiring activity softer than expected and unemployment edging higher. While some of the weakness reflects temporary distortions, the report suggests less cushion in the labor market than previously assumed. Inflation progress remains uneven, with core PCE (Personal Consumption Expenditures) still near 3% amid firmer goods prices and sticky services inflation – supporting a cautious Federal Reserve even as labor conditions cool.

Geopolitical developments have become another key swing factor. News of a U.S.–Israel attack on Iran revived fears of recession, particularly given that nine of 10 U.S. recessions since WWII were preceded by sharp oil price spikes. The geopolitical risk premium on oil has moved higher, with markets pricing escalation risks that could push prices over \$100 per barrel. However, this historical pattern is unlikely to repeat for the U.S. economy: in our analysis, even if oil prices reach \$120 and remained there, recession is still not likely, as the U.S. is far more insulated than 45 years ago.

Trade policy remains a manageable headwind, with the effective tariff burden stabilizing near 9–10%, adding modest price pressure but not threatening the expansion. Overall, we expect growth to remain steady in 2026, supported by a temporary Q1 rebound as shutdown effects fade, though the outlook is increasingly sensitive to whether recent labor market softness proves transitory or more persistent.

- **Growth:** We forecast above consensus real GDP growth of 2.6% on an annual average basis (2.4% Q4-over-Q4) in 2026, reflecting firmer late 2025 momentum and steadier incoming activity data. Growth moderates as consumer spending cools, but fiscal supported equipment investment, AI related capex, and improving productivity help keep the expansion near trend rather than stalling.
- **Labor market:** February's employment report was a clear downside surprise. Payrolls fell and prior months were revised lower, pushing trend job growth close to stall speed, while the unemployment rate edged back up to 4.4%. Some weakness reflects temporary factors, including healthcare strike effects, but softness was broad-based across private industries. With wage growth still firm, the labor market appears to be cooling rather than unraveling, but upcoming reports will be key in determining whether hiring re-stabilizes or slips below breakeven.

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- **Inflation:** Core PCE rose 3.0% over the 12 months through December, with recent firmness driven in part by goods sector price pressures linked to tariffs, while services disinflation continues but remains uneven. We expect core PCE to move up to 3.2% by mid 2026 before gradually converging toward the Fed's 2% target by the end of 2027, though elevated energy prices linked to geopolitical risks could slow near-term progress.
- **Federal Reserve:** The Fed held rates steady in January, reinforcing a patient, data-dependent stance amid growing cross-currents. February's labor market weakness lowers the bar for eventual easing if softness persists, but rising geopolitical risks tied to the Iran conflict could complicate the inflation outlook and limit near-term flexibility. We continue to expect two rate cuts in 2026, though the balance of risks suggests the Fed may remain on hold somewhat longer than previously assumed as it navigates increased tension between its dual mandates.
- **Risks:** Downside risks remain elevated, though the base case continues to favor a soft landing. Recent labor market softness suggests less cushion. We maintain a 30% near-term recession probability, while noting rising geopolitical risks tied to the Iran conflict – particularly through energy prices and financial conditions. Policy uncertainty and the risk of a Fed misstep continue to cloud the outlook.

U.S. Bank Economics Research Group March 2026 Macro forecast summary

	Actual 2025	Forecast 2026	Forecast 2027	Forecast 2028
Real GDP	2.2	2.6	2.3	2.3
Consumer Spending	2.7	2.2	2.0	2.0
Investment	2.0	2.8	4.3	4.0
Housing Starts	1.36	1.43	1.40	1.35
Unemployment Rate	4.3	4.5	4.4	4.4
Consumer Price Index	2.7	3.2	2.7	2.3
Core PCE Price Index	2.8	3.0	2.3	2.0
Federal Funds (Upper Target)	4.37	3.56	3.19	3.19

Forecast as of: March 4, 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 Economics Group.

From the desk of the Chief Economist: Oil, guns and butter: The war with Iran

News of the U.S.-Israel attack on Iran reminded many of the 12-day conflict last year. But the similarities stop there. And since nine of 10 U.S. recessions since WWII were preceded by sharp oil price spikes, the concept of "Guns and Butter," first used in WWII, needed 'Oil' added to the phrase.

The geopolitical risk premium on a barrel of oil climbed higher (up \$18 for Brent crude) on concerns that the war will be long, with the principal tail risk in Iran's capacity to disrupt shipping through the Strait of Hormuz. Current market estimates are \$120 per barrel, or higher, depending on escalation dynamics. Oil supply shocks would cause significant economic losses in net energy importers, and emerging markets with high energy intensity and fewer buffers, likely leading to recession.

Not for the U.S. economy. In our analysis, if oil prices reach \$120 and remain there, recession in the U.S. would still not be likely. Even in this scenario, consumer spending and GDP growth would be reduced by 50 and 60 basis points (bps), respectively, technically a soft landing that may not feel like one for many.

Why? The U.S., now the largest producer of fossil fuel energy in the world and a net exporter, is much more insulated than 45 years ago. The U.S. has also become less dependent on oil. Currently, household spending on energy as a share of after-tax income is 5.7%, near a 40-year low and well below its 1980 10% peak. In 1970, the average U.S. car on the road got 12 miles per gallon (MPG). Today the average car gets 25–26 MPG. That insulation provides the U.S. economy protection.

However, the costs in the U.S. are not spread out evenly. The lowest income quintile spends 15-18% of their income on energy (while higher income’s share is less than 2%). This war also comes at a time when U.S. household affordability is already squeezed by still-high and sticky inflation (PCE is now at 3.0%) and high borrowing costs.

Still, I expect the impact to be less than what the U.S. economy faced 45 years ago. This time spillovers to U.S. core inflation and overall economic activity is expected to be limited unless price increases are both large and sustained. Even a sustained 10% increase in oil prices would reportedly only raise core consumer inflation by 20 bps. I don’t see that materially altering underlying inflation dynamics, which gives the Fed reason to stay on the sidelines as events unfold. A much different outcome than 45 years ago.

That’s the best of a bad situation. But if oil price gains are much higher and sustained longer, the Fed may be forced to take a page from 1980 to tame inflation with the U.S. expansion as collateral damage.

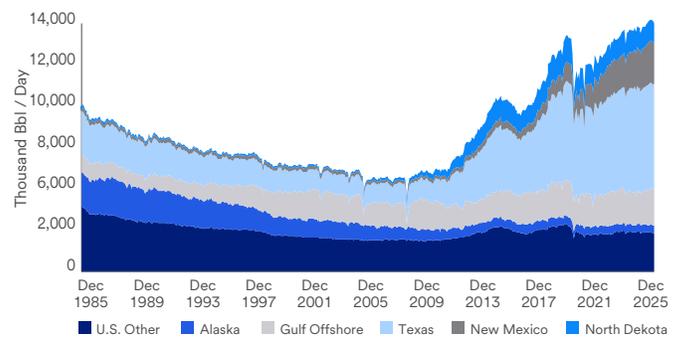
Why today’s threshold is higher than in the 1970s

The U.S. economy is much less oil-intensive today.

Metric	1970s	Today
Oil use per \$ of GDP	Very high	~½ of 1970s
Vehicles mpg	~13 mpg	~25-26 mpg
Domestic production	Low	High (shale)

Source: Energy Information Administration (EIA), Dallas Fed, Pew Research

U.S. oil production by state



Source: Energy Information Administration (EIA)

Trade update: The devil is in the effective rate

Over the past year, tariff policy has shifted from being viewed as a potential stagflationary shock immediately following ‘Liberation Day’ last April, to a more measurable and manageable headwind today. With nearly a full year of data on revenue collections and trade-flow adjustments now available, the evidence suggests tariffs have raised costs and weighed on activity, but by less than initially feared last spring. Uneven pass-through to prices, broad exemptions and carveouts, and firms’ ability to substitute across suppliers have helped keep the realized tariff burden well below the most aggressive headline proposals. In practice, duties paid as a share of imports have settled closer to 9–10%, rather than the 25–30% outcomes that appeared plausible in mid-2025 – in our view, reducing both downside risks to growth and upside risks to inflation.

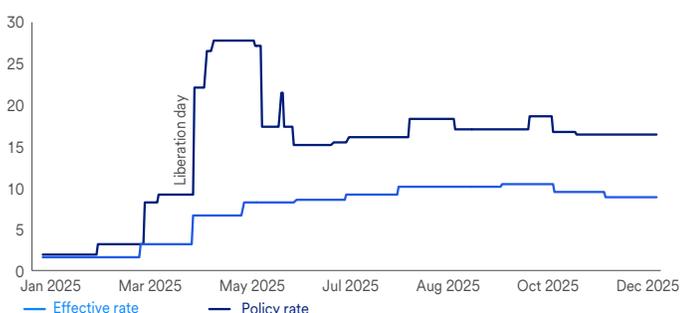
The Supreme Court’s mid-February decision fits within that broader context. The ruling is best viewed as a constraint on the legal mechanism used to impose tariffs, rather than a shift in the underlying trade posture. While the decision invalidated the use of emergency powers to levy broad-based tariffs, it does not materially alter the economic backdrop, as firms have already adjusted supply chains, contracts and pricing strategies around a higher-tariff environment. As a result, the ruling is unlikely to deliver meaningful near-term macro relief, even as it reshapes the process through which tariffs are pursued.

The administration’s response reinforces this interpretation. Following the decision, the White House pivoted to Section 122, announcing a 15% global tariff that can remain in place for up to 150 days. While temporary and subject to congressional extension, the measure includes broad carve-outs – such as for USMCA-compliant trade and goods already subject to

sector-specific tariffs – limiting its impact on the effective tariff burden. At the same time, the administration has signaled it will use the 150-day window to initiate additional investigations under Sections 232 and 301. Taken together, we expect the effective tariff rate to remain near current levels, around 9–10%, even if stated rates temporarily move higher. At these levels, tariffs are likely to continue acting as a steady headwind – contributing to somewhat stickier goods prices at the margin and reinforcing a cautious Federal Reserve, but not posing a material threat to the broader economic expansion.

U.S. Tariff rate

Customs duty revenue as a percent of goods imports



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

Economy: Holding the line

The U.S. economy finished 2025 on a steadier underlying footing than the headline fourth quarter GDP figure suggests. Real GDP growth slowed sharply to a 1.4% annualized rate in Q4, from 4.4% in Q3. But that deceleration was heavily influenced by the October–November 2025 federal government shutdown. Stripping out policy driven and volatile components, “core” private demand remained more trend like, with real final sales to private domestic purchasers rising at a solid mid 2% pace – indicating that the private sector did not abruptly roll over, even as labor market momentum cooled and hiring slowed more noticeably early this year. Viewed through the lens of the full year, the picture is clearer: GDP growth came in at 2.2% on both an annual and Q4-over-Q4 basis in 2025, only slightly below 2024 and broadly consistent with estimates of potential output growth.

In our view, that distinction – realized growth near potential – matters for two important reasons. First, it underscores underlying resilience. An economy expanding at potential implies continued (if moderating) income generation and more resilience to shocks than the headline quarter-to-quarter swings might suggest. Second, it matters for inflation. When growth runs at or above potential, the risk is less about an

immediate recession and more about whether demand continues to press against supply constraints – especially in categories where capacity has been slow to adjust. In other words, ‘trend-like’ growth is consistent with ongoing disinflation but also argues for patience, as it is harder to expect inflation to return quickly to target if the economy is not cooling meaningfully below its longer-run speed limit.

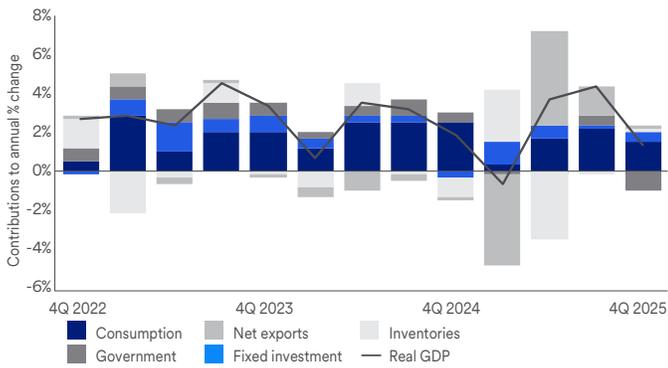
Within that broader picture, consumers remained the anchor of late 2025 resilience, even as the composition of household strength continued to evolve. In our view, the income spending gap that emerged last year remains a key vulnerability. Real disposable income growth has been comparatively restrained, reflecting slower wage and salary gains as hiring demand normalized. Households have bridged that gap partly by running down savings, leaving less cushion as labor market conditions show early signs of further softening. Even so, balance sheets have been supported by firm asset prices, and debt service burdens remain manageable for most borrowers – helping explain why consumption has remained surprisingly durable despite growing concerns about job security and still elevated living costs.

The persistent gap between stronger output and softer labor market signals is increasingly consistent with another theme we’re watching closely: improved productivity dynamics. Even allowing for meaningful measurement noise, nonfarm business productivity – measured as real output per worker – has averaged a notably strong pace, roughly in the mid-2% annualized range, since early 2023. And recent downward revisions to payroll employment point to even larger productivity gains in prior years than currently estimated. In our view, that overall pattern reflects efficiency improvements driven by sustained postpandemic cost pressures, a gradual unwinding of labor hoarding from the recovery period, and increased reliance on cost-offsetting automation. At the same time, a new investment cycle is emerging, with AI-related outlays already allowing firms to equip workers with more – and better – technology, which should support productivity over time even if the full effects have yet to appear in the data.

Looking ahead to 2026, we expect several tailwinds to keep growth on a steady footing, including continued AI driven investment, a supportive fiscal backdrop, and a less restrictive monetary policy stance as inflation continues to normalize. In the near term, our Q1 tracking estimate is around 2.9%, reflecting a temporary boost as shutdown related drags fade. For the full year, we forecast 2.4% GDP growth on a Q4-over-Q4 basis – consistent with an economy keeping near trend rather than stalling, though with a continued tension

between still solid activity and a labor market that appears to be cooling more than output alone would suggest – a dynamic that bears close watching in coming quarters.

U.S. Real GDP



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

Labor market: Normalization without unraveling

Even as overall activity remains near trend, the labor market continues to downshift into a slower, more “normalized” regime, with February’s employment report underscoring how close hiring activity has moved toward stall speed. Payrolls declined outright, prior months were revised lower, and the unemployment rate edged up to 4.4%. While part of the weakness reflects temporary factors – most notably healthcare strike activity and population control revisions – the softness was broad-based across private sector industries. At the same time, wage growth remained firm, complicating the signal and highlighting the growing tension between slower hiring and still-steady labor income dynamics. Taken together, the February data suggest less cushion in the labor market than previously assumed, even if they do not yet point to a clear break in conditions.

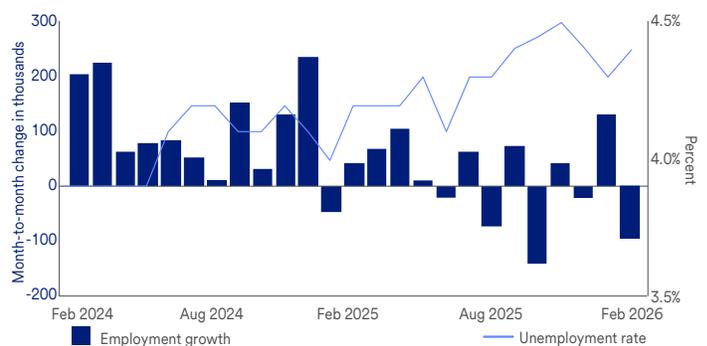
The recent annual benchmark revision reinforced this interpretation, confirming that last year’s job growth was materially overstated in real time and that the labor market had already slowed more than the headlines suggested. As a result, the economy is now operating with a meaningfully lower breakeven pace of job creation. That breakeven – now closer to ~25,000 jobs per month – reflects slower labor force growth, allowing the economy to sustain trend-like output growth with fewer net hires. Tighter immigration policy continues to weigh on labor force expansion, reducing the amount of hiring needed to keep slack from building. With fewer new workers available, pockets of labor scarcity can still emerge in labor-intensive sectors such as construction, leisure and hospitality, manufacturing, and personal services, even as aggregate wage growth cools gradually.

Demand for labor has also cooled, though in a distinctive low churn pattern. Job Openings and Labor Turnover Survey (JOLTS) data continue to show job vacancies deflating and labor market tightness settling below pre-pandemic norms, while hiring and quits remain historically subdued – evidence that job switching opportunities are limited and net job creation is modest. Importantly, layoffs have yet to accelerate meaningfully in the hard data. Weekly jobless claims remain low by historical standards, consistent with employers continuing to hoard labor after years of staffing difficulty. That said, in an environment of very low hiring, even modest increases in separations can have a larger impact, making the evolution of layoffs and job-finding rates an important watch point.

Labor market perceptions are gradually catching up to this slower reality. Consumer surveys continue to show households uneasy about job availability, leaving confidence fragile despite generally stable employment conditions. If unemployment drifts higher or job-finding rates deteriorate further, spending growth would likely cool more noticeably – particularly for lower- and middle-income households that are more sensitive to lost labor income.

Our base case for the first half of 2026 remains that monthly job gains hover in the 0–50,000 range, consistent with unemployment drifting modestly higher into the mid-4% range. That trajectory remains consistent with a labor market operating close to full employment, though with less room for negative surprises. Risks are tilted modestly to the downside. If hiring fails to recover to at least breakeven levels in coming months, prolonged policy uncertainty or tighter financial conditions could pull job growth below breakeven and push unemployment higher. Still, the continued absence of broad-based layoffs suggests that the most likely path remains ongoing normalization rather than abrupt deterioration—supporting a patient, data-dependent Fed as it seeks clearer confirmation that both labor conditions and inflation are cooling sustainably.

U.S. Labor Market



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

Inflation: Uneven descent – and the Fed’s patience

The latest inflation data did little to change the broader story. Disinflation is still intact, but it has yet to prove durable enough to give us confidence that inflation is on a sustained return to 2%. December’s Personal Consumption Expenditures (PCE) report showed core PCE inflation firming to 3.0% year-over-year, the highest reading since the first half of 2024 and a reminder of the uneven nature of disinflation late last year. On a monthly basis, core prices rose a firm 0.4%, the fastest pace since February, lifting the near-term three-month annualized rate to 3.1%. In our view, this backdrop keeps the Fed’s “hold” message intact for the first half of 2026, as policymakers can afford patience while awaiting clearer evidence that inflation is resuming a sustained glide back toward 2% – particularly amid rising uncertainty around energy prices linked to geopolitical developments.

Beneath the headline figures, the composition of inflation continues to matter more than the level. The most notable development late last year was renewed firming in core goods prices, reversing the softness seen in October and November. Some of this reflects payback after earlier weakness, but there is also growing evidence that tariff-exposed categories are contributing to additional upward pressure – consistent with recent anecdotal reports from businesses and policymakers alike. While we still expect much of the tariff pass-through to fade as 2026 progresses, the timing and persistence of these effects add uncertainty to the near-term outlook and help explain why goods prices have stopped providing the reliable disinflationary offset seen earlier in the cycle.

At the same time, services inflation remains the stickier side of the basket. Housing-related inflation showed signs of renewed firmness in December, and while shelter inflation should continue to slow over time, the path is likely to be uneven. Non-housing services also reaccelerated late last year, underscoring that labor-intensive prices are cooling only gradually even as labor market conditions normalize. Importantly, the PCE data suggest that the government shutdown had a more limited distorting effect on services prices than in the Consumer Price Index (CPI), reinforcing the message that underlying services inflation remains elevated rather than artificially suppressed.

Taken together, these dynamics align closely with the tone of the January FOMC meeting minutes. Policymakers acknowledged that inflation has moderated substantially from earlier peaks but emphasized that progress toward the 2%

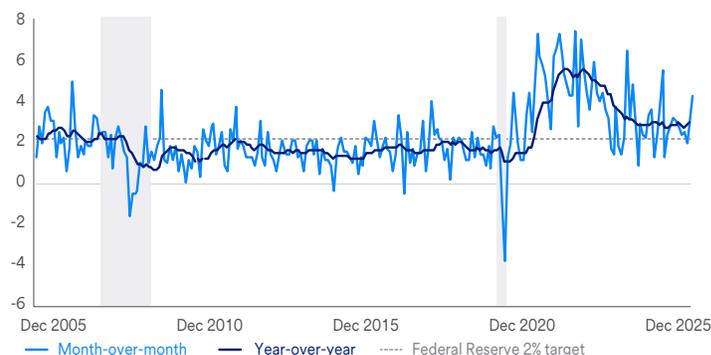
objective has been slower and more uneven than anticipated. With labor market risks viewed as more balanced and downside employment risks having diminished, the Committee appears increasingly sensitive to the risk that inflation could remain persistently above target if policy eases prematurely – a concern that could be reinforced if geopolitical tensions translate into sustained energy-price pressures.

Beyond the inflation prints themselves, household finances continue to shape the inflation outlook indirectly. Income growth remained steady in December, but the saving rate edged lower, reinforcing signs that households are becoming more constrained as inflation progress stalls. At the same time, even as inflation has cooled from its 2022–23 peaks in rate-of-change terms, the cumulative rise in prices over the past several years continues to weigh on affordability – particularly for essentials such as food, housing and childcare. This dynamic limits consumers’ ability to absorb further price increases and is likely to restrain discretionary spending, even as overall demand remains resilient.

Bottom line: this month’s inflation narrative looks more like reinforcement than revision. Inflation is still easing, but not in a smooth or fully reassuring way. As a result, we continue to expect the Fed to remain on hold through at least the first half of 2026. Our baseline outlook remains that core PCE drifts up to 3.2% in the near term before gradually moving lower as goods-price pressures fade and services disinflation gains traction—but the balance of risks has tilted modestly toward a longer and bumpier “last mile” back to 2% – though elevated energy prices tied to geopolitical risks could slow progress along the final leg back to 2%.

U.S. Inflation

Core PCE Price Index, annualized percent change



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

U.S. Bank Economics Research Group March 2026 Macro forecast summary

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

Economic Data¹

Nominal GDP	5.1	5.2	5.0	4.6	4.7	4.6	4.6	4.5	5.1	5.5	4.6
Real GDP	1.4	2.9	2.2	2.2	2.3	2.3	2.2	2.3	2.2	2.6	2.3
Consumer Spending	2.4	1.9	1.9	1.9	2.0	2.0	2.0	2.0	2.7	2.2	2.0
Investment	3.8	4.7	5.6	4.4	4.5	4.2	4.0	4.0	2.0	2.8	4.3
Residential Structures	-1.5	-0.9	0.1	0.2	0.2	0.2	0.2	0.2	-2.2	-1.7	0.2
Non-Residential Structures	-2.4	2.8	2.5	2.2	2.3	2.3	2.2	2.2	-5.0	0.0	2.3
Intellectual Property	7.4	7.0	6.5	6.0	5.5	5.0	5.0	5.0	5.8	7.1	5.3
Equipment	3.2	7.5	7.0	5.5	5.0	4.5	4.0	4.0	8.2	6.0	4.7
Change in Inventory	-13.6	-20.0	-15.0	-15.0	-10.0	-5.0	0.0	5.0	29.0	-15.0	2.5
Government Spending	-5.1	6.6	0.8	0.8	0.8	0.8	0.8	0.8	1.2	1.2	0.8
Federal	-16.6	16.6	0.6	0.6	0.6	0.6	0.6	0.6	-1.2	0.6	0.6
State & Local	2.4	1.0	1.0	1.0	1.0	1.0	1.0	1.0	2.6	1.5	1.0
Imports	-1.3	3.0	3.0	2.5	2.5	2.0	2.0	2.0	2.7	-1.3	2.2
Exports	-0.9	1.0	2.0	3.0	3.0	2.5	2.5	2.5	1.7	2.1	2.6
Housing Starts	1.33	1.41	1.43	1.43	1.43	1.42	1.41	1.39	1.36	1.43	1.40
Unemployment Rate	4.5	4.4	4.5	4.6	4.5	4.4	4.4	4.4	4.3	4.5	4.4

Prices²

Consumer Price Index	2.7	2.8	3.4	3.3	3.3	3.0	2.7	2.7	2.7	3.2	2.7
Core PCE Price Index	2.9	2.9	3.2	3.1	2.9	2.7	2.4	2.2	2.8	3.0	2.3

Interest rates³

Federal Funds (Upper Target)	4.02	3.75	3.65	3.44	3.38	3.19	3.19	3.19	4.37	3.56	3.19
2-Yr Treasury Note	3.52	3.46	3.36	3.36	3.35	3.35	3.35	3.35	3.81	3.38	3.35
10-Yr Treasury Note	4.10	4.11	4.11	4.20	4.25	4.27	4.28	4.29	4.29	4.17	4.29
30-Yr Freddie Mac Mortgage	6.23	6.06	5.99	6.02	6.03	6.04	6.05	6.05	6.60	6.03	6.05

Forecast as of: March 4, 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 Economics Group.



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