Monthly — May 13, 2026

U.S. Economic Outlook: May 2026

Growth Holds Firm as Oil Pushed Inflation Higher, Delays Fed Cuts

Key Themes

- **GDP Remains on an Upward Trajectory:** The 2.0% quarterly annualized pace of real GDP in Q1 showed a generally sturdy pace of expansion ahead of the Iran war. The quarterly rise largely reflected resilient (though moderating) consumer spending and strong AI-related investment. Despite recent volatility and renewed geopolitical and trade uncertainty, the initial read on incoming data for Q2 suggests growth has not materially deviated off this path.
- **AI Capex and Fiscal Shock Absorbers.** Looking ahead, fiscal stimulus should help negate the impact of higher oil prices on the household sector, allowing for a steady pace of consumer spending this year. Meantime, AI-related business investment appears to be accelerating, which should provide an offset to tepid investment in interest rate sensitive sectors such as nonresidential and residential construction.
- **Inflation Pressure Lies Ahead.** We have slightly pushed up our forecasts for both headline and core PCE inflation. In terms of the headline, higher oil prices are exerting upward pressure on energy prices, with knock-on effects on food inflation likely in train. Meanwhile, core inflation is likely to experience cost-push pressure related to the AI buildout. A moderating trend in shelter costs and fading tariff impacts seem likely to provide a disinflationary counterweight. Still, we now expect core PCE inflation to peak at 3.5% in Q2 and end the year at 3.1%, modestly higher than our March forecast.
- **Labor Market Stable Within No Hire/No Fire Context.** The recent string of monthly job gains and continued low readings on initial jobless claims indicates that the labor market is not spiraling downward. Beneath the surface, however, conditions are far from ideal. Low hiring rates and moderating wage growth continue to signal sluggish demand for new workers. In our view, there are not many catalysts for a meaningful pickup in labor demand on the near-term horizon, with delayed monetary easing, heightened geopolitical uncertainty, and firms increasingly allocating capital toward AI. Thus, we continue to anticipate a modest pace of hiring in coming quarters and see nonfarm payrolls averaging 55K per month over the balance of the year. The moderate pace of job gains should coincide with the unemployment rate drifting up to 4.4% in Q3, where it is likely to hold through year-end.
- **The Fed's Next Move Is a Cut.** We are sticking with our call for additional monetary easing in 2026. Higher inflation in the wake of Iran war will continue to instill a "wait and see" approach, however, we still view the balance of risks as tilted toward underlying weakness in the labor market, despite recent signs of stabilization. As such, we continue to foresee 50 bps of reductions this year. We remain agnostic on the timing, however, are penciling in 25 bp cuts at both the October and December FOMC meetings, somewhat later than our previous forecast.

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U.S. Forecast Table

Wells Fargo U.S. Economic Forecast

	Actual								Forecast								Actual		Forecast	
	2024				2025				2026				2027							
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	2024	2025	2026	2027
Real Gross Domestic Product (a)	0.8	3.6	3.3	1.8	-0.6	3.8	4.4	0.5	2.0	1.7	1.8	2.4	2.2	2.5	2.4	2.4	2.8	2.1	2.1	2.2
Personal Consumption	1.7	3.9	4.0	3.9	0.6	2.5	3.5	1.9	1.6	1.5	2.0	2.3	1.8	2.2	2.3	2.1	2.9	2.6	2.0	2.1
Business Fixed Investment	1.5	2.5	3.5	-3.7	9.5	7.3	3.2	2.4	10.4	7.2	5.0	3.7	5.1	6.2	4.7	5.2	2.9	4.1	6.1	5.1
Equipment	0.5	8.9	8.2	-4.3	21.4	8.5	5.3	4.3	17.2	10.2	5.8	3.0	4.5	6.0	5.0	4.0	3.5	8.3	9.0	5.0
Intellectual Property Products	6.7	0.7	2.6	-0.6	6.5	15.0	5.6	5.4	13.0	6.8	5.1	4.5	6.4	7.1	4.5	6.5	3.5	5.6	8.0	5.8
Structures	-5.0	-3.9	-2.2	-8.1	-3.1	-7.5	-5.0	-6.5	-6.7	-2.1	2.8	3.2	3.1	4.2	4.5	4.8	1.1	-5.3	-3.9	3.2
Residential Investment	8.2	-2.0	-4.8	4.3	-1.0	-5.1	-7.1	-1.7	-8.0	-4.3	-1.8	2.7	3.5	4.1	4.5	4.8	3.2	-2.2	-4.4	2.5
Government Purchases	2.3	3.3	5.4	3.3	-1.0	-0.1	2.2	-5.6	4.4	2.8	0.4	0.8	1.2	1.0	1.1	1.1	3.8	1.1	0.9	1.1
Net Exports	-964.1	-1032.2	-1064.9	-1069.0	-1380.7	-1058.0	-955.5	-968.7	-1067.5	-1098.3	-1110.2	-1131.0	-1151.2	-1170.7	-1190.2	-1206.2	-1032.6	-1090.7	-1101.7	-1179.6
Pct. Point Contribution to GDP	-0.4	-1.0	-0.4	-0.1	-4.7	4.8	1.6	-0.2	-1.3	-0.5	-0.2	-0.3	-0.3	-0.3	-0.3	-0.3	-0.5	-0.2	0.0	-0.3
Inventory Change	12.4	75.1	69.4	17.1	172.0	-18.3	-23.9	-15.6	-7.5	-1.3	-11.0	8.4	17.5	18.2	23.4	30.5	43.5	28.5	-2.9	22.4
Pct. Point Contribution to GDP	-0.8	1.2	-0.1	-0.9	2.6	-3.4	-0.1	0.1	0.4	0.1	-0.2	0.3	0.1	0.0	0.1	0.1	0.0	-0.1	-0.1	0.1
Nominal GDP (a)	4.0	6.3	5.1	4.3	2.9	6.0	8.3	4.2	5.6	7.0	4.2	4.3	4.3	4.8	4.6	4.5	5.3	5.0	5.7	4.6
Real Final Sales	1.7	2.4	3.5	2.8	-3.2	7.5	4.5	0.3	1.6	1.6	2.0	2.0	2.0	2.5	2.3	2.3	2.8	2.2	2.3	2.2
Retail Sales (b)	1.8	2.5	2.3	3.9	4.5	4.3	4.4	3.0	3.7	5.7	5.1	5.2	4.5	2.3	1.9	1.7	2.6	4.0	4.9	2.6
Inflation Indicators (b)																				
PCE Deflator	2.8	2.7	2.4	2.6	2.6	2.4	2.7	2.8	3.1	3.8	3.7	3.4	2.8	2.1	2.1	2.1	2.6	2.6	3.5	2.3
"Core" PCE Deflator	3.1	2.8	2.8	3.0	2.8	2.7	2.9	2.9	3.1	3.5	3.3	3.1	2.6	2.1	2.1	2.1	2.9	2.8	3.3	2.2
Consumer Price Index	3.2	3.2	2.7	2.7	2.7	2.5	2.9	2.7	2.7	4.0	3.9	3.7	3.2	2.0	1.8	1.9	3.0	2.7	3.6	2.2
"Core" Consumer Price Index	3.8	3.4	3.3	3.3	3.1	2.8	3.1	2.6	2.5	2.8	2.7	2.8	2.6	2.3	2.1	2.1	3.4	2.9	2.7	2.3
Producer Price Index (Final Demand)	1.5	2.6	2.2	3.1	3.4	2.5	3.0	3.0	3.6	6.0	5.4	5.0	4.2	2.5	2.5	2.6	2.4	3.0	5.0	3.0
Employment Cost Index	4.2	4.1	3.9	3.8	3.6	3.6	3.5	3.4	3.4	3.3	3.3	3.4	3.4	3.4	3.4	3.5	4.0	3.5	3.4	3.4
Real Disposable Income (a)	4.2	2.4	1.2	2.0	2.3	1.8	1.0	0.0	1.5	-0.7	2.1	2.8	4.5	1.9	1.9	2.4	2.9	1.7	0.9	2.6
Nominal Personal Income (a)	7.6	5.4	3.6	4.9	6.4	4.3	4.4	3.4	3.9	4.4	4.4	4.7	5.0	4.2	4.0	4.5	5.6	4.9	4.1	4.5
Industrial Production (a)	-2.6	2.7	-2.3	-1.5	4.2	1.8	2.1	-1.7	2.4	1.3	1.9	1.4	1.5	1.0	1.1	0.5	-0.7	1.1	1.2	1.3
Capacity Utilization	76.3	76.6	76.0	75.5	76.0	76.1	76.2	75.6	75.8	76.1	76.5	76.9	77.3	77.6	77.9	78.1	76.1	76.0	76.3	77.7
Federal Budget Balance (c)	-555	-209	-544	-711	-596	-30	-438	-602	-566	-256	-592	-647	-701	-176	-476	-649	-1817	-1775	-1950	-2000
Nonfarm Payroll Change (e)	203	76	72	135	20	34	23	-39	63	70	50	62	64	60	59	54	122	10	61	59
Unemployment Rate	3.8	4.0	4.2	4.1	4.1	4.2	4.3	4.5	4.3	4.3	4.4	4.4	4.3	4.3	4.3	4.3	4.0	4.3	4.3	4.3
Housing Starts (f)	1.42	1.34	1.34	1.39	1.40	1.35	1.35	1.32	1.42	1.30	1.30	1.30	1.37	1.37	1.37	1.37	1.37	1.36	1.32	1.37
Light Vehicle Sales (g)	15.5	15.7	15.7	16.4	16.4	16.2	16.6	15.7	15.4	15.3	15.2	15.5	16.4	16.6	16.7	16.9	15.9	16.2	15.3	16.7
Crude Oil - Brent - Front Contract (h)	81.2	84.4	78.0	73.6	74.3	65.9	67.5	62.7	76.3	105.5	103.0	93.7	86.0	81.0	78.0	76.7	79.3	67.6	94.6	80.4
Quarter-End Interest Rates (i)																				
Federal Funds Target Rate (j)	5.50	5.50	5.00	4.50	4.50	4.50	4.25	3.75	3.75	3.75	3.75	3.25	3.25	3.25	3.25	3.25	5.27	4.33	3.63	3.25
Secured Overnight Financing Rate	5.34	5.33	4.96	4.49	4.41	4.45	4.24	3.87	3.68	3.65	3.65	3.15	3.15	3.15	3.15	3.15	5.15	4.24	3.53	3.15
Prime Rate	8.50	8.50	8.00	7.50	7.50	7.50	7.25	6.75	6.75	6.75	6.75	6.25	6.25	6.25	6.25	6.25	8.27	7.33	6.63	6.25
Conventional Mortgage Rate	6.82	6.92	6.18	6.72	6.65	6.82	6.35	6.20	6.18	6.35	6.20	6.20	6.20	6.20	6.20	6.20	6.72	6.60	6.23	6.20
3 Month Bill	5.46	5.48	4.73	4.37	4.32	4.41	4.02	3.67	3.70	3.65	3.50	3.15	3.15	3.15	3.15	3.15	5.18	4.21	3.50	3.15
6 Month Bill	5.38	5.33	4.38	4.24	4.23	4.29	3.83	3.59	3.72	3.60	3.40	3.20	3.20	3.20	3.20	3.25	5.00	4.09	3.48	3.21
1 Year Bill	5.03	5.09	3.98	4.16	4.03	3.96	3.68	3.48	3.68	3.55	3.40	3.30	3.30	3.30	3.35	3.40	4.69	3.91	3.48	3.34
2 Year Note	4.59	4.71	3.66	4.25	3.89	3.72	3.60	3.47	3.79	3.70	3.50	3.40	3.40	3.45	3.50	3.55	4.37	3.81	3.60	3.48
5 Year Note	4.21	4.33	3.58	4.38	3.96	3.79	3.74	3.73	3.92	3.85	3.70	3.65	3.70	3.75	3.80	3.80	4.13	3.92	3.78	3.76
10 Year Note	4.20	4.36	3.81	4.58	4.23	4.24	4.16	4.18	4.30	4.30	4.20	4.25	4.25	4.30	4.30	4.30	4.21	4.29	4.26	4.29
30 Year Bond	4.34	4.51	4.14	4.78	4.59	4.78	4.73	4.84	4.88	4.90	4.85	4.90	4.95	5.00	5.00	5.00	4.41	4.78	4.88	4.99

Forecast as of: May 13, 2026

Notes: (a) Compound Annual Growth Rate Quarter-over-Quarter
(b) Year-over-Year Percentage Change
(c) Quarterly Sum - Billions USD; Annual Data Represents FisBZI Year
(d) Federal Reserve Advanced Foreign Economies Index, 2006=100 - Quarter End
(e) Average Monthly Change
(f) Quarterly Data - Average Monthly SAAR; Annual Data - Actual Total Houses Started
(g) Quarterly Data - Average Monthly SAAR; Annual Data - Actual Total Vehicles Sold
(h) Quarterly Average of Daily Close
(i) Quarterly Data - Period End; Annual Data - Annual Averages
(j) Upper Bound of the Federal Funds Target Range

Source: U.S. Department of Commerce, U.S. Department of Labor, IHS Markit, Federal Reserve Board and Wells Fargo Economics

Forecast Delta Table

Changes to the Wells Fargo U.S. Economic Forecast

	Actual								Forecast								Actual		Forecast	
	2024				2025				2026				2027				2024	2025	2026	2027
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q				
Real Gross Domestic Product (a)	0.00	0.00	0.00	0.00	0.00	0.00	0.00	-0.17	-0.73	0.29	-0.07	0.09	0.04	0.01	0.02	0.03	0.00	-0.01	-0.16	0.04
Personal Consumption	0.00	0.00	0.00	0.00	0.00	0.00	0.00	-0.04	0.22	0.09	0.00	0.00	0.00	-0.01	-0.01	-0.01	0.00	0.00	0.06	0.00
Business Fixed Investment	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.14	2.59	1.95	0.02	0.06	0.02	0.03	0.02	0.02	0.00	0.01	1.02	0.15
Equipment	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.38	0.48	1.78	-0.02	0.03	-0.01	0.00	0.03	0.00	0.00	0.03	0.52	0.11
Intellectual Property Products	0.00	0.00	0.00	0.00	0.00	0.00	0.00	-0.30	7.87	1.47	0.05	0.10	0.03	0.06	0.03	0.03	0.00	-0.02	2.17	0.14
Structures	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.52	-2.22	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.03	-0.46	0.00
Residential Investment	0.00	0.00	0.00	0.00	0.00	0.00	0.00	-1.17	-2.47	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	-0.07	-0.85	0.00
Government Purchases	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.18	-5.03	2.84	-0.19	0.00	0.00	0.00	0.00	0.00	0.00	0.01	-0.65	0.15
Net Exports	0.00	0.00	0.00	0.00	0.00	0.00	0.00	-0.45	-35.89	-62.73	-63.40	-64.21	-64.89	-65.48	-66.05	-66.61	0.00	-0.11	-56.56	-65.76
Pct. Point Contribution to GDP	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	-0.25	-0.44	-0.01	-0.01	-0.01	-0.01	-0.01	-0.01	0.00	0.00	-0.24	-0.04
Inventory Change	0.00	0.00	0.00	0.00	0.00	0.00	0.00	-8.16	-19.84	-0.35	-2.99	2.29	4.75	4.93	6.33	8.27	0.00	-2.04	-5.22	6.07
Pct. Point Contribution to GDP	0.00	0.00	0.00	0.00	0.00	0.00	0.00	-0.14	0.07	0.32	-0.04	0.09	0.04	0.00	0.02	0.03	0.00	-0.01	-0.01	0.05
Nominal GDP	0.00	0.00	0.00	0.00	0.00	0.00	0.00	-0.27	-1.48	0.75	0.10	0.07	0.08	0.01	0.02	0.01	0.00	-0.02	-0.26	0.10
Real Final Sales	0.00	0.00	0.00	0.00	0.00	0.00	0.00	-0.03	-0.80	-0.03	-0.03	0.00	0.00	0.00	0.00	0.00	0.00	0.00	-0.19	0.03
Retail Sales (b)	0.00	0.00	0.00	0.00	0.02	0.00	0.00	0.00	0.71	2.89	3.26	3.27	2.53	0.39	0.00	0.00	0.00	0.01	2.54	0.71
Inflation Indicators (b)																				
PCE Deflator	0.00	0.00	0.00	0.00	0.00	0.00	0.00	-0.01	0.05	0.14	0.18	0.19	0.14	0.05	0.00	0.01	0.00	0.00	0.14	0.05
"Core" PCE Deflator	0.00	0.00	0.00	0.00	0.00	0.00	0.00	-0.01	0.08	0.46	0.41	0.34	0.16	-0.24	-0.25	-0.22	0.00	0.00	0.32	-0.14
Consumer Price Index	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	-0.04	-0.19	-0.03	-0.02	0.03	0.16	-0.01	-0.04	0.00	0.00	-0.07	0.04
"Core" Consumer Price Index	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	-0.03	-0.34	-0.27	-0.21	-0.16	0.13	0.04	-0.04	0.00	0.00	-0.21	-0.01
Producer Price Index (Final Demand)	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.10	-0.02	0.55	0.60	0.36	0.34	-0.21	-0.21	-0.12	0.00	0.02	0.37	-0.06
Employment Cost Index	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.03	0.01	-0.02	-0.02	-0.04	-0.09	-0.10	-0.12	0.00	0.00	0.00	-0.09
Real Disposable Income (a)	0.00	0.00	0.00	0.00	0.00	0.00	0.00	-0.18	-2.00	-0.86	-0.08	0.03	2.04	-0.14	-0.02	0.10	0.00	-0.01	-0.70	0.42
Nominal Personal Income (a)	0.00	0.00	0.00	0.00	0.00	0.00	0.00	-0.20	-0.34	0.15	0.09	0.00	-0.09	-0.14	-0.01	0.08	0.00	-0.01	-0.08	-0.02
Industrial Production (a)	0.00	0.00	0.00	0.00	0.00	0.00	0.00	-0.43	-2.07	-0.96	0.00	0.00	0.00	0.00	0.00	0.00	0.00	-0.03	-0.77	-0.06
Capacity Utilization	0.00	0.00	0.00	0.00	0.00	0.00	0.00	-0.08	-0.51	-0.78	-0.79	-0.79	-0.79	-0.80	-0.80	-0.80	0.00	-0.02	-0.72	-0.80
Federal Budget Balance (c)	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	95.99	-22.76	-89.49	-50.79	19.62	-6.98	-11.85	0.28	0.00	0.00	50.00	-50.00
Nonfarm Payroll Change (e)	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	-5.33	32.70	-0.33	-1.00	-0.67	-1.33	-1.33	-1.33	0.00	0.00	6.51	-1.17
Unemployment Rate	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	-0.01	0.00	0.01	0.01	0.01	0.01	0.01	0.00	0.00	0.00	0.01
Housing Starts (f)	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.05	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Light Vehicle Sales (g)	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	-0.22	0.27	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.01	0.00
Crude Oil - Brent - Front Contract (h)	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	-5.51	9.00	9.33	5.17	2.33	0.33	-0.33	0.00	0.00	3.21	1.88
Quarter-End Interest Rates (i)																				
Federal Funds Target Rate	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.25	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.06	0.00
Secured Overnight Financing Rate	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.25	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.06	0.00
Prime Rate	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.25	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.06	0.00
Conventional Mortgage Rate	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.10	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.02	0.00
3 Month Bill	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.05	0.20	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.06	0.00
6 Month Bill	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.10	0.10	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.05	0.00
1 Year Bill	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.10	0.05	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.04	0.00
2 Year Note	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.20	0.10	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.08	0.00
5 Year Note	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.15	0.05	-0.05	0.00	0.00	0.00	0.00	0.00	0.00	0.04	0.00
10 Year Note	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.10	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.03	0.00
30 Year Bond	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.10	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.03	0.00

Forecast as of: May 13, 2026

Notes: (a) Compound Annual Growth Rate Quarter-over-Quarter
(b) Year-over-Year Percentage Change
(c) Quarterly Sum - Billions USD; Annual Data Represents FisBZI Year
(d) Federal Reserve Advanced Foreign Economies Index, 2006=100 - Quarter End
(e) Average Monthly Change
(f) Quarterly Data - Average Monthly SAAR; Annual Data - Actual Total Houses Started
(g) Quarterly Data - Average Monthly SAAR; Annual Data - Actual Total Vehicles Sold
(h) Quarterly Average of Daily Close
(i) Quarterly Data - Period End; Annual Data - Annual Averages
(j) Upper Bound of the Federal Funds Target Range

Source: U.S. Department of Commerce, U.S. Department of Labor, IHS Markit, Federal Reserve Board and Wells Fargo Economics

Sector Analysis

Personal Consumption Expenditures (PCE)

- Consumer spending held up in the immediate wake of the Iran conflict, but there are early signs of some softening in consumption into the second quarter.

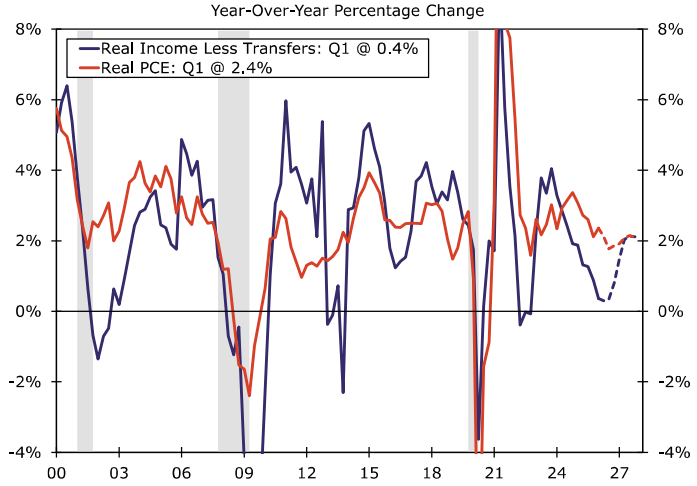
We have not materially adjusted our expectations for consumer spending and continue to anticipate real PCE to rise at an annual average pace of 2.0% this year. Higher tax refunds provided an immediate offset to higher gasoline costs, but high-frequency credit and debit card data suggest a pullback in broad spending in April. Real income growth excluding transfers also fell modestly negative in March. We expect higher prices to continue to erode already weak income growth in coming months, resulting in lower purchasing power and a likely pullback in consumer spending in Q2.

Investment: Equipment, Intellectual Property Products and Inventories

- Firms continue to priorize high-tech investment, which we still anticipate to be the main driver of capex spending this year.

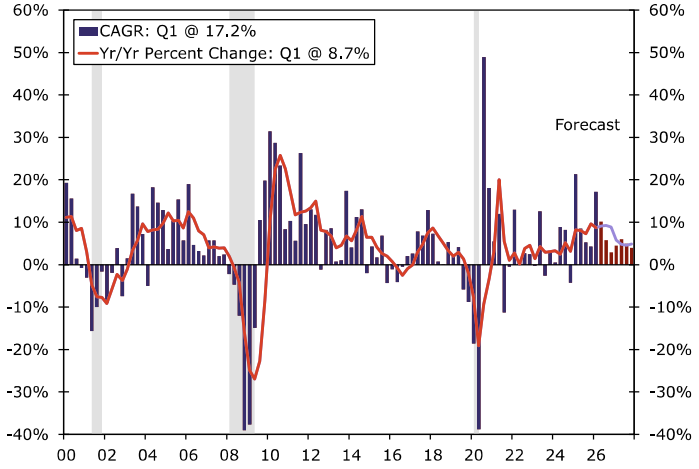
Spending on software, R&D and information processing equipment surged in the first quarter, contributing 1.5 percentage points to Q1 growth—about two-thirds of total GDP expansion--as firms continue to invest in the high-tech transition. While we expect the AI-driven build out to continue to boost spending, we also still see signs of a broadening out in manufacturing after years of delayed activity due to uncertainty around the pandemic, presidential election, rates, and tariffs. Higher energy costs add a new wrinkle, but we've seen the ISM manufacturing index turn positive, durable goods orders are broadening out, and C&I lending has picked up this year. We look for another double-digit growth rate for equipment investment in Q2.

Real Income Less Transfers vs. Real PCE



Source: U.S. Department of Commerce and Wells Fargo Economics

Real Equipment Investment



Source: U.S. Department of Commerce and Wells Fargo Economics

Investment: Residential

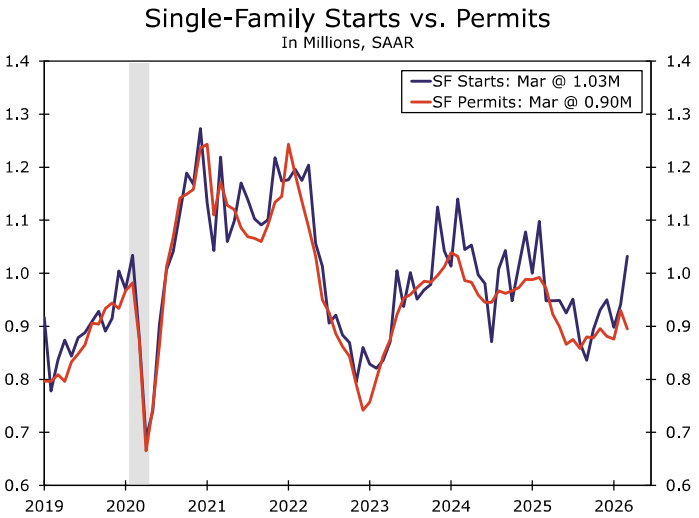
- We have made no major changes to the forecast and maintain our view that residential investment will remain a drag on growth over the next several quarters.

Affordability remains a significant constraint for the residential sector. Over the past several weeks, mortgage rates have ticked higher on the back of the Iran war and its potential effects on inflation and monetary policy. The recent leg-up in financing costs will likely keep home buying activity subdued. In terms of residential construction, building permits have generally trended lower so far this year, which points to a downshift in single-family construction as builders rebalance inventory with more moderate sales. Multifamily activity may see a modest lift as financing costs ease and apartment conditions firm. Meanwhile, recent firming in building material store retail sales indicates that home improvement spending may be starting to recover, though continued low housing turnover and material inflation remain limitations.

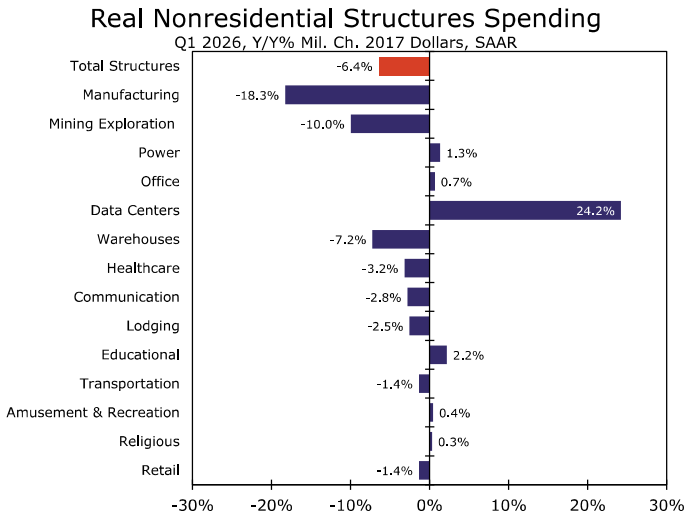
Investment: Nonresidential Structures

- We have not materially altered our outlook for nonresidential structures investment. There are pockets of growth, but overall spending remains weak.

Nonresidential construction is likely to remain in low gear this year. In addition to elevated interest rates constraining new project starts, higher energy prices have introduced new cost pressures. We do see several pockets of growth ahead. Higher oil prices should support energy-related investment through increased drilling activity. At the same time, the AI-driven infrastructure buildout and reindustrialization efforts should underpin strong growth in data centers, power, and manufacturing projects. That noted, new commercial construction starts remain low so far this year, indicating that spending within these categories will remain subdued and keep total structures investment running at a slow speed.



Source: U.S. Department of Commerce and Wells Fargo Economics



Source: U.S. Department of Commerce and Wells Fargo Economics

Net Exports & Trade

- International trade flows remain incredibly volatile month-to-month. We have not materially adjusted our outlook and continue to anticipate a modest widening in the trade deficit over the course of the year.

Continued tariff uncertainty and a high-tech domestic investment prioritization are driving trade flows and causing volatile demand. Imports were strong through the first quarter and suggest a further widening in the trade deficit into Q2, but we will refine our estimate as the data comes in given recent volatility. U.S. Customs and Border Protection has started the IEEPA tariff refund process with money already on the way to businesses. We continue to anticipate refunds will act as profit-margin protection for firms rather than have a stimulative effect on growth and expect the administration to try and re-implement tariffs in late July under other legislation once the current 10% universal tariff expires. Tariff rates should thus remain near current levels.

Labor Market

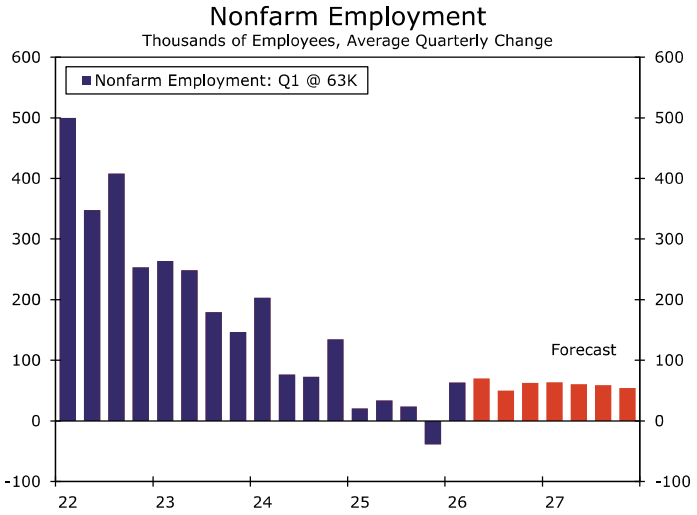
- We made no material changes to our labor market forecast.

Recent data still point to a low-hire, low-fire labor market. Layoffs remain contained outside the tech sector, but there are few signs that demand for new workers is improving with job openings continuing to move sideways and hiring announcements down from last year. Without stronger labor demand, low layoffs alone are unlikely to deliver a durable pickup in job creation. We expect nonfarm payroll growth to average around 55K per month over the balance of the year, compared to 76K the past four months. The more modest pace of job gains should coincide with the unemployment rate drifting up to 4.4% in Q3, where it is likely to hold through year-end. With hiring subdued, we suspect compensation growth will cool a bit more and look for the ECI to subside to 3.3% year over year in Q2.

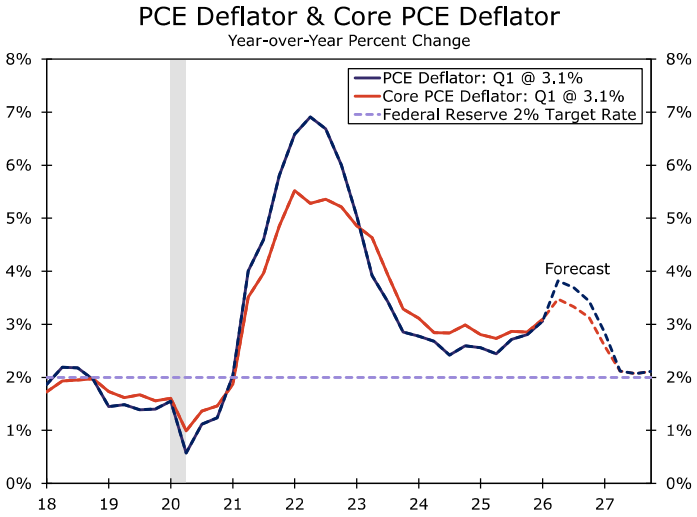
Inflation

- We raised our inflation outlook modestly. We now look for core PCE inflation to end the year at 3.1% on a Q4-over-Q4 basis, up from 2.8% previously.

Higher energy prices are beginning to seep into other categories. Beyond prices at the pump, food inflation is set to strengthen later this year as transportation costs and other agriculture-related input prices rise. Core inflation is also likely to run hot in the near term, led by airfares and high-tech goods related to the AI buildout. These pressures should be partly offset by continued cooling in shelter costs and fading tariff-related increases. But on net, we expect core PCE inflation to peak at 3.5% in Q2 and end the year at 3.1%, as disinflation outside housing has become harder to come by.



Source: U.S. Department of Labor and Wells Fargo Economics



Source: U.S. Department of Commerce and Wells Fargo Economics

Fiscal Policy

- We have modestly increased our budget deficit forecast to $1.95T in FY 2026 and $2.00T in FY 2027, up from $1.78 trillion in FY 2025.

We expect a wider federal budget deficit due to the combination of softer tariff revenues following the rollback of IEEPA tariffs, potential refund outflows to businesses, and a potential supplemental defense spending package tied to the ongoing Middle East conflict. While risks to more defense spending have risen, any increase is likely to be relatively small and phased in over time, limiting the near-term impact in 2026. Section 122 tariff authority remains the key swing factor, with refunds and lower ongoing revenues expected to drive a modest widening in the deficit in the near term. Overall, fiscal policy should not materially alter the outlook, and we expect Fed policy to continue to be the primary driver of rates.

Monetary Policy & Interest Rates

- We have pushed our expectation for the Fed's next cut to Q4 and now look for the FOMC to lower its target range by 25 bps in October and December, still followed by an extended hold at 3.00%-3.25%. Our year-end 10-year Treasury yield forecasts remain unchanged at 4.25% in 2026 and 4.30% in 2027.

The FOMC remains in wait-and-see mode. The labor market is resilient enough that policy easing is not urgent, especially with core inflation still running near 3%. At the same time, growth has fallen short of warranting further tightening, and policymakers are unlikely to be seriously contemplating rate hikes. The Committee appears to retain a modest easing bias, though that bias is increasingly tenuous. If the labor market holds steady, energy prices remain elevated, and inflation fails to improve, the Fed could drift toward a more neutral stance. Still, we continue to see the next policy move as a cut, rather than a hike.

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