

# PURDUE

## AGRICULTURAL ECONOMICS REPORT

### *The Outlook for the U.S. Economy in 2026*

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**Summary:** *The U.S. economy in 2026 is expected to grow slowly, primarily due to slower consumer spending growth. Unemployment should remain around 4.6%, as the growth in job openings matches the growth in job searchers. Inflation is likely to hold steady near 2.5%, due to lower oil prices and slower growth in housing costs. Tariffs will add to goods inflation. The Federal Reserve may make further modest reductions in the federal funds rate, leading to somewhat lower interest rates. Barring unexpected shocks, the outlook is for another year of slow expansion rather than recession.*

The economy grew more slowly in 2024-25 than it had in any year since the pandemic recession. Gross domestic product adjusted for inflation—real GDP—rose 2.3% from the third quarter of 2024 to the third quarter of 2025. The average increase for 2022-24 was 2.8%. The unemployment rate rose from 4% in January to 4.4% in December. Payroll employment increased just 0.4% over the past year. The consumer price index inflation rate dipped to a 12-month rate of 2.3% in April, but by November it was 2.7%. The Federal Reserve cut its policy interest rate twice, by a total of half a point. Treasury security yields fell.

We spent much of the Fall in a data fog. The Federal government shut down for six weeks, and that included the agencies that measure the economy. The GDP, unemployment and inflation reports were delayed, and the October unemployment and inflation numbers will never be calculated.

Perhaps the most important policy event of 2025 was the imposition of higher tariffs on imports from most of our trading partners. The tariffs added to the data fog. In the first quarter of 2026, businesses increased imports to front-load them before tariffs were hiked in April. Imports rose by \$313 billion, which was a 38% annual rate (the growth rate if the first-quarter increase had continued for a year). Imports then dropped back to previous levels in the second quarter, a 29% decrease.

Imports are subtracted from gross domestic product. GDP is a measure of goods and services produced within the borders of the United States. Imports are produced elsewhere, so they should be excluded. They are subtracted, rather than just ignored, because imported goods are included in consumption and investment spending. The measure of consumption does not differentiate between consumer purchases of cars (for example) built in the U.S. versus those built in Japan or Korea. Imports are subtracted to eliminate their influence on the rest of the accounts.

In the first quarter, a very large import number was subtracted from GDP. As a result, real GDP decreased at an annual rate of 0.6%. The next quarter, when imports dropped back to previous levels, real GDP increased by 3.8%. For the two quarters together, the increase was 1.6%. The unexpectedly large 4.3% increase in the third quarter was driven by investment in equipment and “intellectual property products”—most likely investment in data centers and AI software—plus a rise in national defense spending and a drop in imports.

#### **Gross Domestic Product**

Let's try to forecast real GDP growth for 2026 based on leading indicators of the components of GDP, consumption, investment, government purchases, imports and exports.

### ***Consumption Spending***

Consumers increased spending on goods and services by 2.6% over the past year. This was less than the 3.2% increase the year before. A leading indicator of consumer spending is business orders for consumer goods from domestic producers, in anticipation of future sales. Over the past three months, overall consumer goods orders have fallen 0.1%. Consumer durable goods orders have risen 1.7%, however. This may be an effect of the higher tariffs on imported goods. If imported durables are unavailable or more expensive, buyers may turn to domestic producers.

Consumer sentiment is another leading indicator of consumption spending. The University of Michigan survey of consumers for November gave the second-lowest reading in the past 25 years. It's as low as it was during the pandemic, and lower than during the Great Recession of 2007-09. This may be an indicator of consumer pessimism about their future finances. Or it might reflect a general anger at the course of events that erupts when a survey taker calls to ask questions.

Still, low goods orders and consumer pessimism point to slower growth of consumer spending in 2026.

### ***Investment Spending***

Fixed investment is up 2.6% over the past year, since quarter three of 2024. That includes a 6.3% drop in investment in business structures, a 7.4% increase in equipment investment, and a 1.8% decline in housing construction. Intellectual property investment rose 6.4%.

Non-residential construction spending is down 0.8% in the three months to August. That's a leading indicator of business structure investment. Capital goods orders—a leading indicator of equipment investment—are up 2.7% over the past three months through October. Building permits for housing are down 4.6% through August. That's a leading indicator of housing construction.

Inventory investment jumped in the first quarter by \$172 billion, one of the biggest quarterly increases in history. This was another effect of front-loading imports in the first quarter. About half of these imports went into inventories before being used in production or sold to consumers. Inventories count as investment, so overall investment growth was inflated in the first quarter and reduced for the rest of the year.

All the leading indicators of investment continue to point in the same direction as changes this past year. Intellectual property investment seems likely to continue to grow with AI expansion. Inventories are likely to be reduced further. All this implies that investment growth in 2026 should be similar to growth in 2025.

### ***Government Purchases***

Federal government purchases fell by 1% in 2024-25, while state and local government purchases rose 2.4%. The Congressional Budget Office (CBO) projects Federal discretionary spending to rise 2.7% in 2026. The Federal deficit is likely to drop by a small amount, according to the CBO. The National Association of State Budget Officers (NASBO) surveyed state budgets for 2026 and projects spending to increase 1.3%. Much of this will be Medicaid outlays, so purchases, which are outlays aside from entitlements, are unlikely to rise.

### ***Exports and Imports***

Exports rose by 1.5% in 2024-25. Despite the surge in the first quarter, imports fell by 1.8% over the past four quarters. Net exports, which is the GDP accounts version of the trade balance, became less negative by 10%.

Tariffs have seen an extraordinary increase. Customs duties—tariff revenue of the Federal government—rose from an annual rate of \$97 billion in the first quarter of 2025 to \$331 billion in the third quarter, more than a threefold increase. Still, recent research shows that the implemented tariff rates are only half the legal rates, due to exemptions, avoidance and shipping lags (goods already at sea when the tariffs were imposed).

Tariffs make imported goods more expensive, which causes consumers and businesses to buy less. That's reflected by the drop in imports in the GDP accounts. Further declines in imports are likely in 2026 as people continue to adjust to higher tariffs.

Export growth in 2024 was 3.3%, so growth in 2025 is half that so far. As other nations realign their trade away from the U.S., export growth is likely to be slower still in 2026. A further decline in imports and slower growth in exports should cause the trade deficit to shrink again in 2026.

Summing up these expectations yields real GDP growth of 2.1% for 2026, slightly less than the growth rate over the past year.

### *Unemployment*

The six-week Federal shutdown delayed reports of the unemployment rate and canceled the October report altogether. The December rate was 4.4%. This is up a point from the post-pandemic low of 3.4% in April 2023, and up from 4% in January. Payroll employment rose by 0.4% during the year, and is up by less than 100,000 since April.

The slowdown in the labor market is partly the result of Federal Reserve policy. The Fed increased its policy interest rate starting in early 2022. At the time, the Bureau of Labor Statistics reported 6 million more job openings than there were unemployed people searching for work. This was the biggest labor shortage in the 21st century. The shortage began shrinking as soon as the Fed rate increases started, and by July of this year, the number of openings and job searchers was nearly equal, and remained so in September. Data since then has been murky due to the shutdown.

When job openings and searchers were nearly equal in February 2018, the unemployment rate was 4.1%. An unemployment rate in the low-to-mid 4% range could be called the economy's "sweet spot."

Over the past quarter-century, real GDP growth of about 2.4% has been needed to hold the unemployment rate stable. Such growth causes businesses to expand output and employment enough to provide jobs for the increasing labor force. Growth of 2.1% is less than that, but not so much less as to raise the unemployment rate much. Expect the unemployment rate to remain in the neighborhood of 4.5%.

### *Inflation*

The inflation rate in the consumer price index over the past 12 months through November was 2.7%, the same rate as in 2024. Inflation is way down from its post-pandemic peak of 9% in mid-2022, but is up from its low point of 2.3% this past April.

The inflation rate of durable goods was 1.5% over the past year. Non-durable goods inflation was 2%, and services inflation was 3.2%.

The tariffs are contributing to inflation. The Bureau of Labor Statistics' index of overall import prices is almost unchanged over the past year. This index does not include the effects of tariffs, but is the price received by exporters to the U.S. before tariffs are applied. Exporters are not absorbing the cost of tariffs by accepting lower prices, which implies that most of the cost of tariffs is being passed forward to U.S. businesses and consumers. Recent research finds that the consumer price index is 0.7 percentage points higher than it would have been without the tariffs. This means that the November 2.7% inflation rate would have been 2% without the tariff rise, equal to the Federal Reserve's target inflation rate.

Businesses will continue to pass the costs of tariffs to buyers, but the expected fall of oil prices, the continued fall of housing inflation, and generally slower output growth should lessen this effect. Expect the inflation rate to be near 2.5% by this time next year.

## ***Interest Rates***

The Federal Reserve's policy interest rate—the federal funds rate—was 4.3% through much of 2026. The Fed was balancing the threats of slower growth and rising inflation. In the fall, the Fed decided that slower growth was the greater threat. They reduced the federal funds rate by a quarter point in September and December. As of the beginning of 2026, the rate is in the 3.5% to 3.75% range.

Combined with a quarter-point cut in December 2024, this put downward pressure on interest rates generally. Shorter-term Treasury security yields fell by about three-quarters of a point. The three-month rate averaged 3.6% in December. The ten-year Treasury bond yield fell a quarter point through 2025, to 4.1% in December.

The Fed's policy-making body projects just one quarter-point cut in 2026, which would mean smaller reductions in longer-term rates. The forecast here, for slower growth and stable unemployment and inflation rates, would probably allow two quarter-point cuts. Let's put the three-month Treasury bill yield at 3.1% by December 2026, and the ten-year Treasury bond rate at 3.8%.

## ***Will there be a recession in 2026?***

Recessions are caused by shocks, which are (of course) shocking—unexpected and hard to predict. With the economy weaker than it's been, it is more vulnerable to shocks. A sudden loss of confidence in the AI boom or trouble in the banking sector, a sudden increase in oil prices, a war or natural disaster, a new pandemic—all could send the economy into recession. Barring shocks, though, it looks here like we'll have another year of slow expansion.

**Sources**

Cavallo, Alberto, Paola Llamas, and Franco M. Vazquez, “Tracking the Short-Run Price Impact of U.S. Tariffs,” NBER Working Paper No. 34496, November 2025.

Gopinath, Gita and Brent Neiman, “The Incidence of Tariffs: Rates and Reality,” December 2025.