ECONOMIC OUTLOOK
REGIONS
December 2025

The Whatever You Want It To Be Economy?

Despite the shutdown of the federal government having ended and the various data producing agencies being back at work, the economic data calendar remains somewhat of a jumbled mess. While the economic data are flowing again, at least for now, most of the data releases now seeing the light of day are only helping fill in the remaining blanks in the Q3 growth puzzle rather than providing clues to how the economy is faring in Q4. As of this writing, the release schedules for the Q4 data points are still works in progress, with many key releases yet to be scheduled by the respective agencies. Moreover, there will be some permanent holes in the data for October. The Bureau of Labor Statistics (BLS) was unable to conduct the household survey, which is the source of data on the labor force, including the unemployment rate, and was also unable to conduct the in-person price observations that constitute the bulk of the Consumer Price Index (CPI).

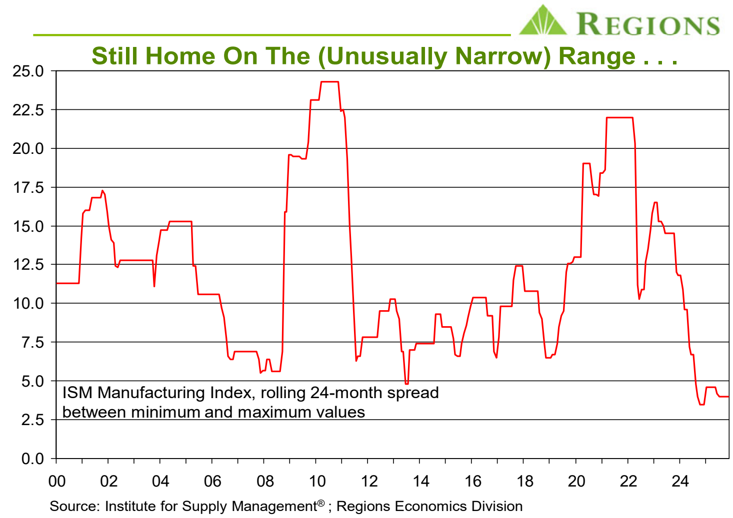
The Q3 data releases now filtering in have not changed how, prior to the flow of data being disrupted by the shutdown, we thought the quarter would shape up. We continue to expect that when the Bureau of Economic Analysis (BEA) ultimately releases the data real GDP will be shown to have grown at an annual rate of between 3.5 and 4.0 percent in Q3. While prior to the shutdown our baseline forecast anticipated a marked slowdown in real GDP growth in Q4, we think the shutdown will have taken around 1.5 percentage points off top-line growth. As such, we now expect real GDP to be roughly flat in Q4 though most of the drag from the shutdown will be reversed in the Q1 2026 data.

Thus far, we have little to go on in the way of data that would tell us whether Q4 real GDP growth is evolving as our forecast anticipates. For instance, while the BLS was able to compile the October data from the establishment survey, the source of the BLS' estimates of nonfarm employment, hours, and earnings, the data will be blended in with the November employment report which was originally slated for release on December 5 but will now not be released until December 16. Note that in any given month the employment reports help shape our expectations for industrial production and personal income, amongst other metrics, so it won't be until the November employment report is released that we'll be able to make what we feel to be reasonable estimates of the October and November values of several key series.

Not exactly an ideal situation for analysts or market participants, not to mention policy makers, but it's where we're all at. The gaps in the data make it hard to resolve the debate about the state of the U.S. economy, particularly since in the data we are seeing there is seemingly something for everyone, regardless of how they see the economy or what they perceive to be the primary risk(s) facing the economy. Then again, even prior to the flow of data having been disrupted by the shutdown, the data were sending mixed signals which was making it difficult for analysts and policy makers to agree on how the economy was faring. This is something we first discussed in our July *Outlook*.

We are not, however, completely lacking timely reads on economic activity in Q4. The ISM's monthly surveys on the manufacturing and services sectors and their S&P Global counterparts, the weekly data on mortgage loan applications, the weekly data on initial and continuing claims for unemployment insurance benefits, monthly reads on existing home sales, monthly data on motor vehicle sales, and various trackers of consumer spending were all undisturbed by the shutdown. To our point, however, these and other available series are doing more to keep the debate about the state of the economy going rather than to settle it.

We noted in our July *Outlook* that the pace of activity across much of the economy was notably stable despite what had become somewhat dour sentiment on growth in general and even more so in specific sectors such as manufacturing and housing. That point still holds, despite what has been mounting unease over the growth outlook. For instance, save for a brief foray to the upside in the first two months of this year, the ISM Manufacturing Index has been below the 50.0 percent break between contraction and expansion in each month since November 2022, well before higher tariffs even entered into the discussion. That the headline index has signaled contraction in thirty-five out of the past thirty-seven months suggests steadily declining activity in the factory sector, but the behavior of the index over this span suggests something quite different. We show this in the following chart, which is an updated version of the one we first showed in July.



The chart shows the spread between the minimum and maximum values of the ISM Manufacturing Index over a rolling two-year period. After the considerable disruptions to global supply chains

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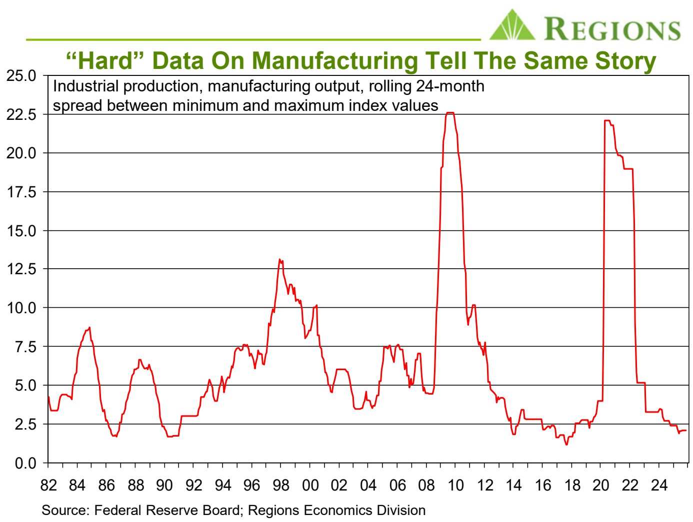
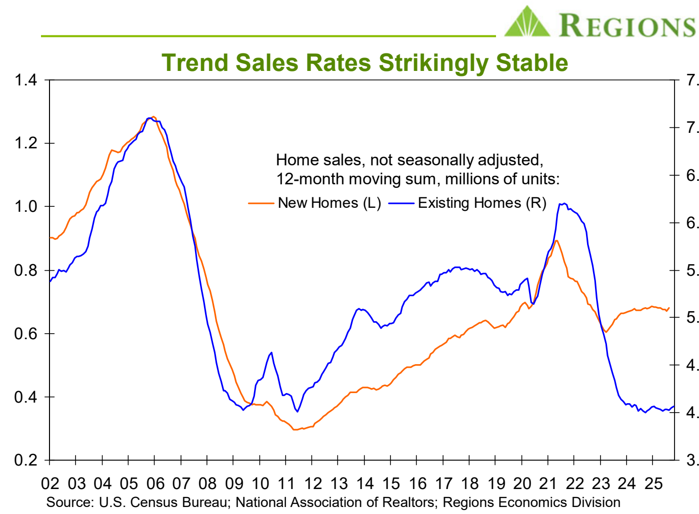
and factory production brought about by the pandemic had run their course, manufacturing activity settled into what has been a somewhat subdued pace, as reflected in the increasingly narrow range into which the ISM's headline index has settled. Though we don't show the entire history here, the headline index has never been in this narrow of a range for this long. That the headline index has been so rangebound is more consistent with manufacturing output being more or less stable, even if at a fairly low level, than with manufacturing output steadily contracting month after month despite the discussion of the ISM data being couched in these terms. For those inclined to dismiss the ISM on the grounds that it is a "soft" indicator, as survey-based data series are often referred to, we offer the following chart based on the data from the Federal Reserve's series on industrial production, which is a "hard" data series.



As measured in the data on industrial production, manufacturing output has been bouncing around within an increasingly narrow range for some time now, which is consistent with the signal sent by the ISM Manufacturing Index. For sure, steady growth would be preferable, but most would likely agree that "low but stable" is better than "steadily contracting." The above chart is based on the Federal Reserve's latest comprehensive revision to the industrial production data, and while this year's revisions were not at all kind to prior estimates of manufacturing output and capacity utilization, the harshest downward revisions were to the data for 2022.

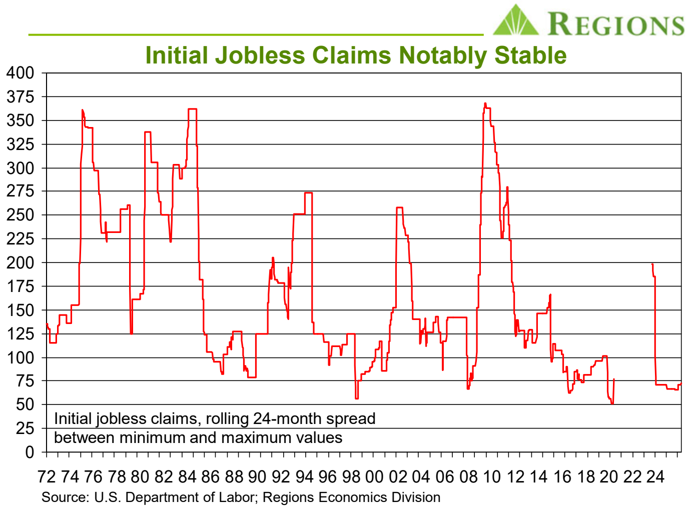
We'll say the same thing here we said in our July *Outlook*, which is that one would be incorrect to argue that higher tariffs and uncertainty around trade policy have had no impacts on the factory sector. It is, however, also the case that the ISM Manufacturing Index first slipped below the 50.0 percent break between contraction and expansion in November 2022, with the headline index hitting a post-pandemic low of 46.3 percent in March and June of 2023, the lowest reading since June 2009. Tariff impacts notwithstanding, that low has not been approached at any point since the start of 2024.

The premise of activity in the factory sector having stabilized, even if at a low level, is supported by the "hard" data on industrial production and orders for core capital goods, both of which have exhibited the same kind of rangebound behavior seen in the ISM Manufacturing Index. As we also noted in our July *Outlook*, the manufacturing sector is not the only instance in which the data show a striking consistency which at time seems at odds with the common narrative and perceptions of steady declines, with sales of new and existing homes another case in point.



The above chart, also first offered in our July *Outlook*, shows the running twelve-month totals of not seasonally adjusted sales of new and existing homes. As our regular readers know, we see the running twelve-month total of unadjusted sales as the best proxy for the underlying sales trend, and the trend sales rate for both new and existing home sales has been strikingly stable for some time. While the last read we have on new home sales is, thanks to the shutdown, the initial estimate of August sales, the trend sales rate has barely budged since late-2023, and the other noteworthy point here is that the trend sales rate has settled in right where it was prior to the onset of the pandemic. The trend sales rate for existing homes, though woefully low, has also barely budged since late-2023. It is also worth noting that the trend sales rate for both new and existing homes peaked in mid-2021, i.e., well before mortgage interest rates began rising rapidly, which we noted at the was a supply-side story. That has clearly morphed into a demand-side story since, but our point here is that the stability seen in the trend sales rates is probably at odds with how you've perceived the housing market and is clearly at odds with some of the more common narratives. To that point, we'll note that over the duration of these stable trend sales rates we've seen, more than once in each case, stories about how the housing market is in a recession and stories about how the housing market is in a bubble. Neither of those characterizations has made sense to us.

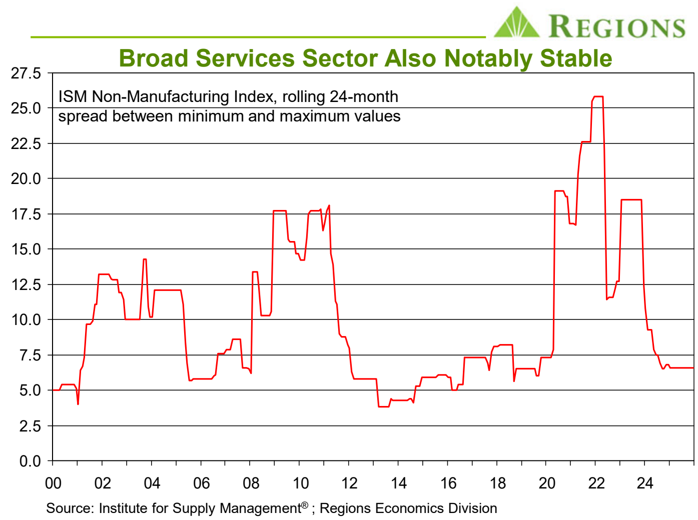
Another area of concern in the economy is the labor market. There is no question that the trend rate of job growth has slowed sharply, and we've pointed to both demand-side and supply-side factors to account for this, though we place more weight on the supply-side factors than many others seem to. The absence of the monthly employment reports for October and November has made it harder to assess the state of the labor market, but even the December 16 release of the November employment report won't necessarily bring a lot of clarity as the October data are likely to show a sizable decline in federal government employment reflecting cutbacks and buyouts implemented earlier this year. Recent announcements of job cuts have added to the concerns over the labor market, and it is likely of little consolation that in certain industry groups such as technology and warehousing/distribution services job cuts reflect firms attempting to right-size head counts after having hired too aggressively during the post-pandemic recovery. At the same time, whether, or to what extent, firms are utilizing AI more intensively in lieu of taking on additional workers remains an open question.



For all the concerns surrounding the labor market, one thing that continues to stand out is how low and stable initial claims for unemployment insurance benefits have remained. The chart above shows the rolling two-year range of weekly jobless claims, omitting data for 2020-2021 to save the scale. As with the other series we've previously shown, note how stable the range of initial claims has been over the past two years. While there have been instances of narrower ranges, there is no prior instance in which the range has been this narrow for this long of a time. While this does not address the "low hire" part of the low hire-low fire characterization of the labor market, it does suggest the latter part still holds.

Many are wondering how to reconcile the still admirably behaved claims data with recent layoff announcements, with some simply dismissing the claims data out of hand as "obviously flawed," an assessment with which we obviously do not agree. It could be that the claims data will increasingly reflect these layoffs in the weeks ahead. That a sizable portion of recent layoff announcements have come from the tech sector could be holding down claims if people are being let go with severance packages which make filing for unemployment insurance benefits less urgent, but this clearly could at some point change. Also, many of the job cuts in warehousing/distribution services that recently hit the media had already taken place so any impact on claims would have already been felt in the data. As for Challenger job cut announcements, aside from a good portion of those cuts announced this year being concentrated in the government sector, it is also the case that this data series does not distinguish between jobs being cut here in the states and jobs cut abroad by those firms operating globally, nor is there a time component assigned to these announcements.

It also helps to recall how dynamic the labor market is and that this remains the case despite the slowing trend rate of job growth. The monthly headline change in nonfarm payrolls is a net number, reflecting the difference between what in any given month are several million hires and several million separations – quits, layoffs, and other forms of exits from jobs. Data from the Job Openings and Labor Turnover Survey (JOLTS) show that both gross hires and gross separations continue to run at over five million a month, and while the gap between the two has clearly narrowed, it could be that many of those being laid off are finding new jobs soon enough that they don't end up filing claims for unemployment insurance benefits. Again, the point here isn't that there are no worries when it comes to the labor market, but instead that the labor market is likely holding up better than would be inferred from many of the common narratives.



Though concerns about the broad services sector are neither as intense nor as widely voiced as is the case with the manufacturing sector, the housing market, or the labor market, this is another area of the economy which is proving to be notably stable. In keeping with our theme here, the chart above shows the rolling two-year spread of the ISM Non-Manufacturing Index, and as in the other cases we've shown, that spread has been notably narrow for quite some time now. This is consistent with the premise of a continued steady, even if moderate, pace of expansion in the broad services sector, which accounts for the bulk of GDP.

What Might This All Mean?

There are several questions you may find yourself asking at this point, and we'll attempt to tackle some of what we think would be the most obvious ones here. The first would be how the stability implied in the series of charts we've shown here squares with real GDP growth over the first three quarters of the year that has been anything but stable. To some extent, the GDP prints thus far this year (assuming real GDP growth at an annual rate between 3.5 and 4.0 percent for Q3) reflect firms and households reacting in anticipation of/in response to a markedly different tariff regime than that which had prevailed for decades. As we frequently point out, trade and inventories tend to be highly volatile from one quarter to the next even in the calmest of times and, as such, can and often do have outsized impacts on real GDP growth in any given quarter. This has been the case so far in 2025 despite what, by many measures, has been relative stability in the underlying pace of economic activity.

One such measure – real private domestic demand – comes right from the GDP data. We've long pointed to real private domestic demand (combined business and household spending adjusted for price changes) as a better gauge of underlying activity than is top-line real GDP growth, given the extent to which the latter is often skewed by swings in net exports and/or inventories. Over the course of 2025 (including our tracking of the Q3 data), growth in real private domestic demand has been much less volatile than top-line real GDP growth. To be sure, there have been notable swings in growth in real consumer spending and business fixed investment over the course of this year, with the one constant being weakness in residential fixed investment, but the sum of these parts has been much less volatile than has real GDP itself.

That ties into two, perhaps more important questions. First, what would it mean if the pace of underlying economic activity is as stable as the metrics we've discussed here suggest? And, even if that was the case through Q3, is that still the case as 2025 comes to a close? One possible explanation is that the considerable disruptions brought about by the pandemic and the policy response to it have faded, if not completely then close to it, from the economy and the economy has settled in or around the steady if not all that inspiring pace of growth that held over the decade prior to the pandemic. For those that don't recall, though setting the mark for the longest U.S. economic expansion on record, the pre-pandemic expansion never got a lot of love and garnered only grudging respect thanks to an average growth rate that while fairly steady was, at just over two percent, sufficiently slow that many constantly doubted the economy's ability to withstand adverse shocks and overcome the hurdles to growth that will inevitably confront any economy from time to time.

That many of the series we track have settled in, either the levels of activity or the ranges within which the data series move, pretty much where they were prior to the pandemic suggests, volatility in trade and inventories notwithstanding, the underlying pace of economic activity may be back in line with the pre-pandemic trend rate. And, though the lack of complete data makes it hard to assess, the data series still at our disposal suggest the economy didn't suddenly roll over in the final quarter of 2025. While by no means a perfect comparison, there may be more similarities between where the economy is now and where it was in 2019 than you might think would be the case.

Having jumped in the Wayback Machine for a trip down memory lane, we unearthed the January 2019 edition of our *Outlook*, in which we discussed our outlook for the year. At the dawn of the new year, many were on recession watch; escalating global trade tensions, wobbly equity markets, a shaky housing market, and fears of accelerating inflation amid concerns that monetary policy was off course and a somewhat fractured political environment led many to incorporate recession into their baseline forecasts. Those concerns intensified over the course of 2019, particularly as the ISM Manufacturing Index fell below the 50.0 percent threshold in August 2019 with mounting trade tensions weighing on U.S. manufacturers. Raise your hand if any, or all, of that sounds vaguely familiar at present . . .

Back then, we took the other side; our baseline 2019 forecast anticipated above-trend real GDP growth with solid growth in business investment and accelerating growth in nonfarm labor productivity acting as key supports. Present day, we've maintained a fairly constructive growth outlook and do not think it unreasonable to expect slightly above-trend real GDP growth in 2026. That said, there are some glaring contrasts between the present economic environment and that which prevailed back in 2019, and the downside risks to our baseline outlook seem more formidable now than was the case then.

Of those contrasts, the most glaring center on the labor market, both in terms of the pace of job growth and consumer perceptions of labor market conditions. The trend rate of job growth has slowed sharply over the past several months, and as we and others have noted, thus far this has been more a function of a slowing rate of hiring as opposed to a rising rate of layoffs. What is less clear, however, is what is behind the slowing trend rate of hiring. We can point to demand side effects, such as an uncertain outlook for final demand, firms reacting to higher tariff costs and a still uncertain outlook for trade policy, and a push for greater operating efficiency, that are weighing on hiring, and we can also point to supply side effects, particularly the significant outflow of foreign born labor largely stemming from changes in immigration policy. We attach more weight to the supply side factors than many others seem to, and one point we think supports our view is that, slowing rate of job growth notwithstanding, growth in aggregate labor earnings continues to easily outpace inflation. Were this more of a labor demand story, we think we'd have seen a much more pronounced slowdown in earnings growth than has been the case.

Even if we are correct, that still leaves the economy vulnerable to a significant and sustained increase in layoffs, which is one reason we place such significance in the weekly data, not seasonally adjusted of course, on weekly jobless claims. That claims have remained so well behaved, as discussed earlier, doesn't mean that will remain the case, but it does beg the question of what would trigger such a development. Increased utilization of AI has become the popular explanation to account for the slowing rate of hiring and it would follow that as utilization becomes more broadly based then that will trigger rising layoffs. While we won't argue there are no impacts on employment stemming from AI, we do not think that to be the primary culprit behind the slowing pace of job growth, nor do we think we're close to the point where that would be the catalyst for a wave of layoffs. We continue to view AI as, on net, something that will enhance labor productivity rather than something that will replace labor. It also helps to ask why firms are so intent on increasing labor productivity, and we think this is where labor supply issues are playing a role.

With listless labor supply growth, the bottom line is that either labor productivity increases, or the growth rate of output slows. If it isn't the case that automation/technology is being extensively used to replace labor, another catalyst for rising layoffs could be firms scaling back their perceived needs for labor if they expect a weaker growth outlook to persist. We're not sure that at present there is widespread evidence of this, particularly given our earlier point about layoffs coming in sectors that hired aggressively, in some cases too aggressively, in the early phases of the post-pandemic recovery. Moreover, if we are correct, or at least on the right path, in our take on the underlying pace of economic activity settling back at or near the pre-pandemic trend pace, that would be consistent with a low hire-low fire labor market, particularly if labor supply constraints are a factor on the "low hire" side of that.

Another glaring contrast between present conditions and those that prevailed back in 2019 is inflation. While there were fears of accelerating inflation back in 2019, those fears came after a prolonged period in which inflation had been below the FOMC's

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2.0 percent target rate, whereas at present inflation seems stubbornly perched above that 2.0 percent target after a period in which it was significantly higher. The cumulative effects of higher prices over the past few years have been a source of significant financial stress, particularly amongst lower-to-middle income households, and have contributed to interest rates being higher than they otherwise would have been. That said, early-stage delinquency rates on consumer credit were notably stable over the four quarters ending with Q3 2025, remaining slightly below pre-pandemic norms. Again, delinquency rates may have ticked higher in Q4 but there is nothing in the labor market data or the data on personal income to suggest a significant spike.

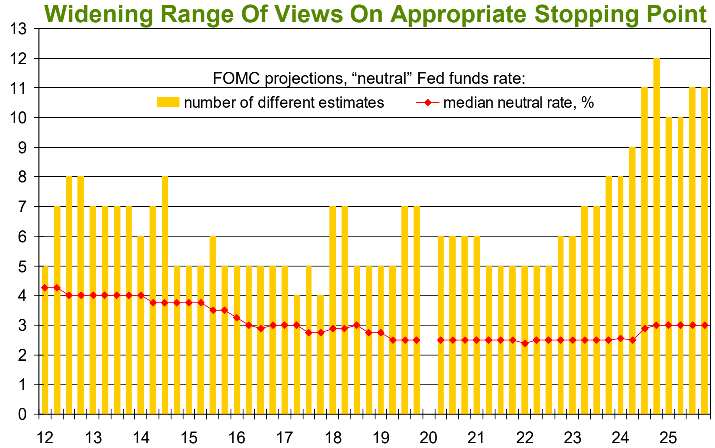
We could continue to compare and contrast the current economic environment with that which prevailed prior to the pandemic, but the main point here is that much of the economic data have been notably, not to mention somewhat surprisingly, stable, and there is little to suggest that will have changed once we have the full complement of Q4 data at our disposal. We can also point to factors that we think could lead to a pick-up in real GDP growth in Q1 2026 aside from the boost that will come in the form of the drag on Q4 growth stemming from the government shutdown being reversed. Changes in the corporate tax code in the bill signed into law this summer are freeing up cash for corporations, and we think will prompt stronger growth in business investment in equipment and machinery. At the same time, changes in the individual tax code in that bill will lead to a substantial boost to after-tax personal income in Q1, much of which will go toward those households currently feeling the greatest financial stress. We do expect job growth to remain fairly listless in 2026, but if we're correct in expecting continued anemic growth in the labor force, that will cap any increase in the unemployment rate.

To be sure, the stability we now see in so many of the data series could be a mirage that will be wiped away in subsequent revisions, or we could simply be wrong in how we're interpreting what this stability means. That we're still missing so much of the economic data obviously makes it hard to know for sure, and the lack of data will keep the debate going. But, that so many data series are exhibiting the same pattern and have done so for so long is, at least in our view, sending a signal about the underlying health of the U.S. economy even if the risks seem weighted to the downside. As a side note, the lack of data/delayed data releases have pushed back the usual timing of our updating our forecasts. As such, the forecast table that typically accompanies these monthly outlooks is absent this month. As usual, our January edition will present our annual economic outlook, and while that will be hampered to some extent by missing/delayed data, our forecast table will return then.

Wide Range Of Views Amongst FOMC

In stark contrast to the stability we've highlighted across a wide swath of the economic data series, deepening divisions within the FOMC are being reflected in a notably wide range of views on the value of the "neutral" Fed funds rate. While we are of course aware with the difficulties in attempting to peg the "neutral" funds rate, i.e., the value of the funds rate consistent with monetary policy neither stimulating nor restricting economic activity, and that it cannot actually be observed, FOMC members' perceptions of the neutral funds rate are nonetheless closely watched by market participants as a marker against which to assess the stance of monetary policy. For instance, after a twenty-five basis point cut in the Fed funds rate target range at the December FOMC meeting left the target range mid-point at 3.625 percent, that still leaves the mid-point above the median estimate of the neutral funds rate which held at 3.00 percent in the updated dot plot. While that would imply monetary policy is still restrictive, Chair Powell did note in his post-meeting press conference that the funds rate is "within a broad range of estimates" of a neutral setting.

Widening Range Of Views On Appropriate Stopping Point



Source: Federal Reserve Board; Regions Economics Division

"Broad range," however, may be a bit of an understatement. As seen in the above chart, the range of estimates of neutral is much broader over the past several meetings than has historically been the case despite the median estimate having not changed over that span. In the December dot plot, there were eleven unique estimates of the neutral funds rate, nine of which were above the median estimate. It is also worth noting that while the median year-end 2026 dot, at 3.375 percent, was unchanged from the September dot plot, the dispersion around that median was much wider, with a spread of 175 basis points between the high and low forecasts, up from 125 basis points in September.

That there is such a wide range in the estimates of the year-end 2026 dot doesn't necessarily mean FOMC members are at odds with what the risks to the economy are. With a majority seeing the risks to their inflation forecast as weighted to the upside and a majority seeing the risks to their forecasts for the unemployment rate weighted to the upside, the division stems from how members weight these risks, i.e., higher inflation or lower employment. That, however, is a question that will be answered by the incoming economic data in the months ahead.

The wide range of estimates of the neutral funds rate, however, suggests more fundamental divisions over the economy's capacity to grow and the longer-term path of inflation. This, in turn, makes it harder for market participants to assess where the stopping point may be in the current rate cutting cycle which is, keep in mind, aimed to make policy less restrictive as opposed to more accommodative. Either way, assessments of how restrictive policy still is are all over the map, and while some argue that does not impact the policy decision at any given FOMC meeting, we'd argue it is already raising the bar for further funds rate cuts.