

U.S. ECONOMIC & INTEREST RATE OUTLOOK

IN THIS ISSUE

- **Keeping Warm**

Seasons are changing, and those of us in the Northern Hemisphere are engaged in our annual tradition of finding cold-weather gear and ensuring our homes are ready for winter. Preparation now can prevent discomfort as temperatures drop.

The U.S. economy looks well-equipped to work through the seasons ahead. Stable hiring and ongoing business investment show the economy is maintaining a balanced pace of activity. Consumer spending has yet to fall, though fuel has taken over a larger share of demand on the consumer wallet. Recent inflation readings have shown some reheating, which will prompt further tightening from the Fed. Trade policy has entered a steadier state.

Energy prices, rising debt costs and shifting sentiment around AI investment are the key risks to an otherwise calm outlook. Growth has been resilient in the face of geopolitical risks and recent increases in interest rates.

Following are our thoughts on the outlook.

Key Economic Indicators

	2026				2027				Q4 to Q4 change			Annual change		
	26:1a	26:2a	26:3a	26:4f	27:1f	27:2f	27:3f	27:4f	2025a	2026f	2027f	2025a	2026f	2027f
Real Gross Domestic Product (% change, SAAR)	2.5	2.2	2.6f	2.4	2.3	2.4	2.5	2.5	2.0	2.3	2.4	2.1	2.2	2.4
Consumer Price Index (% change, annualized)	3.2	6.1	1.7	2.0	2.2	2.3	2.2	2.2	2.8	3.1	2.2	2.7	3.3	2.3
Civilian Unemployment Rate (% average)	4.3	4.3	4.1	4.1	4.1	4.1	4.1	4.1				4.3*	4.2*	4.1*
Federal Funds Rate	3.63	3.63	3.66	3.94	4.13	4.13	4.13	4.13				4.21*	3.71*	4.13*
2-yr. Treasury Note	3.57	3.97	4.36	4.78	4.86	4.86	4.86	4.86				3.81*	4.17*	4.86*
10-yr. Treasury Note	4.20	4.42	4.76	5.25	5.35	5.35	5.35	5.35				4.29*	4.66*	5.35*

a=actual
f=forecast
*=annual average

Influences on the Forecast

- The September employment report showed a labor market that is finding its rhythm. Job creation of 29,000 is likely close to the breakeven rate of job growth needed for a steady unemployment rate, though negative revisions to the prior two months' estimates show the market is not overheating. The unemployment rate rounded up slightly to 4.2%. An average hourly earnings gain of 3.0% over the past year shows that wages are not an inflationary risk, but they are below the pace of overall inflation.
- The consumer price index (CPI) for September showed an elevated gain of 3.7% year over year, or 2.6% core (excluding food and energy); both measures were a step up from August. The run-up in fuel prices in September led the increase, as gasoline

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prices are back to levels seen in spring, while diesel prices are setting record highs. Goods prices, especially durables, are trending up, possibly reflecting some pass-through of fuel and tariff costs.

- The personal consumption expenditures (PCE) price index, the base of the Fed's 2% inflation target, fell to 3.4% (3.0% core) in August. Routine annual revisions to the methodology lowered the reading by about three tenths of a point.
- An above-consensus August CPI report cemented expectations for a September rate hike. We do not expect the September CPI will do the same for the October Fed meeting. Several Federal Open Market Committee members have given speeches suggesting a gradual approach to tightening policy, a consensus affirmed in the minutes of the September meeting. We expect one additional rate hike in December, followed by a prolonged hold.
- The bond market remains a focal point, with the 10-year U.S. Treasury note reaching a peak of 5.31% in the past month. Yields have come down recently, but the market remains unsteady. Higher benchmark yields will help to do some of the work of cooling financial conditions as they push up the cost of servicing debt. We expect some ongoing volatility, with yields settling into a steady state above 5%. Though current yields feel high relative to recent experience, they are well within historical norms; we do not anticipate yields at this level will bring about a broader credit downturn.
- Consumer spending has defied gravity. Annual revisions to national accounts data revealed a 3.8% annualized consumption gain in the second quarter. Real disposable income receded in August, with an increase in spending supported by households saving less. Wealth effects, especially for holders of tech-related assets, have contributed to this momentum.
- Investment in AI has been the leading source of growth, raising concentration risk. Second quarter data on business investment showed an increase in spending on structures in other sectors like commercial and healthcare buildings, an encouraging sign that investment is broadening beyond data centers.
- Briefly, because the question arises regularly: The upcoming midterm election has no bearing on the economic outlook.

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