

U.S. ECONOMIC & INTEREST RATE OUTLOOK

IN THIS ISSUE

• Tug Of War

The U.S. economy is being pulled in competing directions. A temporary easing in geopolitical tensions has steadied sentiment, but tariff uncertainty is re-emerging as a headwind. Inflation remains mixed, with elevated headline readings but contained core pressures. Markets have shifted their expectations of Fed policy from easing to potential tightening.

AI-led investment remains a key source of support, but it hasn't translated into a broad-based momentum. The economy is still advancing unevenly, with strength in one area offset by softness in another. The U.S.-Iran deal reduces critical downside risks but does little to change the broader trajectory.

Following are our thoughts on the outlook for the domestic economy.

Key Economic Indicators

	2026				2027				Q4 to Q4 change			Annual change		
	26:1a	26:2f	26:3f	26:4f	26:1f	26:2f	26:3f	26:4f	2025a	2026f	2027f	2025a	2026f	2027f
Real Gross Domestic Product (% change, SAAR)	1.6	2.4	2.2	1.9	2.1	2.2	2.2	2.3	2.0	2.0	2.2	2.1	2.1	2.2
Consumer Price Index (% change, annualized)	3.2	6.2	2.8	2.6	2.4	2.4	2.3	2.3	2.9	3.7	2.3	2.7	3.5	2.7
Civilian Unemployment Rate (% average)	4.3	4.3	4.3	4.3	4.3	4.3	4.2	4.2				4.0*	4.3*	4.3*
Federal Funds Rate	3.63	3.63	3.63	3.63	3.63	3.63	3.63	3.63				5.19*	3.63*	3.63*
2-yr. Treasury Note	3.57	3.91	3.72	3.87	3.87	3.87	3.87	3.87				4.37*	3.77*	3.87*
10-yr. Treasury Note	4.20	4.40	4.26	4.50	4.50	4.50	4.50	4.50				4.21*	4.34*	4.50*

a=actual
f=forecast
*=annual average

Influences on the Forecast

- U.S. economic momentum remains resilient, even as growth in much of the world slows. Looser fiscal policy and an AI-driven boom in business investment are key drivers of activity. There were signs that higher energy costs were beginning to bite into household spending, yet the latest retail sales data highlighted the continued resilience of consumers. The U.S.-Iran truce has reduced the risk of further dislocations, with falling gasoline prices helping to support consumption.
- The labor market remains a central pillar of this resilience, with conditions still very much consistent with a healthy expansion. The May employment report showed little sign of stress, as payrolls rose by a stronger than expected 172,000, alongside upward revisions of 93,000 to the prior two months. Gains were led by leisure and hospitality, healthcare, and local government, while employment declined in

Global Economic Research
50 South La Salle Street
Chicago, Illinois 60603
northerntrust.com

Carl R. Tannenbaum
Chief Economist
312-557-8820
ct92@ntrs.com

Ryan James Boyle
Chief U.S. Economist
312-444-3843
rjb13@ntrs.com

Vaibhav Tandon
Chief International Economist
630-276-2498
vt141@ntrs.com

information and financial activities. The unemployment rate remained steady at 4.3%. The “no hire, no fire” dynamic appears to be tilting back toward modest hiring.

- Inflation data are sending a more nuanced signal. The consumer price index (CPI) rose by 0.4 percentage points to 4.2% year over year in May, its highest rate in three years, driven largely by energy costs. However, there is little evidence of pass-through from the energy shock into broader prices. Core inflation (excluding food and energy) edged up modestly to 2.9%, suggesting that second-round effects remain contained for now. With energy costs now declining, inflation should follow. But a return to the central bank’s target is unlikely anytime soon, given persistent price pressures in areas such as housing and AI-related infrastructure.
- The Fed, under new Chair Warsh, left the Fed Funds Rate unchanged in June. The Federal Open Market Committee (FOMC) post-meeting statement was notably pared down, with its forward guidance largely removed. However, it acknowledged that inflation remains elevated, partly due to supply shocks, and reiterated its focus on delivering price stability. Though the meeting had a hawkish tone, we think the Fed has room to remain on the sidelines, assessing whether inflation pressures broaden. Combined with a steady labor market, policy is likely to stay on hold for longer, with risks tilted toward further tightening rather than easing.
 - Chair Warsh announced five new task forces to reevaluate the FOMC’s approaches to policymaking. Reforms to practices like the press conference are likely but will be studied and communicated in advance.
- Trade policy is re-emerging as a key source of uncertainty. President Donald Trump has signaled he does not intend to reauthorize USMCA, the North American free trade agreement. Rather than expiring, the pact would shift to annual reviews for up to a decade unless a country formally exits. While full termination appears unlikely, uncertainty alone could be nearly as damaging for business, trade, and investment plans.

The U.S. administration has also revived its tariff agenda, with the Office of the U.S. Trade Representative proposing levies of up to 12.5% on 60 trading partners over forced labor, with limited scope for legal challenges. Taken together, the renewed tariff push reinforces that the external environment is unlikely to be smooth, adding another layer of risk to the outlook through this year and into 2027.

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