

# US Economy Adjusts to AI & Tariffs While Debt Load Spirals Further Out of Control

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**PARTICIPANTS** | Conf. Board = Conference Board, New York, New York; Fannie Mae = Fannie Mae, Washington, D.C.; GSU - EFC = Georgia State University, Economic Forecasting Center, Atlanta, Georgia; Moody's Economy = Moody's Economy.com, Westchester, Pennsylvania; Mortgage = Mortgage Bankers Association, Washington, D.C.; National Restaurant = National Restaurant Association, Washington, D.C.; Perryman Gp = The Perryman Group, Waco, Texas; Royal Bank of Canada, Toronto, Ontario, Canada; S&P = Standard & Poor's, New York, New York; US Chamber = U.S. Chamber of Commerce, Washington, D.C.; Wells Fargo = Wells Fargo Bank, San Francisco, California.

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**T**he implications of the war with Iran, which began at the end of February, remain uncertain for both the U.S. and the global economy. The national average cost for a gallon of gas in the US has risen by 34% over the past month as shipping through the Strait of Hormuz, a crucial oil passage, remains nearly at a standstill. The national average price for diesel is at \$5.41 per gallon at

the end of March, up 44% from a month ago.

Wells Fargo indicates that the recent surge in oil prices introduces new risks to an already complex economic environment. Their outlook had been for a solid 2026 in terms of economic growth, despite the challenges of a slowing labor market and elevated inflation. However, they now see increased downside risks stemming from

higher gasoline prices and other energy-related costs. Nevertheless, they remain cautiously optimistic about a modest expansion, even as real income and consumer spending face potential pressure.

For the period from the second quarter of 2026 to the first quarter of 2027, Consensus forecasts suggest that GDP will grow by 1.67%. While this represents modest growth, it can be considered adequate given the current geopolitical tensions. The Federal Reserve has revised its GDP growth forecasts slightly upward for both 2026 (2.40% compared to 2.30% in December) and 2027 (2.30% compared to 2.00%).

According to Rajeev Dhawan of the Economic Forecasting Center at Georgia State University's J. Mack Robinson College of Business, real GDP growth is expected to rise from 1.30% in the first half of 2026 to a trend-like 1.90% in the second half of 2026, and further to an above-trend 2.40% in the first half of 2027. He adds that, on an annual average basis, growth is projected to be 1.90% in 2026, 2.10% in 2027, and 1.90% in 2028. Moreover, the economy, according to Dhawan, will adjust to artificial intelligence developments and tariff adjustments to grow in a balanced fashion (both income and well-paying job growth) by early 2027.

Over the same period—Q2 2026 to Q1 2027—Consensus projects an increase in the M2 money supply by 4.07%, rising from \$22,899.19 billion in Q2 2026 to \$23,832.44 billion in Q1 2027, up from \$22,667.30 billion in February 2026. This increase in the money supply may contribute to further upward pressure on prices in the economy.

The unemployment rate is projected to be 4.40% in 2026, and 4.30% in 2027 (revised up from 4.20%) by the Fed. The February unemployment rate stands at 4.40%. Inflation expectations have also been adjusted upward, with the Federal Reserve projecting a rate of 2.70% for this year. In contrast, the OECD suggests that U.S. inflation could rise as high as 4.20% because of the war with Iran.

## **CONSUMERS: WAR PUSHING PRICES HIGHER, CONSUMER SPENDING RESTRAINED DESPITE INCREASE IN DISPOSABLE INCOME**

Consensus forecasts indicate that personal disposable

income will increase by 3.50% from Q2 2026 through Q1 2027, outpacing the projected 3.14% growth in personal consumption expenditures over the same period. This variance suggests that consumers continue to remain cautious in their spending behavior amid continued uncertainty in the economy. The consumption-to-disposable-income ratio is expected to remain stable at 92% throughout 2026, reflecting a pattern of steady but restrained consumer spending.

Wells Fargo has reduced its forecast for consumer spending this year amid higher oil prices, which it views as a tax on consumers. They also expect rising oil and gasoline prices, tied to the conflict in the Middle East, to push headline inflation higher in the near term. Their forecast calls for inflation to peak at 3.20% in Q2. They add that food inflation should continue to moderate despite the energy shock, as food-related commodity prices have been easing for several months.

Consensus forecasts indicate that light vehicle purchases will increase by 2.57% from Q2 2026 through Q1 2027, with sales reaching 16.17 million units by Q1 2027. Moreover, Consensus forecasts, the Chained Price Index is projected to increase by 1.58%, while the Consumer Price Index (CPI) is expected to rise by 1.95% over the forecast period. Although both measures track price changes, the Chained Price Index is generally regarded as a more accurate gauge of inflation.

## **FIRMS: CONFLICT IN MIDDLE EAST & AI PRODUCTIVITY GAINS DAMPEN APPETITE FOR HIRING, AI INVESTMENT EXPANDING RAPIDLY**

Consensus expects the unemployment rate—4.40% in February—to change slightly from 4.52% in Q2 of 2026 to 4.49% in Q1 of 2027; though the forecast indicates the rate to go up to 4.57% in the middle of the year.

From Wells Fargo's perspective, a weaker pace of hiring and a rising unemployment rate reinforce the labor market's fragility, placing it in a delicate position. Renewed uncertainty stemming from the conflict in the Middle East, along with cautious optimism about the productivity-enhancing potential of AI, is expected to keep demand for new workers subdued. They project nonfarm employment to increase at an average pace of a roughly 40,000 jobs

PARTICIPANTS	GROSS DOMESTIC PRODUCT (GDP) Bil. of Chained 2017 Dollars   Level				PERSONAL DISPOSABLE INCOME Based on GDP Concept   Curr. Bil. of \$, Level (SAAR)			
	26-2	26-3	26-4	27-1	26-2	26-3	26-4	27-1
Conf. Board   Yelena Shulyatyeva	24,255.68	24,340.73	24,438.70	24,548.55	23,224.50	23,282.35	23,340.34	23,427.38
Fannie Mae   Mark Palim	24,366.00	24,490.00	24,641.00	24,798.00	23,829.00	24,133.00	24,485.00	24,828.00
GSU-EFC   Rajeev Dhawan	24,263.24	24,367.85	24,495.44	24,633.39	23,999.97	24,351.99	24,696.84	24,986.08
Moody's Economy   Mark Zandi	24,383.36	24,536.76	24,656.83	24,762.28	23,376.74	23,736.86	24,065.94	24,397.13
Mortgage   Mike Fratantoni	NA	NA	NA	NA	NA	NA	NA	NA
National Restaurant Association   Chad Moutray	24,800.00	25,000.00	25,200.00	25,450.00	NA	NA	NA	NA
Perryman Gp   Ray Perryman	24,354.74	24,481.74	24,629.47	24,784.96	23,460.15	23,675.82	23,917.79	24,132.88
Royal Bank of Canada   Nathan Janze	24,307.94	24,411.06	24,520.06	24,629.87	23,616.00	23,820.60	24,037.90	24,253.60
S & P   Satyam Panday	24,306.47	24,435.32	24,572.88	24,680.46	24,214.23	24,535.70	24,914.38	25,266.41
US Chamber   Curtis Dubay	24,377.76	24,511.84	24,646.65	24,782.21	23,873.67	24,222.12	24,575.66	24,934.36
Wells Fargo   Jay Bryson	NA	NA	NA	NA	NA	NA	NA	NA
<b>Consensus</b>	<b>24,379.47</b>	<b>24,508.37</b>	<b>24,644.56</b>	<b>24,785.52</b>	<b>23,699.28</b>	<b>23,969.80</b>	<b>24,254.23</b>	<b>24,528.23</b>

PARTICIPANTS	PERSONAL CONSUMPTION EXPENDITURE Based on GDP Concept   Curr. Bil. of \$   Level (SAAR)				CONSUMER PRICE INDEX 1982-1984=100   LEVEL			
	26-2	26-3	26-4	27-1	26-2	26-3	26-4	27-1
Conf. Board   Yelena Shulyatyeva	21,513.90	21,580.64	21,682.10	21,784.04	NA	NA	NA	NA
Fannie Mae   Mark Palim	21,995.00	22,230.00	22,449.00	22,679.00	333.00	334.00	336.00	337.00
GSU-EFC   Rajeev Dhawan	21,848.91	22,110.39	22,343.57	22,584.20	328.40	329.55	330.85	332.49
Moody's Economy   Mark Zandi	NA	NA	NA	NA	328.35	331.15	333.58	335.90
Mortgage   Mike Fratantoni	NA	NA	NA	NA	NA	NA	NA	NA
National Restaurant Association   Chad Moutray	21,900.00	22,140.00	22,365.00	22,580.00	331.31	333.73	335.97	338.08
Perryman Gp   Ray Perryman	21,823.33	22,099.70	22,335.34	22,609.48	NA	NA	NA	NA
Royal Bank of Canada   Nathan Janze	NA	NA	NA	NA	332.22	333.53	333.36	335.35
S & P   Satyam Panday	22,033.20	22,305.69	22,527.37	22,714.31	332.00	334.00	336.00	337.00
US Chamber   Curtis Dubay	21,913.74	22,233.58	22,558.10	22,887.35	328.90	331.30	333.30	335.00
Wells Fargo   Jay Bryson	NA	NA	NA	NA	NA	NA	NA	NA
<b>Consensus</b>	<b>21,861.15</b>	<b>22,100.00</b>	<b>22,322.92</b>	<b>22,548.34</b>	<b>330.60</b>	<b>332.47</b>	<b>334.15</b>	<b>335.83</b>

per month this year, down from the previously anticipated 70,000. This more modest hiring pace is likely to push the unemployment rate up to 4.50% in Q2 and Q3, keeping it uncomfortably above most Fed officials' definition of "full employment."

Dhawan notes that the wholesale trade and information technology sectors—including higher-level film industry technicians—have lost more than 200,000 jobs. He states that, when combined with corporate job losses, the total exceeds 462,000 jobs over the past two years—a significant number of well-paying positions that have disappeared. He adds that some of these losses include entry-level roles, which serve as the lifeblood for recent graduates and early-career workers entering the labor market.

As of the beginning of April, average fixed mortgage rates were about 6.38% for a 30-year fixed rate loan and 5.75% for a 15-year loan. According to Freddie Mac, the housing market continues to show gradual improvements compared to a year ago amid recent rate volatility. Purchase and refinance applications are up year-over-year, and rates remain lower than last year when they averaged 6.65%. Looking ahead, Consensus projects private housing starts to rise from 1.35 million units in Q2 2026 to 1.40 million units in Q1 2027, a 3.56% increase.

According to Wells Fargo, adverse affordability remains as a significant limitation for the residential sector. They state that although slightly lower mortgage rates have led to a modest improvement in home sales, their expectation for financing costs to remain elevated (averaging between 6.10% and 6.20% over the forecast horizon) means home buying activity will likely continue to run at a sluggish rate.

In addition to lackluster demand, they believe new single-family construction appears set to downshift as builders realign high inventory levels with sales. Further, they add that lower financing costs and firming apartment market conditions should promote a modestly stronger pace of new multifamily construction. In essence, they expect reduced interest rates, improved turnover, positive home price appreciation and elevated homeowner equity levels should support growth in home improvement outlays, with labor and building material inflation remaining as limitations.

Industrial capacity utilization is projected to increase from 75.11% in Q2 2026 to 75.19% in Q1 2027, a tiny increase of 0.11% according to Consensus. Over the same period, nonresidential fixed investment is expected to increase by 2.51%.

Wells Fargo has boosted its near-term forecast for structures investment, based on expectations that higher oil prices will lead to a pickup in energy investment. They note that private nonresidential construction spending remains on a downward trend amid higher interest rates, although less-restrictive monetary policy should support a turnaround over the course of 2026.

Meanwhile, they add that "mega-project" categories—such as data centers, power, and communications—are expected to remain strong as AI-related investment continues to expand rapidly. The primary catalyst for their more optimistic structures investment outlook, however, is the expectation that oil prices will rise well above drilling break-even levels, leading to a temporary increase in new energy-related investment.

## **INTEREST, CREDIT, AND THE FED: GRADUAL EASING OF INTEREST RATES INTO 2027 TO BENEFIT SMES & HOME SALES BUT RECESSION CANNOT BE DISCOUNTED**

Following the FOMC's March meeting, the effective federal funds rate remains within a target range of 3.50% to 3.75%. Consensus forecasts anticipate a gradual easing path, with the federal funds rate declining from 3.64% in the second quarter of 2026 to 3.12% by the first quarter of 2027. Similarly, the AAA corporate bond rate—5.30% in February—is projected to edge down from 5.49% in Q2 2026 to 5.22% in Q1 2027.

Dhawan expects the Federal Reserve to cut rates aggressively in the second half of 2026. He adds that this third-round of cuts since 2024 finally will bring the cost of financing for bank-dependent firms (small and medium enterprises) to a level where they can exploit growth opportunities. Further, this round of cuts will also benefit the housing construction industry, and a drop in mortgage rates close to 5.00% will help with home sales and refinancing.

Despite ongoing financial market volatility, Wells Fargo projects two 25-basis-point rate cuts by the FOMC this year, while maintaining its year-end forecast for the 10-year Treasury yield at 4.25%. However, risks to this outlook are skewed toward a later or more limited easing cycle, which could result in somewhat higher interest rates than currently anticipated, particularly along the short and

intermediate segments of the yield curve.

At the same time, downside risks remain. Should the tail risk of a U.S. recession materialize, significantly deeper rate cuts could be warranted, potentially altering the trajectory of both short- and long-term interest rates.

## CONCLUSION: ECONOMIC GROWTH CRITICAL TO MANAGING MASSIVE US DEBT, SUPREME COURT'S TARIFF RULING & INCREASING IMPORTS TO WORSEN BUDGET DEFICIT

Fed Chairman Powell warns that the US debt is growing substantially more than the US economy and it is not sustainable. He urges that there is a need to grow the economy progressively and to balance it.

The ECB has kept interest rates on hold while warning that the war in the Middle East could have a material impact on near-term inflation. Surging energy costs triggered by the Iran conflict have already pushed eurozone inflation to its highest level in nearly two years, with headline inflation rising to 2.50% in March, as reported by the Financial Times. This renewed inflationary pressure complicates the ECB's policy outlook, as higher energy prices may delay the pace of monetary easing and reinforce a more cautious stance, despite underlying signs of moderating core inflation.

The U.S. Census Bureau and the U.S. Bureau of Economic Analysis announced that the 2025 U.S. goods and services

deficit was \$901.5 billion, slightly down from \$903.5 billion in 2024, reflecting a persistent trade gap where imports (\$4,333.8 billion) exceeded exports (\$3,432.3 billion). While the goods deficit grew, a growing surplus in services helped stabilize the overall balance. This deficit represents roughly 3.60% of GDP.

As for fiscal policy, Wells Fargo projects budget deficits of \$2.00 trillion for FY 2026 and \$1.95 trillion for FY 2027, up from \$1.85 trillion and \$1.90 trillion, respectively, in its February forecast. Several factors have contributed to this upward revision. First, the Supreme Court's decision overruling President Trump's authority to use IEEPA to impose broad-based tariffs threatens the outlook for tariff revenue. Second, it appears increasingly likely that the administration will be required to issue refunds to businesses that previously paid IEEPA-related tariffs, potentially adding \$100-\$150 billion to the FY 2026 deficit if these payments are made in the coming months. Third, a supplemental budget bill will likely be needed to replenish military munitions and provide additional support amid the ongoing conflict with Iran.

Wells Fargo notes that U.S. international trade flows remain volatile, as importers sharply curtailed imports last year in response to tariff uncertainty. They assume that tariffs will remain in place at roughly current levels throughout the forecast horizon. As trade flows gradually normalize over the course of the year, import growth is expected to rebound, leading to a widening of the U.S. international trade deficit.

This deterioration in net exports is likely to act as a modest drag on GDP growth, particularly in the near term, and could also place some downward pressure on the U.S. dollar depending on broader capital flow dynamics.

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