



United States Economic Outlook

2026–2028

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The U.S. Economic Outlook for 2026–2028

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Executive Summary

AI Boom Bolsters the U.S. Economy

The U.S. economy continued to expand in the first quarter of 2026, with headline real GDP growing at an annualized rate of 2.0 percent. Growth was bolstered by the reopening of the federal government after last fall's shutdown and a solid pace of private domestic demand, particularly in technology sectors. Final sales to private domestic purchasers added 2.2 percentage points to growth, a step up from late 2025. The current expansion is increasingly driven by investment in intellectual property and information processing equipment, while stock market gains help sustain consumption growth. However, the ongoing surge of investment is heavily fueled by imports. Crucially, our outlook is predicated on the assumption that the ongoing war in Iran does not escalate further, a negotiated agreement is reached within a few months, and shipping through the Strait of Hormuz largely normalizes by the end of 2026.

While Labor Market Steadies, Inflation Spikes

Headline CPI inflation jumped to 3.8 percent year-over-year in April, primarily driven by soaring gasoline prices following the outbreak of war with Iran, and an unusual shelter inflation calculation that temporarily lifted measured inflation. More concerning, core PCE inflation has reaccelerated sharply: from December 2025 through March 2026, it ran at a 4.3 percent annualized pace. Some of the increase reflects AI-related price jumps for computer memory chips, as well as tariff-sensitive goods such as clothing and shoes. Longer-run inflation expectations have moved up only modestly, but the recent data give the Federal Reserve little reason to hurry toward further rate cuts.

The labor market looks firmer than it did in the second half of 2025. The unemployment rate has held in the 4.3–4.4 percent range, partly because labor force participation has declined. Household survey employment has trended down, but private payroll data have been more encouraging. Private payroll gains

averaged 86,000 per month from January through April, the strongest four-month stretch since late 2024. Job openings appear to have stabilized and hiring has recently improved. Government employment remains a drag, with federal job losses and weaker state employment offsetting some local gains. Wage growth has remained stable in recent months.

Housing Strained, Sentiment Dips, Vehicles Hold

The housing market faced renewed headwinds this spring as mortgage rates ticked back up to 6.4 percent in May, sales momentum cooled, and builder sentiment softened further. A significant inventory overhang continues to weigh on activity; the supply of new single-family homes averaged 9.1 months in the first quarter, well above balanced levels. While single-family starts improved briefly to a 1.0-million-unit pace in March, high construction costs and builder hesitation are expected to pull activity back down in the near term.

Sentiment has deteriorated more than the hard activity data. The University of Michigan consumer sentiment index fell to a record-low 48.2 in May's preliminary reading, as the conflict in the Middle East weighed on the mood.

Despite this gloom, the light vehicle market has shown resilience; after a dip in January, sales recovered to average 15.9 million units from February through April. Higher gasoline prices have triggered some interest in hybrids but have not yet caused a broad shift toward smaller vehicles. Stable demand and modest vehicle price inflation suggest the auto sector will remain steady despite elevated financing costs and trade uncertainty.

The Fed to Wait for Signs of Oil Passthrough

So far in 2026, the Federal Open Market Committee has adopted a wait-and-see approach, holding the federal funds rate in the 3.5–3.75 percent range throughout this year. With PCE core inflation re-accelerating, and a possibility of meaningful passthrough from energy price

inflation into core, we think further rate cuts are now delayed past the end of 2026. The recent confirmation of Kevin Warsh as Fed Chair may result in shifts in communication and balance sheet strategy, but a consensus for further easing will likely require clearer evidence of subsiding price pressures. We expect the Fed to eventually deliver two 25 basis point cuts in 2027 to reach a neutral stance.

Tariffs Ease, Deficits Linger

The effective import tariff rate averaged roughly 10 percent in 2026Q1 but retreated to 7.4 percent in March following the termination of global IEEPA tariffs. We anticipate \$160 billion in refunds to be distributed to businesses over the next two quarters, which will largely boost corporate profits. We expect USMCA to remain in place, subject to annual reviews. On fiscal policy, the forecast assumes no further federal shutdowns before the midterms, with divided government limiting action afterward. Driven by continued strength in defense spending and modest nondefense spending growth, the federal deficit remains near 6 percent of GDP.

The 2026–2028 Outlook

Real GDP growth is projected to pick up to a 2.6 percent annualized pace in 2026Q2, supported by business fixed investment and tax refunds. Growth is expected to decelerate to 1.9 percent in the third quarter, as elevated inflation weighs on consumption. Consumption contributes roughly 1.2–1.3 percentage points per year to growth over 2027–28, while AI-related business investment remains an important support. A meaningful pickup in productivity keeps quarterly real GDP growth above 2.0 percent through 2028. On a calendar year basis, we project real GDP to expand by 2.2 percent in 2026, followed by 2.1 percent in 2027 and 2.0 percent in 2028.

The labor market is expected to remain largely balanced but somewhat vulnerable. We project the unemployment rate to edge up to 4.5 percent in 2026H2 due to the drag from the oil price spike, and then to stabilize. Monthly payroll job gains are expected to average 79,000 in 2026Q2 before settling near a sustainable pace of 70,000 in the second half of the year. In 2027–28, job gains are projected to accelerate to approximately 80,000 per month, a solid trajectory given the constraints of slow population growth and lower net immigration.

Headline CPI inflation is projected to reach 4.0 percent year over year in 2026Q2, driven by energy price pressures, and then decline as oil prices come down. Core PCE inflation is expected to start declining toward the Fed's target after its recent spike, as price jumps for computer components fade, tariff passthrough wanes, and shelter data distortions end. We project that year-over-year PCE inflation will gradually decelerate through 2027, eventually falling to the 2.0 percent level by the first quarter of 2028.

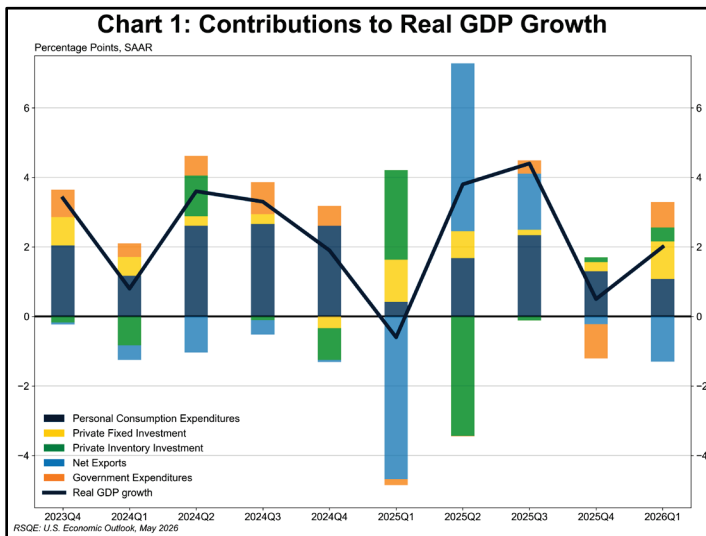
The housing market faces near-term strains, but we expect conditions to improve as mortgage rates resume their decline. Total housing starts are expected to fall to 1.3 million units by 2026Q4 before recovering to 1.4 million by the end of 2028. Single-family starts dip to 908,000 units by 2026Q4, before improving to 981,000 by 2028Q4 as mortgage rates decline. Multi-family starts flatline near 400,000 units.

Light vehicle sales are projected to remain near 15.8–15.9 million units over the forecast. Elevated financing costs, tariff uncertainty, and affordability concerns restrain demand, but stable household spending, improving delinquency trends, and easing supply-chain pressures keep the market broadly steady.

	Actual	RSQE Forecast		
	2025	2026	2027	2028
GDP (billions of current \$)	30762.1	32612.7	34176.7	35626.9
Real GDP (billions of 2017 \$)	23850.4	24382.8	24893.3	25401.0
% change: year-over-year	2.1	2.2	2.1	2.0
% change: 4th-qtr-to-4th-qtr	2.0	2.2	2.1	2.0
Nonfarm payroll employment (millions)	158.4	158.9	159.8	160.7
Civilian unemployment rate (%)	4.3	4.5	4.5	4.5
Capacity utilization, total industry (%)	76.0	75.7	75.6	75.4
Inflation (private nonfarm GDP deflator, % change)	2.8	3.7	2.6	2.2
Inflation (CPI-U, % change)	2.7	3.7	2.6	2.2
Inflation (core CPI, % change)	2.9	3.1	3.0	2.6
Light vehicle sales (millions)	16.2	15.7	15.9	15.9
Private housing starts (thousands)	1356.1	1352.8	1345.5	1378.2
3-month Treasury bill rate (%)	4.1	3.6	3.2	3.1
10-year Treasury note rate (%)	4.3	4.2	4.0	3.9
Conventional mortgage rate (%)	6.6	6.2	5.9	5.8
Real disposable income (billions of chained 2017 \$)	18027.5	18178.5	18503.9	18891.7
% change	1.7	0.8	1.8	2.1
Corporate profits after tax (billions of current \$)	3518.8	4095.4	4113.0	4230.6
Value of U.S. \$ (FRB broad index), % appreciation	-0.1	-3.2	-0.1	0.0
Current account balance (NIPA basis, billions of current \$)	-1134.7	-1067.9	-1113.9	-1213.8
Federal surplus (FY, NIPA basis, billions of current \$)	-1883.6	-1948.7	-1971.8	-2087.9

The Current State of the Economy

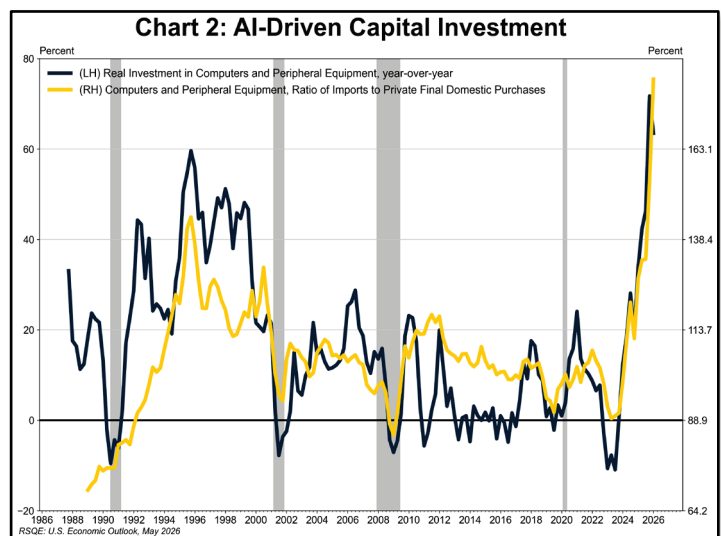
The U.S. economy continued to expand in 2026Q1, with headline real GDP growing at an



annualized rate of 2.0 percent. The end of the federal shutdown in November largely restored the real value added of the federal government, which helped lift the government sector's contribution to overall growth to 0.7 percentage points in 2026Q1. Aside from that contribution, private domestic demand continued to grow at a solid pace, supported in

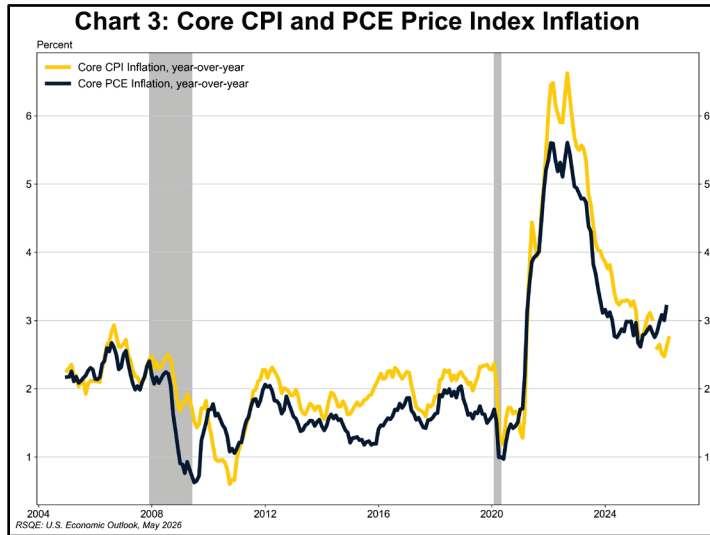
particular by investment in intellectual property products and information processing equipment. Final sales to private domestic purchasers, a measure of demand from consumers and businesses, corresponds to the sum of the maize and blue bars in Chart 1. It added 2.2 percentage points to GDP growth, up from 1.6 percentage points in 2025Q4. Net exports and inventory investment, which have been volatile amid trade tensions, subtracted a combined 0.9 percentage points from growth.

Growth in computers and peripheral equipment has been exceptionally strong. As shown in Chart 2, the recent run-up in investment shares some resemblance to the 1990s tech boom. However, the current surge appears to rely on imports to a far greater extent than in the 1990s, and domestic industrial production in relevant categories has not yet reflected a comparable acceleration.



The maize line in Chart 2 shows the ratio of nominal imports of computers and peripheral equipment to private final domestic purchases of information processing equipment, which is the sum of private fixed

investment and consumption expenditures on such equipment. We include this measure as a rough directional guide of the role of imports in meeting domestic demand for information processing equipment. This ratio has risen sharply and now stands well above its level in the mid-1990s.¹ Nevertheless, the domestic content of AI-related investment could rise over time. Publicly announced capacity expansions by chipmakers and server manufacturers suggest that we are likely still in the early stages of domestic



capacity building.²

Headline CPI spiked to 3.8 percent year over year in April, largely thanks to sharply higher gasoline prices. The April CPI report also featured an unusual calculation for shelter inflation.³ That calculation finally corrected the level of shelter prices after the missing October survey data had introduced a temporary downward bias. The contribution

from shelter prices to month-on-month inflation was larger as a result.

A more concerning development has been the substantial re-acceleration of core PCE inflation since December 2025. From December 2025 through March 2026, the average annualized pace of core PCE inflation jumped to 4.3 percent, up from 2.7 percent on average between March and September 2025. It is not surprising that several Federal Open Market Committee (FOMC) members have publicly expressed a preference to bring the possibility of rate hikes back on the table.

At the same time, year-over-year core CPI has been running significantly behind year-over-year core PCE inflation for five consecutive months. That is quite an unusual situation. Generally, differences between the CPI and PCE inflation rates primarily reflect differences in the index weights assigned to

¹The ratio can exceed 100 percent because the numerator and denominator are not defined on the same accounting basis. Some imports of computers and peripheral equipment may enter inventories rather than final purchases, while others may be incorporated into domestically produced goods outside information processing equipment, such as motor vehicles.

² de Soyres, François, Alex Haag, Mike Liu, and Eva Van Leemput (2026). "The Global Trade Effects of the AI Infrastructure Boom," FEDS Notes. Washington: Board of Governors of the Federal Reserve System, February 13, 2026, <https://doi.org/10.17016/2380-7172.3994>.

³ Instead of the usual 6-month change between April 2026 and October 2025, BLS had to calculate monthly shelter inflation based on the 12-month comparison.

different categories of goods and services, as well as differences in the scope of coverage within some categories. Most of the time, differences in scope and weights for gasoline, housing, and medical services account for the vast majority of the gap between CPI and PCE price index growth rates.

Part of the PCE–CPI core inflation gap up to March may reflect the aforementioned undercount of shelter inflation, because shelter carries a substantially larger weight in the CPI than in the PCE price index. Over the past year, healthcare did contribute to the acceleration of PCE inflation relative to CPI inflation, but another unusual category contributed much more. The AI demand-driven price spike for flash memory cards showed up as a cumulative 20 percent price increase in the “computer software and accessories” price index in both PCE price index and CPI from December 2025 to March 2026. Because this category has a higher weight in the PCE price index than in the CPI, it boosted PCE inflation more than CPI inflation. As these anomalies fade, we expect core PCE inflation to eventually fall behind core CPI inflation, consistent with the long-run trend.

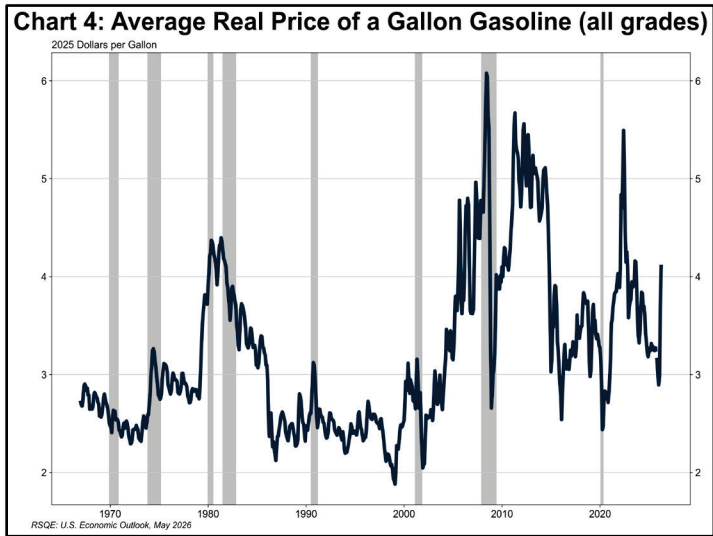
Inflation has also accelerated meaningfully over the past few months for several goods categories, such as clothing and shoes, which are potentially more exposed to tariffs. So, the tariff pass-through into consumer prices may not be over yet. However, recent policy developments in the tariff landscape may help limit further pressure on prices.

Energy prices remain an important near-term inflation driver. The pass-through of the oil price spike, along with related price increases for aluminum, fertilizer, and similar inputs, into the broader inflation trend will likely depend on the duration and severity of the trade disruption through the Strait of Hormuz. The increases in oil and domestic fuel prices observed so far are significant. However, they are somewhat smaller than the increases seen in 2022 after the Russian invasion of Ukraine.

The starting point also matters. Unlike the 2022 episode, the real level of oil and gasoline prices before the shock had been relatively low. Chart 4 shows the average monthly price of gasoline (all grades) deflated by the headline CPI and converted to 2025 dollars.⁴ In addition, the U.S. economy is likely less sensitive to oil price shocks than it was in the 1970s and even the 2000s because of improved energy

⁴ This chart uses Energy Information Administration data back to 1994 and imputes gasoline prices prior to that date using the CPI-U for gasoline.

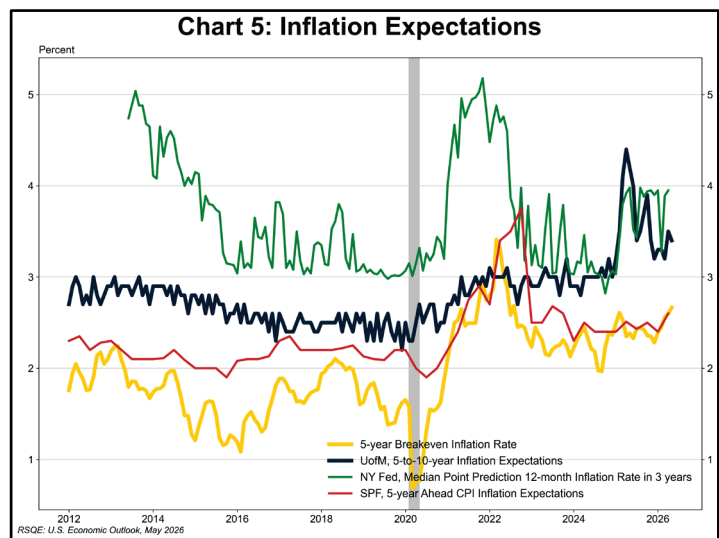
efficiency and a larger domestic energy sector. Taken together, these factors suggest that the impact on



economic activity could be fairly modest, unless the situation in the Middle East escalates. So far, run-ups in the prices of other key commodities, including fertilizer, have generally remained contained.

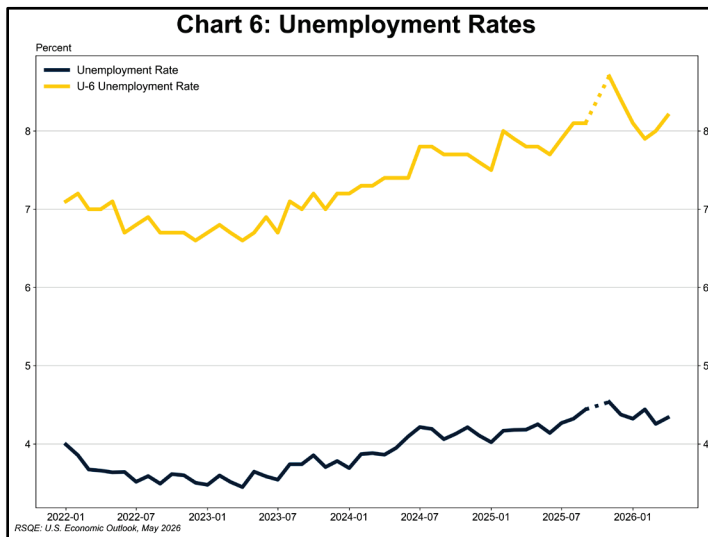
Given the wealth of news regarding inflation, the impact on longer-run inflation expectations has been surprisingly muted.

The 5-year breakeven inflation rate has trended higher in recent months but remains substantially below its recent 2022 peak. Likewise, the New York Fed and University of Michigan's Survey of Consumers' measures of long-term inflation expectations have increased since February, but only modestly. The Survey of Professional Forecasters' 5-year ahead expected CPI inflation edged up slightly in the 2026Q2 survey.



Overall, the recent inflation data point to a noisier and less favorable inflation environment. Headline inflation has moved higher because of gasoline prices, but the run-up in core PCE inflation will definitely weigh heavily on the minds of FOMC members.

So far in 2026, the labor market is looking less vulnerable than it did in the back half of 2025. The unemployment rate has remained stable in the 4.3–4.4 percent range. The household survey employment count has trended down so far this year, but the cumulative job loss looks less alarming when adjusted to align more closely with the payroll job count concept. The broader U-6 unemployment

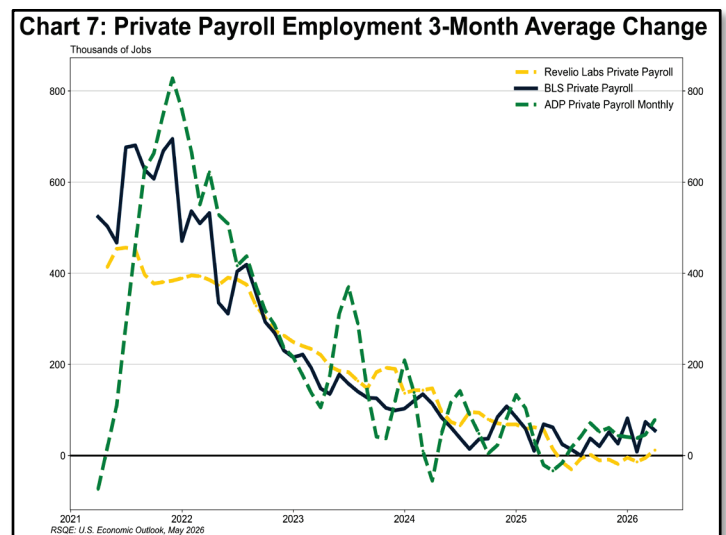


rate has edged up in recent months, reflecting more people employed part-time who are unable to find full-time employment due to economic conditions.

One reason declining household employment and a flat headline unemployment rate have been able to co-exist is that the labor force participation rate has also declined modestly. The decline in

participation has absorbed some of the weakness in household employment, limiting upward pressure on the unemployment rate. The drop has been concentrated among men over the age of 65, primarily among White and Hispanic or Latino men.

The payroll data have been more encouraging than the household data. Private payroll job gains averaged 86,000 per month from January through April, the strongest four-month stretch since late 2024. Chart 7 shows the three-month average of job gains in the establishment survey, alongside two prominent privately compiled measures of payroll job growth. Both the ADP and the Revelio Labs measures of private payroll employment suggest that job growth trends have firmed relative to the second half of 2025.



In absolute terms, monthly job gains remain quite weak. However, given the ongoing demographic challenges and the current immigration policy environment, the job market has done reasonably well so far this year. The pace of job creation is not strong by historical standards, but it has improved compared with the softer readings seen during the second half of 2025.

Other labor demand indicators also point to stabilization. Data from both the Bureau of Labor Statistics (BLS) and Indeed suggest that the level of job openings has stabilized. The hiring rate in the BLS data ticked up in March to its best reading since February 2024. While that series is noisy, the uptick is encouraging and suggests that hiring activity may be finding a floor after a period of weakness.

The government sector remains a clear source of drag, however. After the large federal layoffs and deferred resignations of 2025, federal employment continued to decline slowly in three of the first four months of 2026. Job gains at the local level were not enough to offset meaningful declines at the federal level alongside smaller declines at the state level. As a result, the government sector continued to bleed jobs even as private payroll growth improved.

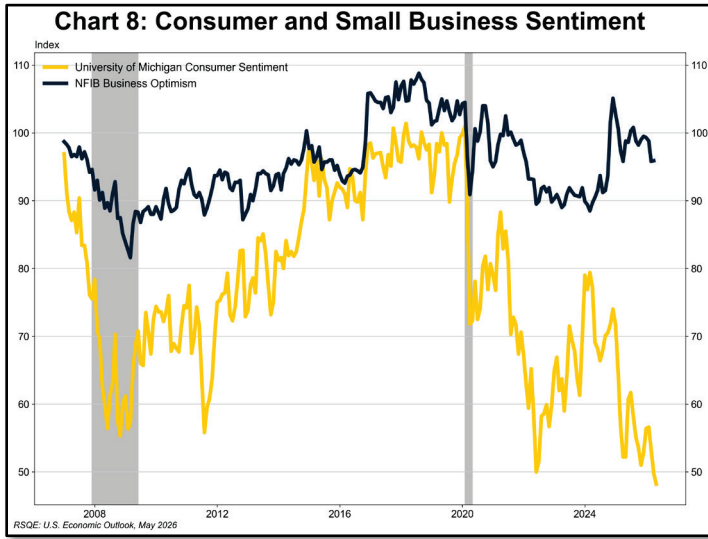
Compensation growth has sent a mixed but generally stable signal. The employment cost index, which holds the mix of jobs fixed, accelerated in the first quarter of 2026, largely because of a jump in benefits. Growth in the wages and salaries component, however, was steady relative to the fourth quarter of 2025, running at around a 3.0 percent pace. The Atlanta Fed's median wage tracker data through April suggest that wage growth has been broadly stable slightly below 4.0 percent year over year.

In the near term, we expect modest upward pressure on the unemployment rate as consumers feel the pinch of higher gasoline prices. At the same time, because the labor market appears firmer now, the decline in the participation rate may slow. If the labor force participation rate stabilizes while the weak trend of household survey employment growth endures, the combination could contribute to a marginally higher unemployment rate.

Gauging a sustainable trend for payroll jobs remains very difficult. Real-time estimates of net immigration are still very imprecise, and that uncertainty complicates the interpretation of monthly payroll gains. Demographic constraints and immigration policy both matter for the pace of job growth that can be sustained.

Overall, the labor market has firmed relative to the second half of 2025, but we would still not characterize it as "strong."

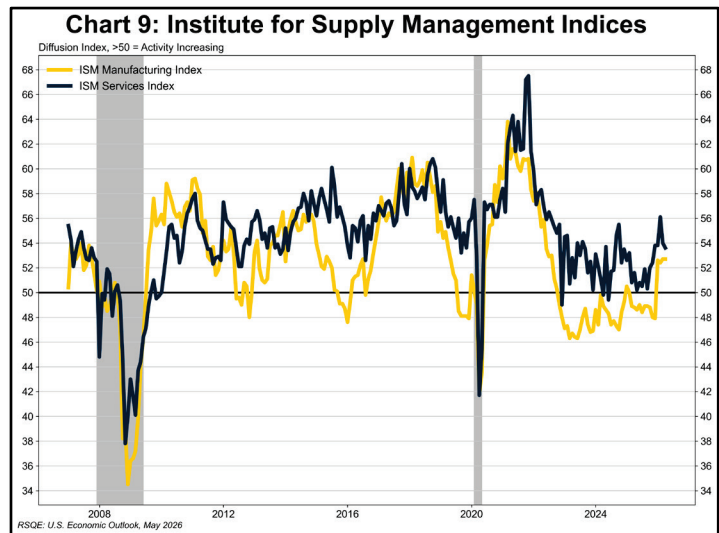
Consumer and small business sentiment has weakened notably since the war with Iran began in late February. The University of Michigan's index of consumer sentiment reached a record low of 48.2 in



its May preliminary reading. This deterioration in mood is more prevalent among low-income households and younger households, while sentiment among wealthy households appears to have stabilized. The National Federation of Independent Businesses' measure of optimism among small businesses has also softened since March. However, the

more broad and timely Business Trends and Outlook Survey (BTOS) by the Census Bureau suggests that, on average, the surveyed firms' self-reported current performance so far in 2026 has been consistently better compared to 2025, whereas their expected performance six months ahead has also swung positive since February.⁵

The Institute for Supply Management's Purchasing Managers' Index (PMI) for the manufacturing sector has remained above the 50-point threshold for expansion since January. Despite the war with Iran, the synchronized uptick in both the manufacturing and service sectors continues. Excluding slower supplier deliveries, which add to the headline reading, the manufacturing index has

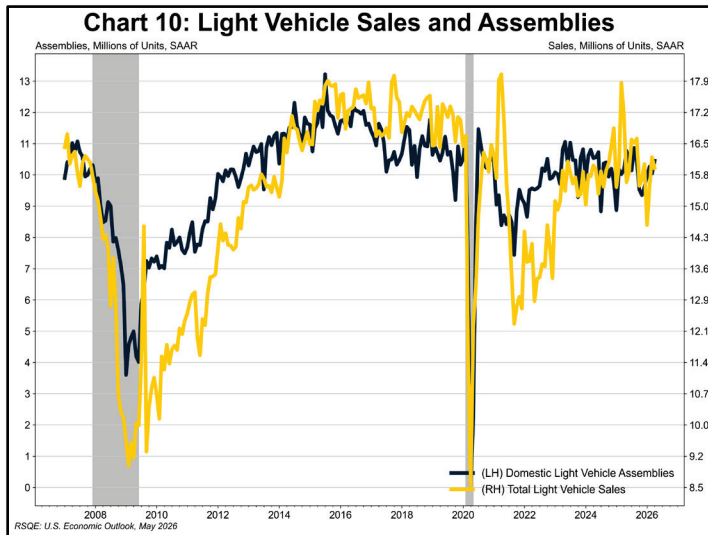


been supported by increases in new orders and production. The service sector index also continues to

⁵ The BTOS provides nationally representative data on U.S. employer nonfarm business every 2 weeks. As of this writing, the latest reading was released on May 3rd.

indicate expansion. However, the employment activity subindex has retreated into contractionary territory following a brief three-month improvement.

Taking the helicopter view and smoothing through the spikes and troughs caused by tariff-related news and EV tax credit policy changes, the trend pace of light vehicle sales has arguably been largely stable over the past three years. Time and again, the annualized sales pace has returned to the mid-to-



high-15-million range. Most recently, sales dipped to a 14.6 million annualized pace in January 2026 before recovering to average 15.9 million in February through April.

The recent increase in gasoline prices has had only a limited effect on new vehicle sales so far. Gasoline prices rose from under \$3 per gallon in February to over \$4 in April.

Sales of some hybrids have increased

considerably, but there are still few signs of broader substitution toward more fuel-efficient vehicles, either within vehicle classes or between them. For now, the shift appears concentrated rather than broad-based. As noted earlier, the run-up in the price of gasoline was significant, but since it started from a relatively low base, current gasoline prices have yet to trigger large-scale reassessment of vehicle buying choices.

On a more positive side, CPI inflation for new vehicles has been quite modest so far this year in light of the recent tariffs. A complex set of manufacturer credits offsetting tariff costs, as well as the effective removal of penalties for missing Corporate Average Fuel Economy (CAFE) standards, may have helped tame price increases. Credit conditions are mixed. New delinquencies on auto loans have been edging down for several quarters according to the New York Fed's recently released quarterly report on household debt and credit. However, vehicle finance interest rates remain elevated, keeping affordability challenging for many buyers. High stock market valuations may be helping to offset some of that pressure.

On balance, several forces are pushing in different directions. Higher gasoline prices and elevated financing costs are headwinds, while stable demand, modest new vehicle inflation, improving delinquency trends, and strong stock valuations are more supportive. As a result, we expect light vehicle sales to remain stable in the near term.

The pace of domestic light vehicle assemblies remains volatile, but it is broadly in line with about 10 million vehicles assembled in 2025, down from 10.4 million in 2023. Tariff costs and uncertainty, alongside aluminum and memory chip shortages and a bleaker outlook for EV sales, may be holding down production. Meanwhile, the pace of medium- and heavy-duty vehicle sales has firmed in 2026. That market had been in free fall through most of the second half of 2025, likely due to the freight recession caused by sharply higher tariffs on imported goods.

Overall, the economy appears resilient enough to continue expanding at a moderate pace and is unlikely to be derailed by adverse external shocks of modest size.

Next, we detail several key policy and economic assumptions underlying the forecast.

Monetary Policy

The FOMC is adopting a wait-and-see approach as tariffs and the conflict in the Middle East put upward pressure on inflation amid a still-soft but broadly stable labor market. After lowering the policy target by 25 basis points (bps) in December 2025, the FOMC has maintained the target range for the federal funds rate at 3.5–3.75 percent at its 2026 meetings to date, including in April. With inflation recently re-accelerating and high uncertainty about the outlook, we now expect the Fed to wait until early 2027 before resuming its cutting cycle. We project two 25 bps cuts by mid-2027, bringing the fed funds rate range to 3–3.25 percent.

Financial market expectations have shifted toward even more delay, with investors not pricing in further cuts through 2028. The April meeting also revealed a more divided Committee, as one member dissented in favor of a 25-bps cut and three others supported holding rates steady but opposed retaining the statement's easing bias. Chair Jerome Powell characterized the dissents as evidence that the center of the Committee is moving toward a more neutral stance, noting that he currently estimates the neutral rate to be between 3 and 4 percent, rendering the current policy target only mildly restrictive. We believe

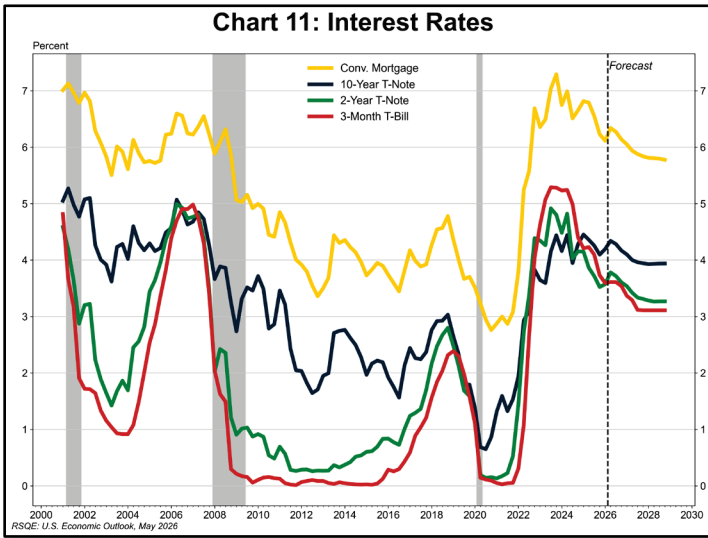
that the neutral rate is closer to the bottom of that range and expect the Fed to deliver a couple of cuts after the current inflation flare-up fades and the unemployment rate stabilizes.

The reacceleration of inflation is the primary hold on further cuts this year, as core PCE inflation spiked in January and February, while energy prices pushed March headline PCE inflation to 3.5 percent year-over-year. The Fed still appears to view much of the recent core inflation pressure as tied to tariffs, but the minutes from the March meeting emphasized that a prolonged Middle East conflict could increase the risk that energy prices pass through to core inflation. The labor market appears to have stabilized with some signs of firming up, signaling lower urgency for further rate cuts. The unemployment rate has been broadly stable around 4.3–4.4 percent since July 2025, while private sector job gains have improved so far in 2026. The economy has continued to expand at a solid pace, supported by resilient consumer spending and brisk fixed business investment, especially in technology and data centers. This resilience gives the Fed time to wait for more evidence on inflation before changing rates.

The new Fed Chair Nominee Kevin Warsh was confirmed by the Senate in mid-May. Although he has advocated for changes in monetary policy that include the removal of forward guidance, reducing the size of the balance sheet, and considering the positive effects of AI on potential output, the timing of any rate reductions will likely depend on the new chair gaining consensus.

Our forecast aligns with a Fed slowly transitioning toward what we believe to be a neutral stance while looking past temporary price-level shocks. As tariff and energy pressures moderate, we expect two 25 bps cuts to the federal funds rate in early- and mid-2027. However, a more persistent inflation shock risks the Committee removing its easing bias entirely, and holding rates unchanged for longer, or potentially even raising them.

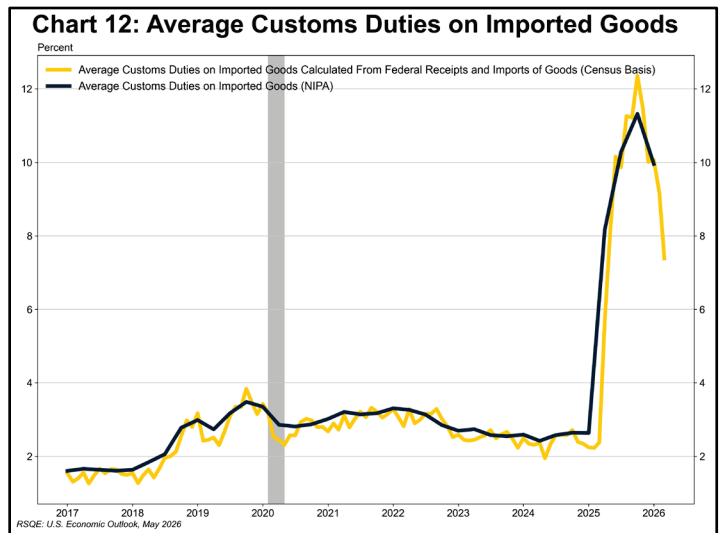
Chart 11 shows our projections for selected key interest rates. The 3-month Treasury bill rate hovers around 3.6 percent through 2026Q3, before falling through the end of 2027 and then stabilizing at 3.1 percent. The 10-year Treasury rate is expected to average 4.3 percent in 2026Q2 and slowly decline before stabilizing at 3.9 percent by 2027Q4. The spread between the 10-year and 2-year yields stays in the 0.6–0.7 range throughout the forecast. The 30-year conventional fixed-rate mortgage holds



steady around 6.3 percent mid-2026, before declining to 5.8 percent in 2027Q4 where it remains over the rest of the forecast. The announced conversion of maturing and prepaid mortgage-backed securities on the Federal Reserve's balance sheet into Treasury bills will likely slow the narrowing of the spread between the 30-year fixed mortgage rate and the 10-year Treasury yield.

Trade and Fiscal Policy

A year after “Liberation Day,” the tariff outlook appears to have moderated slightly. Quarterly readings from the NIPA data suggest that the effective tariff rate averaged roughly 10 percent in 2026Q1, during which the global tariff implemented under the International Emergency Economic Powers Act (IEEPA) was overruled, but the 10 percent Section 122 tariff took effect shortly after. Monthly readings derived from Treasury statements, which are highly correlated with the quarterly NIPA measure, showed the effective tariff rate retreating to 7.4 percent in March. Both series point to a moderation in tariff rates faced by businesses. Meanwhile, we do not expect the recent U.S. Court of International Trade ruling against the temporary 10-percent Section 122 tariff to materially affect near-term tariff rates, because the Section 122 authority expires after 150 days unless the Congress extends it, and the appeals process is likely to extend beyond that window. We do not expect the Congress to provide an extension.



After accounting for recent increases in

Section 232 tariffs on steel, aluminum, and copper imports, we expect the average tariff rate to hover

around 8 percent throughout our forecast window. Ongoing Section 301 investigations involving 60 trading partners, including Canada, Mexico and China, are likely to provide a new statutory basis for sustaining an overall elevated level of tariff rates. By contrast, already completed deals and active negotiations suggest to us that a renewed jump in tariff rates is less likely compared with a year ago. Nevertheless, looming Section 232 tariffs on patented pharmaceutical products and the threatened reinstatement of higher tariffs on imported European vehicles continue to contribute to uncertainty around trade policy.

IEEPA refunds appear to be underway. The Trump Administration suggests that refunds should be issued within 60–90 days once declarations are accepted.⁶ We have penciled in a total of \$160 billion in refunds to be distributed during the current and next quarters. As most consumers did not pay tariffs directly, we expect most of the refunds to accrue to businesses, thereby bolstering corporate profits and proprietors' income.

Progress on the fiscal 2027 budget has been limited. President Trump's budget proposal called for \$1.5 trillion in defense spending alongside sharp cuts to nondefense spending. We view those proposed levels as directional, and we assume continued strength in defense spending and modest growth in nondefense spending. Our forecast assumes no more federal shutdowns before the midterm elections, and we believe a divided Congress is more likely than not to return after the elections, which would make passing large-scale fiscal reform difficult. Additionally, we do not anticipate any meaningful

	FY Forecast			
	2025	2026	2027	2028
Current receipts	5525.8	5738.3	6001.8	6209.9
% change	8.7	3.8	4.6	3.5
Current expenditures	7409.5	7687.0	7973.6	8297.9
% change	7.3	3.7	3.7	4.1
Consumption	1493.0	1521.1	1583.9	1647.5
% change	5.6	1.9	4.1	4.0
Transfer payments	4640.6	4834.8	5039.0	5246.1
% change	7.6	4.2	4.2	4.1
Federal subsidies	110.9	106.8	96.2	98.1
% change	17.3	-3.7	-9.9	2.0
Interest payments	1165.0	1224.3	1254.5	1306.1
% change	7.1	5.1	2.5	4.1
Surplus (+) or deficit (-)	-1883.6	-1948.7	-1971.8	-2087.9
Percent of GDP	-6.2	-6.1	-5.8	-5.9

change to the existing USMCA framework. Missing the July joint review deadline would not terminate the agreement; instead, the current framework would remain, subject to annual reviews.

Table 1 shows the data and our projections for the federal budget on a NIPA basis for fiscal years 2025 through 2028 by

⁶ See <https://www.cbp.gov/trade/programs-administration/trade-remedies/ieepa-duty-refunds>.

receipts and major expenditure categories. Nominal revenue growth increased by a brisk 8.7 percent in fiscal 2025 owing to a sharp increase in tariff revenue. As IEEPA refunds roll out and tax cuts work their way through the economy, revenue growth slows to 3.8 percent in fiscal 2026. Growth picks up to 4.6 percent next year before slowing again to 3.5 percent in fiscal 2028.

We project that growth in federal expenditures will moderate as Medicaid enrollment slides, transfer payments decelerate, and federal hiring remains weak. Growth in federal consumption spending drops to 1.9 percent in fiscal 2026 before recovering in fiscal 2027 and 2028, supported by firm defense spending. Transfer payment growth holds at 4.2 percent for two fiscal years as cuts to safety net programs outlined in the OBBBA take effect, but higher inflation props up transfer outlays and offsets some of the declines. Federal subsidies decline in fiscal 2027 as agricultural subsidies wane. Finally, growth in interest expenses continues to decelerate in fiscal 2026 and 2027 as interest rates edge down. However, the overall debt service spending level stays elevated, and maturing long-term debt continues to be refinanced at higher rates.

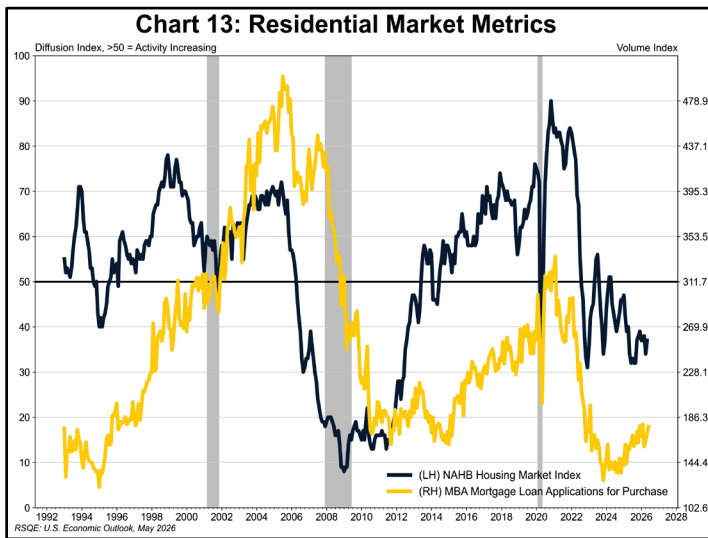
The federal deficit-to-GDP ratio hovers around 6.0 percent throughout our forecast horizon. We do not anticipate efforts to shrink the Fed balance sheet sizably to materialize through 2028. Therefore, federal debt held by private investors is projected to continue to rise slowly, from 84.9 percent of GDP in 2026Q1 to 88.4 percent in 2028Q4.

The Housing Market

The housing market faces renewed headwinds in the spring of 2026 as the improvement in financing costs seen over much of 2025 has stalled. While single-family housing starts have been choppy around a subdued trend, sales momentum has cooled and builder sentiment has softened as mortgage rates have ticked up. This combination of still-elevated borrowing costs, subdued sales, and a persistent overhang of new-home inventory shows a market that remains strained relative to historical averages. Recent monthly data confirm a slowdown in home price appreciation across a range of new and existing home price indices. Looking ahead, we project mortgage rates will resume their descent and home price appreciation will gradually ramp back up to our 4 percent estimate of the long-run trend.

After declining in late 2025, financing costs have recently trended higher. The 30-year conventional fixed-rate mortgage ticked up to 6.4 percent in early May 2026, after averaging 6.1 percent over the first three months of 2026. Existing single-family home sales slipped to a 3.6-million-unit annualized pace in March, bringing the 2026Q1 average of 3.7 million below the 3.8-million-unit pace averaged in 2025Q4. New single-family home sales corrected more noticeably, averaging a subdued 633,000-unit annualized pace in 2026Q1 after reaching a 709,000-unit pace in 2025Q4, quickly moving from one of the stronger quarterly readings of recent years to one of the softer ones.

Chart 13 captures both soft buyer activity and builder caution by showing the Mortgage Bankers Association's (MBA's) purchase application volume index and the National Association of Home Builders (NAHB)/Wells Fargo Housing Market Index (HMI). Housing-related sentiment has softened alongside the recent rise in rates and elevated economic uncertainty. The NAHB/Wells Fargo HMI slid to 34 in April,



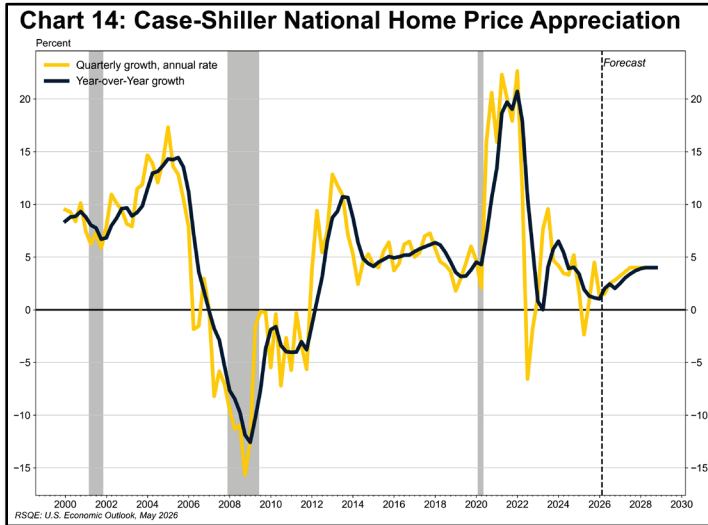
after hovering around 38 since 2025Q4, remaining well below the neutral level of 50. Builder optimism for the near future has also dissipated, with the sub-index for sales expectations over the next half-year dropping to 42 in April, a further step down from its average of 48 over 2026Q1. The MBA's purchase application index has softened since

January, when it reached its highest monthly average since early 2023.

The inventory of new homes remains high relative to sales. Months' supply of new single-family homes averaged 9.1 months in 2026Q1, up from 8.2 months in 2025Q4 and well above the 6-month mark that historically characterized the upper bound of a balanced market. This uptick occurred even as the total stock of new homes for sale edged down to a 480,000-unit average in 2026Q1, reflecting that sales have slowed more rapidly than inventories have cleared. Perhaps reflecting unseasonably early starts to construction in parts of the country, single-family housing starts rose to a 1.0-million-unit annualized pace in March, lifting the 2026Q1 average to 957,000 units and extending the recovery from

the 2025Q3 low, though the pace remains subdued by recent standards. Meanwhile, single-family permits held near a 900,000-unit annualized pace in 2026Q1, little changed from late 2025 and below their average pace in the first half of last year. We expect the pace of starts to fall back under 1.0 million shortly.

We expect the 30-year mortgage rate to increase to 6.3 percent through 2026Q2 before resuming



a steady decline, ultimately stabilizing at 5.8 percent in 2028. Our preferred measure of home prices, the seasonally adjusted S&P Case-Shiller Home Price Index (Chart 14), remained subdued in early 2026 with a quarterly annualized growth rate projected at 1.3 percent in the first quarter. We forecast a gradual acceleration in home prices to 2.8

percent by the end of 2026, reaching 4.0 percent by the end of 2027.

Energy Markets

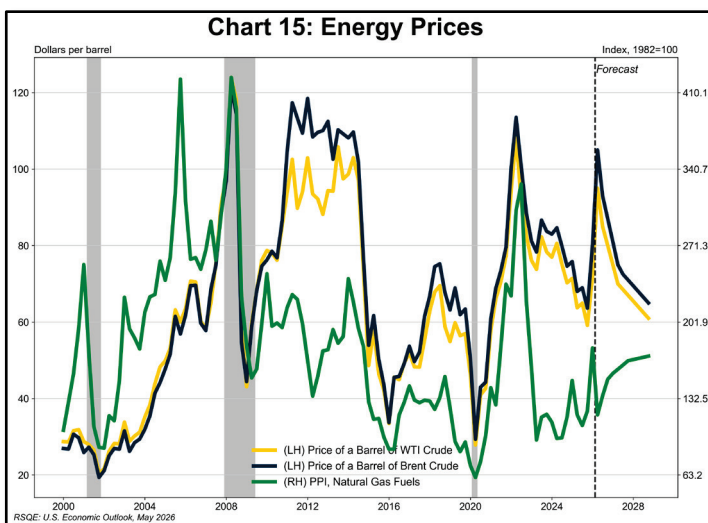
Since late February, the price of West Texas Intermediate (WTI) crude oil has risen sharply and remained highly volatile, climbing from the mid-\$60s per barrel to well above \$100 at several points this spring as markets re-priced the scope and duration of disruptions to energy production and shipping through the Strait of Hormuz amid the ongoing war in Iran. More recently, WTI crude prices have been gyrating around \$90 to \$105 per barrel, reflecting shifts in market sentiment around U.S.–Iran negotiations. Nevertheless, energy prices remain sensitive to geopolitical developments, and price volatility is likely to persist until a durable agreement is reached and regional shipping flows begin to normalize.

Our forecast assumes that a negotiated agreement will be reached within a few months, followed by de-escalation and no lasting damage to major energy infrastructure or shipping capacity. Additionally, our outlook also assumes that shipping conditions normalize in the Strait by the end of 2026. However,

a prolonged war and a delayed agreement would raise the risk of lasting infrastructure damage, tighter inventories, and higher prices for longer than we have projected.

Despite ongoing geopolitical turmoil, we expect the global oil market to return to a state of oversupply toward the end of our forecast as disruptions ease and production expands. The United Arab Emirates' departure from the Organization of the Petroleum Exporting Countries and its allies (OPEC+), alongside OPEC+'s continued unwinding of production cuts, should support global supply once Middle Eastern shipping flows improve. On the domestic front, in May 2026, the Energy Information Administration (EIA) projected that U.S. crude oil production would reach a record 14.1 million barrels per day (mbpd) in 2027, roughly 4 percent higher than 2025 production levels. Meanwhile, elevated prices and supply disruptions are expected to restrain near-term liquid fuels consumption, though demand growth should normalize in 2027. Overall, the EIA expects global inventories to fall by 2.6 mbpd in 2026 before increasing by 3.9 mbpd in 2027.

Chart 15 shows our forecast for WTI and Brent crude oil prices in maize and blue, respectively, alongside the Producer Price Index (PPI) for natural gas fuels in green. The price of WTI averaged nearly \$72 per barrel in the first quarter of 2026, and we expect it to average \$95 per barrel this quarter due to the war in Iran. As a deal is reached and traffic in the Strait returns to normal, we expect WTI prices to decline to \$80 per barrel by the end of 2026. As persistent oversupply takes hold in the market, the price



of WTI falls to \$67 per barrel by the end of 2027 and to \$61 per barrel by the end of 2028. We thus expect the price of WTI to return to around its pre-conflict level in the second half of 2028.

Since the addition of WTI Midland crude to the Brent benchmark in 2023Q2, the Brent–WTI spread has averaged \$4.6 per

barrel from 2023Q3 through 2025Q4, exceeding \$5 in only a couple of quarters. However, the war with Iran pushed the spread to an average of \$8.3 in the first quarter of 2026. We expect the spread to peak

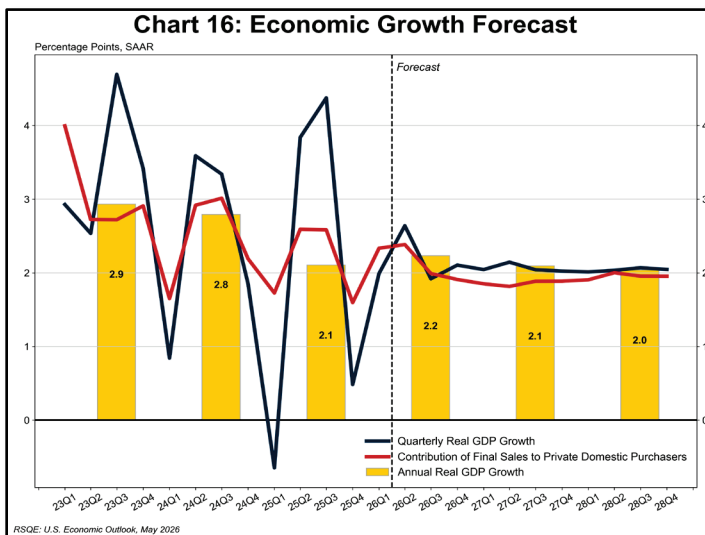
at \$10 this quarter before narrowing to \$4 per barrel in the second half of 2027, where it remains through the rest of the forecast.

Domestic natural gas prices, as measured by the PPI for natural gas fuels, increased late in 2025 amid expectations of a colder winter, and surged further in late January 2026 as severe weather disrupted natural gas production. Since retreating from that winter spike, natural gas prices have remained relatively stable, even as the war with Iran started. One reason prices have remained relatively insulated in the U.S. is that natural gas primarily stays within the domestic market.

Strong global demand for liquefied natural gas (LNG) is expected to continue supporting U.S. exports even as LNG takeaway capacity expands substantially over the forecast period. Hence, we expect natural gas prices to resume their upward trend toward the higher price levels observed overseas over the next two and a half years as global LNG demand remains robust. As a result, we project that natural gas prices will rise by 26.7 percent from the third quarter of 2026 through the end of 2028. By the end of the forecast, natural gas prices are expected to approach the average levels observed in 2026Q1, though without the severe weather-related premium that temporarily boosted prices to start the year.

The Forecast for 2026–2028

With one third of 2026 complete, the U.S. economy remains on a solid footing despite renewed inflation pressure, slow job growth, elevated geopolitical tensions, and substantial policy uncertainty. Looking beyond the buildout in data-center construction, recent data paint a broader picture of an AI-related capital investment surge. Strong equity prices, led primarily by tech firms, have likely been supporting consumer spending through wealth effects. We judge that the AI-related capital investment boom will likely continue for several quarters, although part of the impact on real GDP will be offset by imports. This outlook, however, hinges on robust supply chains for advanced chips and energy infrastructure. Our baseline forecast assumes a near-term reopening of the Strait of Hormuz. While elevated oil prices will continue to put upward pressure on inflation through input and transportation costs, we expect supply chain disruptions to remain relatively contained; as a result, core PCE inflation, after spiking in 2026Q1, eases through 2026 and helps bring year-over-year PCE inflation down toward the Federal Reserve's 2.0 percent target through 2027. Still, consumption growth is expected to moderate slightly in the second half of 2026 as slower real wage growth restrains household spending, the boost from larger tax refunds fades, and IEEPA tariff refunds do not trickle down to consumers. The broader economy nevertheless continues to expand at a healthy pace, as a resilient labor market helps prevent a sharp pullback in household spending and AI-related capital investment plays a larger role in sustaining growth.

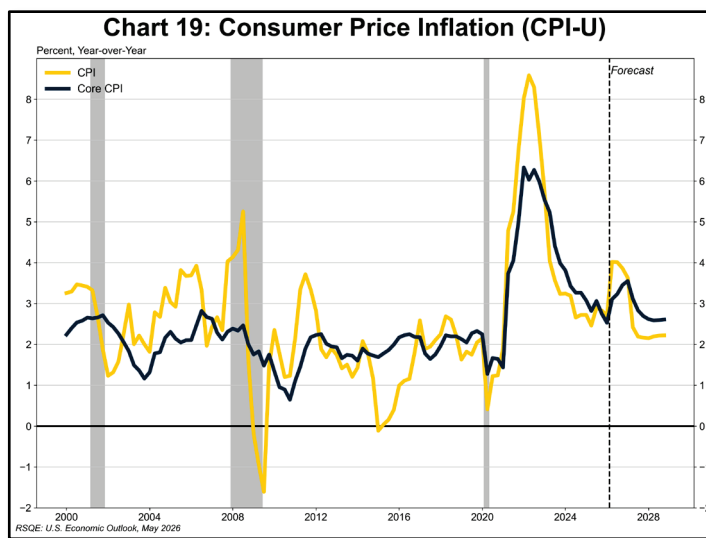
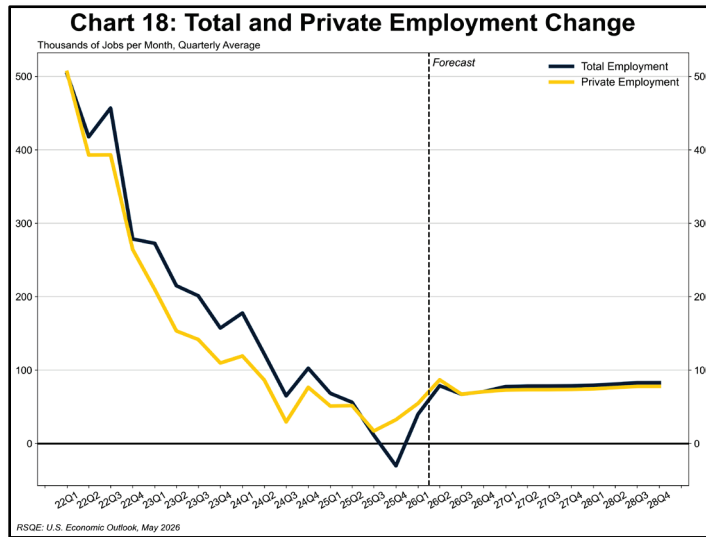
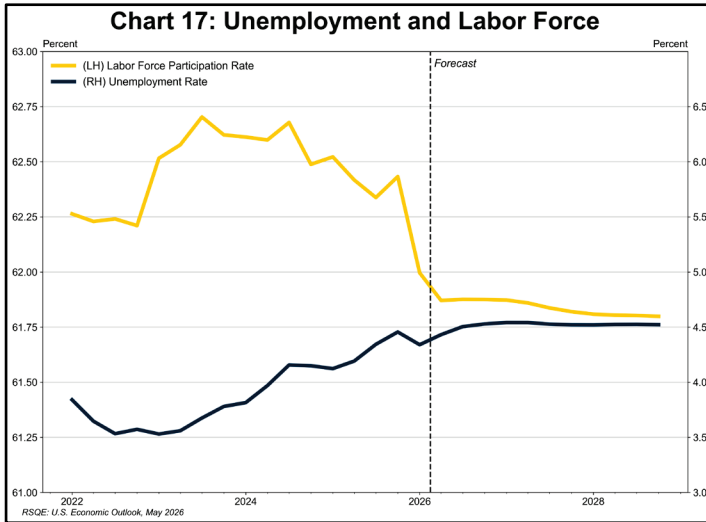


- We expect economic growth to pick up in 2026Q2, supported by solid momentum in business fixed investment and larger tax refunds that help sustain consumption in the face of higher gasoline costs. Real GDP growth accelerates to a 2.6 percent annualized pace.
- We project headline GDP growth to take a breather in 2026Q3. The quarterly annualized pace edges down to 1.9 percent with the unemployment rate rising and elevated inflation weighing on consumption growth, which is sustained partly by a declining saving rate.
- With monetary policy close to neutral, a meaningful pickup in productivity keeps quarterly annualized real GDP growth at or above 2.0 percent through 2028.
- In 2026, calendar year real GDP growth registers 2.2 percent, then moderates to 2.1 percent in 2027 and 2.0 percent in 2028.
- Over 2026H2, a declining saving rate helps consumption expenditures contribute 1.0 percentage point to growth, despite anemic growth in real disposable income. We expect consumption to add 1.2–1.3 percentage points to growth over the rest of the forecast as the saving rate stabilizes and inflation eases.
- The growth contribution of nonresidential fixed investment remains strong over the forecast. The build-out of AI-related infrastructure and software is supported by robust investment in information processing equipment.
- Residential investment drags on growth until 2027, as new single-family home affordability remains a challenge despite declining mortgage rates. Meanwhile, slow projected population growth weighs on the growth contribution of multi-family housing construction over the forecast period.
- After a volatile 2025, the quarterly growth contributions from net exports and inventory investment settle down by 2026H2.

Table 2
Contributions to the Growth of Real GDP
(Average quarterly contributions, percentage points at annual rate)

	'26Q1	'26Q2	'26H2	'27	'28
Real GDP (% change, AR)	2.0	2.6	2.0	2.1	2.0
Contributions to real GDP growth					
Final sales to private domestic purchasers	2.2	2.3	1.9	1.8	1.9
Consumption	1.1	1.2	1.0	1.2	1.3
Nonresidential fixed investment	1.4	1.1	0.9	0.6	0.5
Residential investment	-0.3	-0.1	-0.0	0.1	0.1
Government purchases	0.7	-0.3	0.0	0.2	0.2
Net exports	-1.3	0.1	0.1	-0.1	-0.2
Inventory investment	0.4	0.6	0.0	0.1	0.0

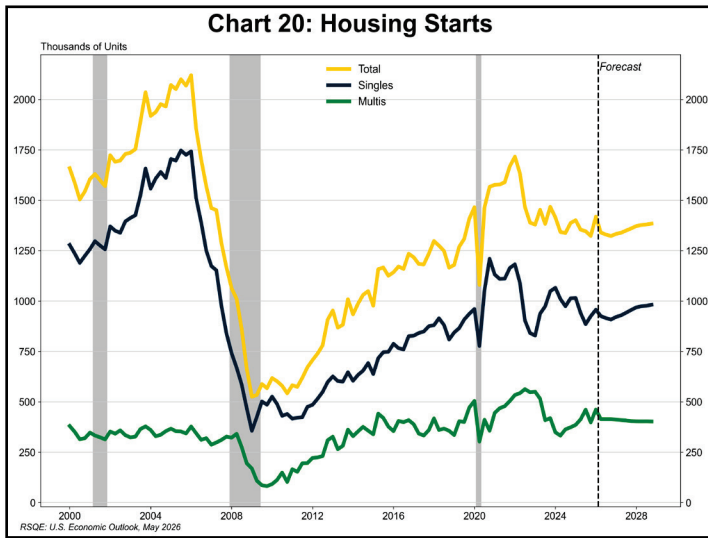
RSQE: U.S. Economic Outlook, May 2026



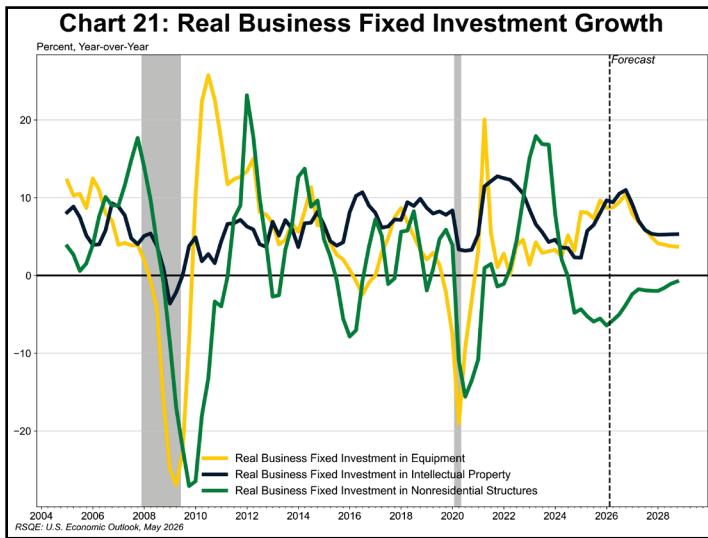
- In 2026 so far, the unemployment rate has held steady in the 4.3–4.4, partly reflecting a decline in the labor force participation rate, suggesting some stabilization in the labor market. The labor force participation rate declined to 61.8 percent in April, driven by declining participation of men over 65 years old.
- We expect the labor market to remain largely balanced, but somewhat vulnerable, over the forecast. We project the impact of the oil shock on the labor market to be mild, with the unemployment rate rising marginally to 4.5 percent by 2026Q3, at which point when the negative drag from the oil price spike will largely dissipate.
- We expect the participation rate to drift down marginally over the forecast. Steady labor demand, alongside slow population growth, will draw enough working-age people into the workforce to almost offset ongoing retirements.

- Payroll employment growth accelerates relative to 2025H2. Following the January–April average of 76,000 job additions per month, we judge that the pace of monthly job gains will slow to a more sustainable 70,000 in 2026H2. In 2027–28, job gains pick up to about 80,000 per month amid the waning impact of the oil price spike and lower interest rates.
- While job gains in the 70,000–80,000 range are modest by historical standards, they reflect a solid pace given slow population growth and net immigration estimates. This trajectory exceeds recent estimates of the breakeven level of job creation—which some Federal Reserve officials place near zero.
- Government payrolls are expected to stagnate, keeping total civilian public employment flat through 2026. Weak growth in government employment resumes in 2027.

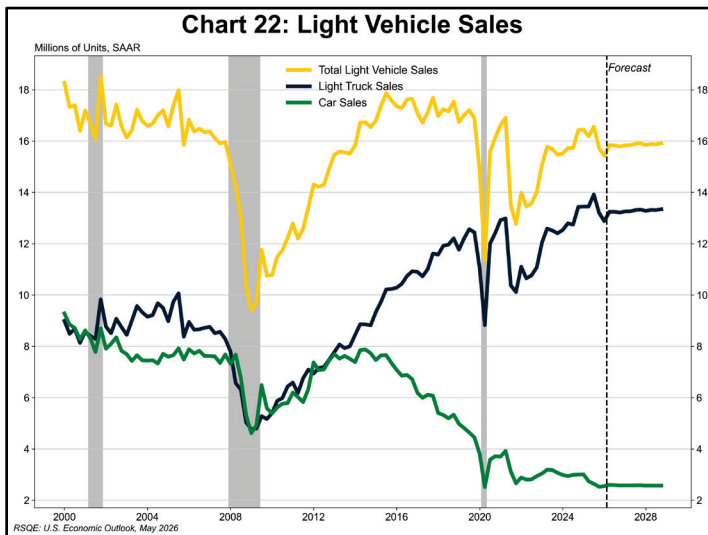
- Year-over-year CPI inflation accelerated from 2.4 percent in January to 3.8 percent in April, largely reflecting upward pressure from energy prices. Twelve-month core CPI inflation firmed to 2.7 percent in April, with non-shelter non-energy services inflation continuing to contribute to underlying price pressures.
- Headline CPI inflation is projected to reach 4.0 percent in 2026Q2, but its broader trajectory is distorted somewhat by last fall’s federal government shutdown. Shelter CPI between 2025Q4–2026Q1 was understated by about 0.3 percent due to the shutdown, creating a “low base effect” that elevates headline year-over-year inflation to 3.9 percent in 2026Q4 and 3.6 percent in 2027Q1. Core CPI inflation mirrors this distortion, registering 3.5 and 3.6 percent, respectively.
- PCE inflation spiked even before the Iran war pushed gasoline prices up, in part due to AI-related price spikes for computer components. Year-over-year PCE inflation, currently tracking unusually above headline CPI, dips back below in 2026Q2, decelerating from 3.8 percent down to 3.6 percent in 2026Q4, before stabilizing at 2.0 percent by 2028Q1.



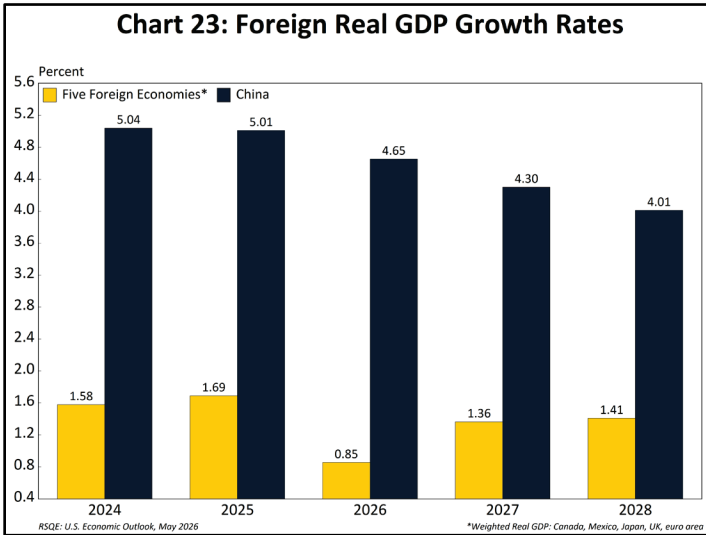
- Perhaps aided by an unseasonably warm March, new single-family housing starts improved to an annualized pace of 957,000 units in 2026Q1, marking two consecutive quarterly gains since the 2025Q3 low. We expect starts to dip to 908,000 units by 2026Q4 amid low builder sentiment and higher construction costs, before steadily recovering to 981,000 units by 2028Q4 as lower mortgage rates provide support.
- Multi-family starts recovered to an annualized pace of 462,000 units in 2026Q1, the highest quarterly rate since 2023Q2. However, the combination of elevated construction costs and improving single-family affordability will likely pull multi-family starts lower. They stabilize near 400,000 units by 2028Q4.
- In the short term, total housing starts slow to 1,323,000 units by 2026Q4. In the medium term, as financing conditions improve, we expect housing starts to rebound slowly, reaching a pace of 1,384,000 units by the end of 2028.



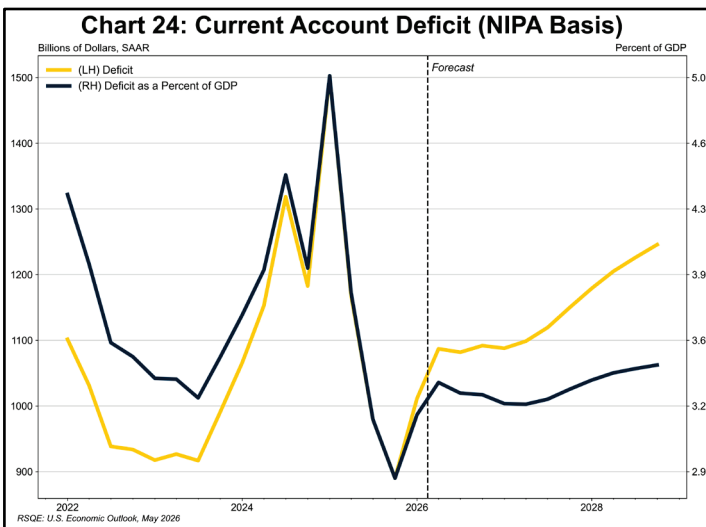
- Business fixed investment in equipment grew by 8.7 percent year over year in 2026Q1, propelled by robust gains in investment in computers and peripheral equipment. We expect this rapid growth to persist alongside intensifying AI development. The year-over-year growth rate holds well above 8.7 percent through 2026, before stepping down to roughly 4.0 percent by the end of 2028.
- Year-over-year growth in intellectual property investment reached 9.7 percent in 2026Q1, driven by accelerating investment in software and research and development (R&D). We expect solid momentum to persist as businesses expand AI usage to produce more intellectual property and R&D through 2028.
- By contrast, investment in nonresidential structures continues to retreat throughout the forecast period. The surge in construction activity tied to microchip factories has given way to a slump as projects near completion, and the data center structures build-out has yet to provide enough support to offset that decline. Domestic drilling activity is likely to turn around with higher oil prices through 2026.



- Light vehicle sales averaged a subdued 15.4-million-unit annualized pace in 2026Q1, held down by severe winter weather early in the quarter. Sales rebounded to a 15.9-million-unit pace in April, suggesting some firming as weather disruptions faded.
- Despite the spring rebound in sales and lower new delinquency rates, the decline in auto finance rates has stalled. We expect these sticky borrowing costs to constrain further growth, anchoring near-term sales at a steady 15.8 million units through 2026Q4.
- We maintain a cautious approach to medium-term vehicle production amid renewed trade uncertainty ahead of the looming USMCA joint review this summer. As automakers adapt supply chains to these conditions and navigate ongoing affordability headwinds, we project light vehicle sales to hover around 15.8–15.9 million units per year over the 2027–28 period.



- To forecast demand for U.S. exports, we construct a trade-weighted index of real GDP for five of our major export markets: Canada, Mexico, Japan, the United Kingdom, and the euro area. We also track China’s economy, but we show it separately because it tends to grow more quickly.
- China’s economic growth remained decent, growing at a 5.3 percent annualized pace in 2026Q1, but the disconnect between strong supply and weak domestic demand persists. With the official growth target dipping below 5.0 percent for the first time in decades, we expect China’s growth to cool gradually, sliding to 4.0 percent in 2028. Our projections are largely based on the Bloomberg survey of forecasters and the International Monetary Fund’s longer-run outlook.
- Higher energy prices led to slower projected growth in the euro area, while growth in Mexico turned negative in 2026Q1, led by weakness in goods-producing sectors. As a result, the five-economy composite growth slips to 0.9 percent in 2026. In 2027–28, growth picks up in all five markets, and the composite growth rate averages 1.4 percent.



- Large recent movements in the raw current account balance and its size relative to GDP have been driven largely by the erratic behavior of net exports of goods immediately preceding and in the aftermath of changes to tariff policy.
- The current account deficit collapsed to 2.8 percent of GDP in 2025Q4, after spiking to 5.0 percent in 2025Q1 due to tariff front-running. Strong growth of net imports of AI-related investment goods (and possibly another spike in other imports due to lower tariffs) brought the current account deficit up to 3.2 percent in 2026Q1.
- Over the forecast, the current account deficit edges up to 3.3 percent of GDP in 2026Q2, as strong net imports of computer components and microchips continue. For the rest of the forecast, the deficit stays in a range of 3.2–3.4 percent of GDP.
- Strong growth of net factor income in 2025Q4 helped push the current account deficit to its narrowest level relative to GDP since early 2020. Going forward, we do not expect net factor income to help to narrow the current account deficit.

Risks to the Forecast

We strive to strike a balance between major quantifiable upside and downside risks to the economy in our forecasts. However, hard-to-quantify risks can also be large at times, whether or not they tilt in an identifiable direction. For this forecast, the quantifiable risks to the domestic outlook seem roughly balanced, with large but effectively unquantifiable risks also present.

The future trajectory of global trade in oil, LNG, and other key commodities passing through the Strait of Hormuz is a key risk to the outlook. This forecast assumes no further escalation and that the Strait will be unblocked soon. Even a lengthy blockade without significant military escalation would have major repercussions, as the world has been running down commercial and public reserves of oil and LNG in anticipation that energy flows will normalize soon. Energy reserves are not spread equally across net importer countries. Some large countries, such as India, are already facing severe shortages, and the Indian government has called on citizens and businesses to sharply ration fuel usage. A prolonged blockage would risk driving energy prices even higher, as countries with large reserves slow sales and countries with low reserves face sharper supply constraints. It could also disrupt supply chains dependent on countries with limited energy reserves. On the upside, if the Strait reopens sooner and damage to energy extraction and processing infrastructure proves less extensive than currently believed, energy prices could come down more quickly than we have assumed.

Monetary policy is another important source of risk. Kevin Warsh, the newly confirmed Chair of the Federal Reserve, made several high-profile promises before and during the confirmation process that could reshape how the Fed conducts policy and communicates with the public. However, he will need to build consensus around those changes, which will take time. The financial market is currently pricing a lengthy pause in rate cuts, but the new Chair's influence on the FOMC is not yet clear. The committee's ultimate decision—whether to lean toward looser policy to support the labor market or instead toward tighter policy to hedge against the re-acceleration of core PCE inflation—will affect policy rates, financial markets, inflation, and the labor market relative to our projections. New developments on either side of the monetary policy trade-off are always a risk. At this point, the Fed's reaction function to unexpected shocks is also up for reassessment.

Fiscal policy risks are meaningful as well, centered around the composition of the Congress starting in 2027. Gridlock is our base case, but single-party control of Congress could lead to more action than we have assumed. The United States is projected to run a deficit of almost 6 percent of GDP over the forecast, which is clearly not sustainable over the long run. The deficit would grow wider if interest rates increase, as roughly 4 percentage points out of the deficit's six already go toward debt service.

Fiscal action to limit the primary deficit will have to come at some point, and it could begin during the forecast window. At the same time, if geopolitical tensions escalate sharply, even a divided Congress would be unlikely to say no to increased military spending.

The AI boom presents a different kind of risk. Its effects have been visible in some portions of the NIPA statistics, but the net measured impact on real GDP based on currently available data has been quite small so far. Elevated stock market indices have arguably supported faster consumption growth among wealthier consumers, while AI-related business investment has been offset by the run-up in net imports of computer components and microchips. It is plausible that official data will take years to properly measure the true impact of AI on spending and productivity. Another wildcard is what growing AI adoption will do to labor demand and inflation pressures, but we believe those effects will be larger outside of our forecast window.

Tariff-related risks remain prominent. With the temporary Section 122 measure expiring soon, ongoing Section 232 and Section 301 investigations could move the average effective import tariff rate away from the path assumed in this forecast. A broad application of tariffs under those authorities would likely invite further legal challenges, prolonging trade-related uncertainty and weighing on business investment. Significant sector-specific tariffs could also keep month-to-month changes in the trade balance volatile, affecting headline growth readings.

Weather adds another risk, as ongoing drought conditions across most of the continental United States outside the Midwest could affect food prices and challenge household budgets.

Finally, geopolitical risks remain two-sided. Several ongoing military and economic conflicts could resolve or de-escalate, easing sanctions and supply constraints and putting downward pressure on some commodity prices. On the other hand, conflicts could expand and draw in more countries, severely straining global trade, commodity markets, and financial markets.