

U.S. ECONOMIC OUTLOOK

Ringling in resilience

Our January 2026 U.S. economic outlook highlights an economy still expanding – Q3 growth accelerated on strong services and early holiday demand – while the labor market’s ‘low-hire, low-fire’ equilibrium masks mounting slack as unemployment drifts higher. Inflation is cooling with caveats, as shutdown-related distortions likely understated the Consumer Price Index (CPI), and shelter normalization should briefly lift core Personal Consumption Expenditures (PCE) before its gradual glide toward 2%. The Fed delivered a hawkish cut in December and is poised to pause in January, preserving optionality amid data gaps and payroll-measurement risks. Against this backdrop, our K-shaped economy framework underscores widening dispersion across households and firms – supporting steady consumption at the top even as mid-to-lower tiers face tighter conditions. Overall, we see modest but sustained growth into 2026, conditional on cleaner inflation prints and labor revisions. Risks remain skewed to the downside given policy uncertainty in fiscal, trade and immigration.

- **Growth:** Economic activity remains broadly intact, supported by resilient consumer spending and steady business investment. Despite a year marked by policy uncertainty, we expect 2025 growth to finish near 2.2%. As uncertainty fades and fiscal support builds, our 2026 forecast has been revised up to 2.5%, signaling modest but sustained expansion.
- **Labor Market:** Labor market stability masks growing slack. Hiring has stalled, with cumulative payroll gains nearly flat since April. The unemployment rate ended 2025 at 4.4%, while average hourly earnings rose 3.8% year-over-year. We expect joblessness to drift into the upper 4s by mid-2026 – close to triggering the Sahm Rule – on weak hiring rather than broad layoffs.
- **Inflation:** Inflation cooled sharply in November, on technical distortions, not the economy. Headline CPI fell to 2.7% and core to 2.6%, but quirks tied to the shutdown and shelter imputation likely overstated the slowdown. We expect core PCE to hover near 2.8–2.9% through early 2026, with a temporary uptick midyear before gradually converging toward the Fed’s 2% target by late 2027.
- **Federal Reserve:** The Fed delivered another 25-basis point (bp) cut in December, lowering rates to 3.50–3.75% and signaling a more data-dependent stance. With the Committee deeply divided and Chair Jerome Powell cautioning that payroll gains may be overstated, we expect a January pause and two additional cuts in 2026 – likely June and December – bringing the terminal rate to 3.00–3.25%.
- **Risks:** Risks remain skewed to the downside, with near-term recession probability holding near 35%. A monetary policy mistake is at the top of our list. Though geopolitical/oil price risk has now entered the fray. Policy uncertainty across fiscal, trade and immigration continues to cloud the outlook. Another federal funding lapse at month-end would lead to another shutdown when the federal government and economic data try to regain footing.

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

	Actual 2024	Forecast 2025	Forecast 2026	Forecast 2027
Real GDP	2.8	2.2	2.5	2.1
Consumer Spending	2.9	2.6	1.9	2.0
Investment	3.0	2.1	1.7	3.1
Housing Starts	1.37	1.37	1.40	1.44
Unemployment Rate	4.0	4.3	4.6	4.4
Consumer Price Index	3.0	2.7	2.8	2.2
Core PCE Price Index	2.9	2.8	2.9	2.2
Federal Funds (Upper Target)	5.3	4.4	3.6	3.2

Forecast as of: January 6, 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: Unwrapping the K-shaped economy for the new year

The holiday season is widely considered to be a season of warmth, generosity and abundance as the streets glow with colorful lights and the promise of joy. But this holiday season also highlighted economic inequality, with more Americans faced with a crisis not a celebration, facing what they cannot provide for themselves and their families.

Popularized by the post-COVID term “K-shaped economy,” in our report, [The K-Economy in 2026: Same Story, New Amplifiers](#), we found this condition was nothing new. It continued a long-term trend of increasing inequality which describes the divergence in the economic fortunes of different societal groups, with the longer legs going back for decades instead of just to 2022. Wealth inequality runs even deeper than income concentration, with disparities reinforced by compounding returns and inheritance, extending gaps across generations.

The flattening of K was the biggest surprise. Pandemic-era stimulus and lockdown driven conditions briefly narrowed the gap, as measured by the Gini Coefficient, to levels not seen since the early 1990s. Yet the reversal was fleeting. Income concentration has since returned to pre-COVID peaks. And recent policy shifts are expected to push inequality to new record highs for the 2026 New Year. In short, the pandemic didn’t rewrite the narrative – it merely paused it, and the economy has since resumed its previous trajectory.

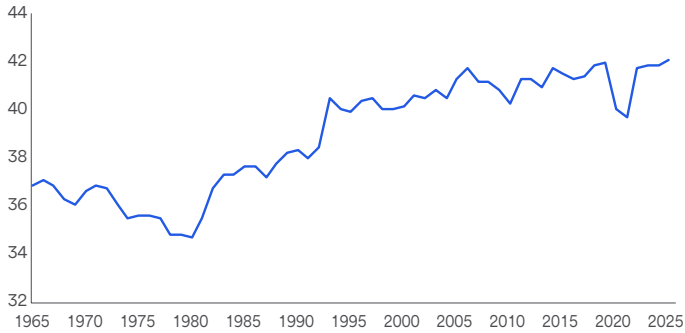
Inequality is necessary for a market economy to function, as it incentivizes investment and expansion. However, as Keynes demonstrated, inequality often leads affluent households to save more and consume less, while those with less means rely on borrowing and debt until those options are exhausted. When these imbalances become unsustainable, the economy tends to swing from boom to bust – exemplified by the Great Recession.

As income concentration reaches critical mass, more households fall to the bottom leg of “K.” The number of Americans considered to be middle class was a sizable 61% in 1971 according to a 2024 Pew Research Center’s State on the Middle Class. In 2023, it stands at 51%, barely a majority. While the number of upper-income households rose, a sign of progress, the share of lower-income households also increased and stands at 30%, as more people are left behind.

Once crowned the engine of the U.S. economy, the destruction of the middle class’s economic power is even more severe. In 1970, middle class households reportedly earned 62% of the nation’s total income. It has plummeted by 19 percentage points to 43% in 2022.

U.S. Income Gini Coefficient

Value of 0 represents absolute equality, a value of 100 absolute inequality



Source: U.S. Bank Economics; Bloomberg; World Bank; Census ACS (2024 Est.); Statista (2025 Est.)

Rapid technological change – especially AI – risks amplifying these divides unless adoption becomes broad-based. One way to build a more inclusive economy: investing in digital education and financial literacy for both the current and future workforce. This will not only help improve upward mobility but also add to economic productivity, yielding a bigger pie for all. Policies that promote equality can help ensure that innovation acts as an equalizer rather than a divider. While poorly designed redistribution may undermine incentives, well-crafted policies can be a win-win for both growth and fairness – ‘two sides of the same coin.’

Perhaps, striving for a solution to extreme income inequality can be our New Years resolution this year.

Economy: Fireworks in Q3, sparklers in Q4

Economic growth accelerated sharply in the third quarter. The delayed Bureau of Economic Analysis (BEA) report showed real GDP rose 4.3% annualized – the fastest in two years and well above expectations – driven by robust consumer spending (+2.4%) and a sizable boost from net exports (+1.6%) as imports fell and exports rose. Government outlays added modestly, while overall investment was flat – held back by residential weakness and inventory drawdowns – even as equipment and intellectual property remained a bright spot, consistent with ongoing technology upgrades and AI-related data center outlays.

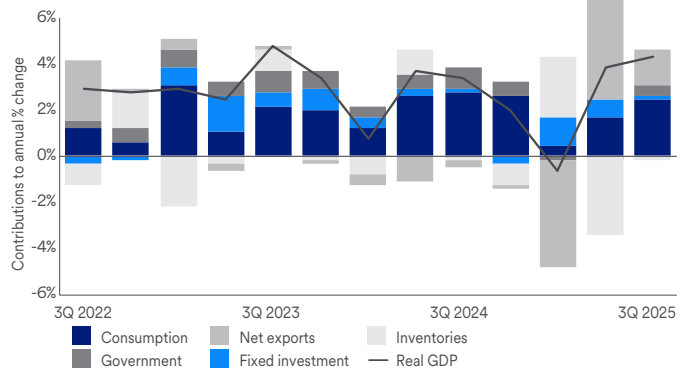
A useful gauge of underlying domestic demand – real final sales to private domestic purchasers – rose 3.0% annualized, broadly consistent with 2.9% in Q2, signaling steady household and business activity beneath headline swings in trade, inventories and government. Otherwise, the report’s cadence was unusual due to the shutdown: December’s

“initial” estimate replaced the normal advance and second estimates, with a final Q3 release set for January 22.

Early signals for Q4 point to solid but slower momentum. October retail sales posted a flat headline but firm underlying details, and high-frequency indicators such as the Dallas Fed’s Weekly Economic Index were tracking around ~2.2% four-quarter growth in late December – consistent with moderation from Q3 – and suggest consumption remained resilient into the holidays. On the investment side, information processing equipment and software remained elevated into year-end, with early industry reports pointing to ongoing AI/data center demand that helped offset softness in other categories. Note: BEA has indicated the Q4 (Advance) GDP release will be rescheduled (Orig. January 29). We will update timing when BEA finalizes the new date on its schedule.

Bottom line: Q3 delivered a backward-looking victory lap, but we still expect growth to moderate toward ~2% in 2026. Consumer spending should cool from Q3’s rapid pace, yet early holiday strength and steady services demand point to resilience. On the investment front, technology-related outlays – particularly AI-driven equipment and intellectual property – will remain a tailwind, even as residential and inventories stay uneven. Firm equity markets support household wealth and discretionary spending, while demographic trends – especially spending by older, asset-rich households – add ballast to services and healthcare. At the same time, gradually easing inflation should buoy real purchasing power, reinforcing the foundation for sustained expansion. Risks persist – softer confidence, labor market cooling, tariff-related trade volatility and inventory swings – but on balance we still see an economy expanding at a solid, if slower, pace into 2026.

U.S. Real GDP



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

Labor Market: Surface stability, mounting slack

The labor market still reflects a “low-hire, low-fire” equilibrium – stable on the surface but steadily losing momentum. December’s Employment Situation report showed payrolls rising by just 50,000, precisely in line with our forecast (consensus: +70,000) and continuing the sharp slowdown that began early in 2025. Over the past three months, job growth has averaged -22,000, compared to more than +200,000 per month at the start of the year – the weakest stretch since the pandemic recovery period. Net revisions to October and November totaled -76,000, deepening the slowdown and highlighting that prior strength was overstated. October’s sharp revision was driven by a -162,000 drop in federal employment, likely tied to deferred resignation programs and post-shutdown workforce cuts.

The unemployment rate’s drop to 4.4% from a revised 4.5% in November is a relatively positive development. While 232,000 people gained jobs (good news), about 46,000 exited the labor force, which is less encouraging. Notably, the decline in labor force participation was concentrated in the Black population, slipping to 63.1% from 63.9%, while participation among the White population held steady at 61.8%. Meanwhile, broader underemployment (U-6) edged down to 8.4% from 8.7%, but remains elevated, with more workers reporting involuntary part-time status.

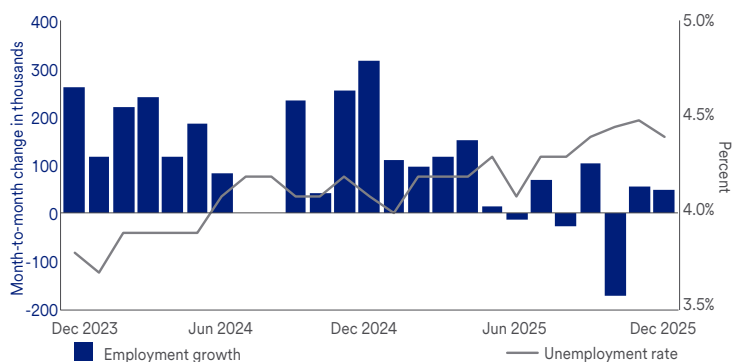
Job Openings and Labor Turnover Survey (JOLTS) data reinforce this picture. Openings were hovering near multi-year lows through November, quits ticked up only slightly, and layoffs edged down – pointing to a “low-hire, low-fire” mix where firms hesitate to add staff but avoid aggressive cuts. Initial claims remain low and stable, signaling that layoffs are still contained. However, continuing claims have trended higher, pointing to slower re-employment and longer job searches as conditions soften. Moreover, businesses shed temporary workers and reduced staff hours in December. While holiday-related distortions may have played a role, if this trend persists, it could signal that firms have excess labor capacity and that the next step may be cutting full-time positions.

The Fed is watching closely. The still-low unemployment rate helped by an increase in jobs together with the 20bps increase in average hourly earnings to 3.8% YoY may give the Fed Hawks reason to ‘crow’ in January. It also supports a pause for the FOMC in January. But the December minutes highlighted growing downside risks to employment, and Chair Powell went further - warning that official payroll

figures may be overstating job growth by roughly 60,000 per month since April. If confirmed by early-February benchmark revisions, that would imply negative true job growth for much of the second half of 2025. This matters for policy credibility: the birth-death model that drives these adjustments has historically been a blind spot, and Powell’s acknowledgment signals the Fed is actively reassessing its labor metrics. In practical terms, it reinforces a data-dependent stance heading into 2026.

Bottom line: The firewall against a sharp spike in unemployment – limited layoffs – remains intact, but hiring is weak and slack is building. After holding near 4.0–4.2% for most of the past year, the unemployment rate has moved decisively higher and is on track to drift into the upper 4s in the first half of 2026 – uncomfortably close to triggering the Sahm Rule recession signal. That risk, combined with Powell’s warning on overstated job growth, tilts the balance toward additional rate cuts later this year, especially if revisions confirm deeper labor weakness.

U.S. Labor Market



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

Inflation: Cooling with caveats

CPI inflation cooled sharply in November, but the reading was difficult to interpret. Headline CPI slowed to 2.7% year-over-year (YoY) and core to 2.6%, both well below September’s clean 3.0% readings and softer than expected. Much of this weakness reflects technical quirks tied to the government shutdown. October price surveys were skipped, and November’s collection period was pushed later into the month, capturing more Black Friday discounts than usual.

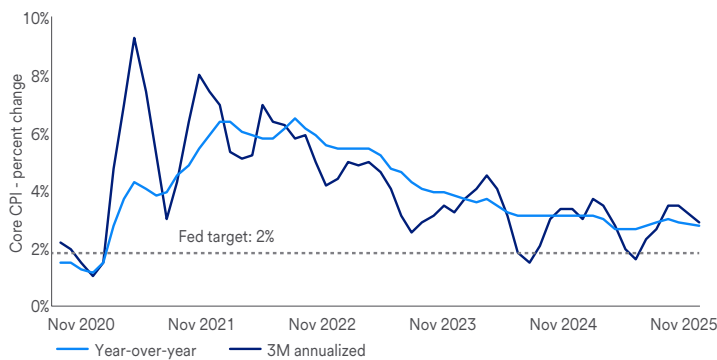
Under the hood, goods inflation softened notably, led by declines in apparel and recreation commodities, while autos posted only modest gains. Housing components also cooled,

supported by very soft readings in rents, while core services excluding housing remained subdued as airfares fell sharply and health services held steady. Otherwise, food inflation moderated and energy stayed firmer – rounding out a mix that looks disinflationary but may overstate the slowdown. Alternative indicators reinforce this directional shift: Institute for Supply Management (ISM) prices-paid indexes fell between September and November, signaling easing cost pressures even though both remain above long-run norms.

But methodology matters this month. Imputation for missing October data and later-than-usual price collection for November likely biased the CPI lower, especially for slow-moving series like shelter – which accounts for over 30% of total CPI. Some of the weakness should reverse in December as collection normalizes, although shelter’s six-month averaging will keep a small downward bias in year-over-year figures through March. Cleaner data will be critical to confirm whether the slowing trend in services inflation is genuine – a key marker for policymakers.

Even allowing for noise, the report nudges inflation closer to the Fed’s preferred gauge, with core PCE tracking near 2.8% YoY through September. Federal Open Market Committee (FOMC) minutes from December acknowledged progress but stressed uncertainty, noting that inflation compensation has moved lower even as risks remain two-sided. Combined with softening labor momentum, this keeps the Fed highly data-dependent. We expect core PCE to hold near 2.8–2.9% through early 2026, with a temporary uptick to around 3.1% in Q2 as shelter effects normalize following shutdown-related imputation. Beyond that, the trajectory resumes its gradual decline toward the Fed’s 2% target by late 2027, consistent with fading tariff impacts and softer demand.

U.S. Inflation



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

Monetary policy: Pause ahead, optionality preserved

The December 9–10 FOMC meeting delivered a widely anticipated 25bp cut, lowering the target range to 3.50–3.75% and reviving the phrase “in considering the extent and timing of additional adjustments” – a clear pivot back to data dependence and a higher bar for near-term easing. Three dissents – one favoring a larger move and two preferring no change – underscored the most divided Committee since before the pandemic. Chair Powell noted that policy is now “within a broad range of estimates of neutral,” but stopped short of declaring it fully neutral, leaving markets to reconcile a hawkish statement with a press conference that leaned modestly dovish.

The Summary of Economic Projections reinforced this mixed tone. The median dots point to a limited pace of easing over the forecast horizon, but dispersion widened. Several participants penciled in no further cuts this year while others saw scope for more aggressive moves in 2026. Growth forecasts were revised higher (about 1.7% in 2025 and 2.3% in 2026), and unemployment is expected to hover in the mid-4s. While inflation excluding tariffs is projected in the “low twos,” headline and core PCE remain above target through 2027 – underscoring two-sided risks and why the Committee stressed uncertainty. Recently released meeting minutes emphasized that policy is not pre-set and decisions will be guided by a wide range of data – an especially important caveat given shutdown-related gaps in official releases and Chair Powell’s caution that recent payroll gains may be overstated.

Bottom line: We read December as a hawkish cut that sets up a January pause and preserves optionality. The revived “extent and timing” language, dispersion in the dots, and Powell’s caution argue for patience. Additional easing is on offer only if labor weakness deepens and cleaner inflation data confirm disinflation. Conversely, any re-acceleration in inflation – or stubborn core services – would lift the bar for further cuts. Our baseline expects two more 25bp reductions in 2026 – likely June and December – bringing the terminal rate to 3.00–3.25%.

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

	Actual	Forecast							Actual	Forecast	
	2025	2025		2026			2027				
	3Q	4Q	1Q	2Q	3Q	4Q	1Q	2Q	2024	20 25	2026
Economic Data¹											
Nominal GDP	8.2	5.3	5.6	5.0	3.9	3.9	4.3	4.1	5.3	5.1	5.5
Real GDP	4.3	2.5	2.0	2.0	2.0	2.1	2.1	2.1	2.8	2.2	2.5
Consumer Spending	3.5	1.6	1.5	1.5	1.7	1.9	2.1	2.2	2.9	2.6	1.9
Investment	-0.3	4.9	2.7	2.8	2.9	3.1	3.2	3.2	3.0	2.1	1.7
Residential Structures	-5.2	-1.5	0.0	0.5	1.0	1.5	2.0	2.0	3.2	-1.9	-1.0
Non-Residential Structures	-6.3	-2.5	-1.3	0.0	1.0	2.0	2.0	2.0	1.1	-5.2	-1.8
Intellectual Property	5.4	4.0	3.5	3.0	3.0	3.0	3.2	3.5	3.5	5.5	4.3
Equipment	5.4	4.0	3.6	3.4	3.2	3.0	2.8	2.6	3.5	8.3	4.1
Change in Inventory	-29.6	0.0	5.0	10.0	15.0	20.0	25.0	30.0	43.5	31.0	12.5
Government Spending	2.2	0.3	0.9	0.9	0.9	0.8	0.8	0.8	3.8	1.5	0.9
Federal	2.9	-2.0	0.0	0.4	0.5	0.6	0.6	0.6	3.8	-0.1	-0.2
State & Local	1.8	1.8	1.5	1.2	1.1	1.0	1.0	1.0	3.8	2.5	1.6
Imports	-4.7	-2.4	-1.2	-0.6	0.0	1.0	2.0	2.5	5.8	2.6	-3.6
Exports	8.8	0.5	1.0	1.5	1.8	2.1	2.4	2.5	3.6	1.7	1.9
Housing Starts	1.36	1.37	1.38	1.39	1.40	1.41	1.43	1.44	1.37	1.37	1.40
Unemployment Rate	4.3	4.6	4.7	4.7	4.6	4.5	4.4	4.4	4.0	4.3	4.6
Prices²											
Consumer Price Index	2.9	2.8	2.8	3.0	2.9	2.7	2.4	2.2	3.0	2.7	2.8
Core PCE Price Index	2.9	2.8	2.8	3.1	2.9	2.7	2.4	2.2	2.9	2.8	2.9
Interest rates³											
Federal Funds (Upper Target)	4.46	4.07	3.75	3.71	3.50	3.44	3.25	3.25	5.31	4.38	3.60
2-Yr Treasury Note	3.72	3.53	3.43	3.39	3.37	3.36	3.36	3.35	4.37	3.81	3.39
10-Yr Treasury Note	4.26	4.09	4.19	4.24	4.27	4.28	4.29	4.29	4.21	4.29	4.24
30-Yr Freddie Mac Mortgage	6.55	6.23	6.16	6.11	6.09	6.07	6.06	6.06	6.72	6.6	6.11

Forecast as of: January 6, 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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