

US Economic Viewpoint

2026 year-ahead outlook: Sunny side up

A dose of optimism

The US economy is at a crossroads, with a striking dichotomy between strong economic activity and soft labor data. Our base case is that consumer resilience will help stabilize the labor market. Fed and private sector growth forecasts have been chronically pessimistic. We look for above-consensus growth of 2.4% in 2026 and 2.2% in 2027.

Five tailwinds for 2026

We see five tailwinds for the economy next year. First, we expect the OBBBA to add 0.3-0.4pp to GDP growth in FY26, via consumer and capex stimulus. Second, the lagged effect of ongoing Fed cuts is likely to buoy activity in 2H26. Third, trade policy should turn more supportive for growth regardless of whether the IEEPA tariffs are overturned. Fourth, we think AI-related investment will continue to support the economy next year. Last, base effects from the shutdown should mechanically boost 2026 GDP growth.

Inflation: stuck above target

Our upgraded growth outlook has led us to raise our 4Q/4Q 2026 headline and core PCE inflation forecasts to 2.6% and 2.8%, respectively. Tariffs should continue to trickle through into prices next year, keeping the core PCE above 3% through 3Q. We also think underlying inflation will remain above 2%, because policy rates are already close to our estimate of neutral. Therefore, we project above-target inflation through end-2027.

Labor market: stabilizing around full employment

The labor market is cooling, but not in the non-linear fashion that is characteristic of cyclical downturns. We estimate that immigration tightening has lowered breakeven job growth to about 20k per month. We expect the labor market to realign with the strength in spending next year, with job growth averaging 50k/month and the u-rate peaking at 4.5% in 4Q25-2Q26, before dropping to 4.3% by 4Q26.

Fed: FOMC composition matters as much as data

In the near term, a December cut is a very close call. Either way, we think there will be enough evidence of labor market stabilization by early 2026 that the Fed won't cut again under Chair Powell. The next Fed Chair will likely lean very dovish. Whether they can get the committee on board will depend on both the data flow and FOMC composition. Assuming minimal turnover, we look for a terminal rate of 3.0-3.25% by 3Q26.

Downside risks: labor downturn, AI-related market shock

The proximate downside risk to our outlook is that the labor market keeps weakening and spending collapses under the weight of income losses, triggering further job cuts. Another risk is that AI investment slows, causing a shock in equity/credit markets. This could have knock-on effects for consumption, given the K-shaped nature of spending.

Upside risks: even easier policy

On the upside, part of the tariff revenues could get refunded to consumers next year via stimulus checks. Or the Fed could cut to ~2% despite a resilient economy. Either way, financial repression might be part of the policy mix, to keep a lid on long-end rates.

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Economics
United States

Aditya Bhave
US Economist
BofAS
+1 646 855 9929
aditya.bhave@bofa.com

Stephen Juneau
US Economist
BofAS
+1 202 442 7429
stephen.juneau@bofa.com

Shruti Mishra
US Economist
BofAS
+1 646 855 1040
smishra44@bofa.com

Matthew Yep
US Economist
BofAS
+1 646 556 2970
matthew.yep@bofa.com

US Economics
BofAS

[See Team Page for List of Analysts](#)

OBBBA: One Big Beautiful Bill Act

GDP: Gross Domestic Product

PCE: Personal Consumption
Expenditure

FOMC: Federal Open Market
Committee

IEEPA: International Emergency
Economic Powers Act

U-rate: Unemployment Rate

DOGE: Department of Government
Efficiency

The perils of forecasting without data

With the US economy at a crossroads, the government shutdown couldn't have arrived at a worse time from a forecasting perspective. But the underlying tension between consumer strength and a soft labor market should still resolve in coming months. We think the consumer will eventually "win", with assists from easier fiscal and monetary policy. Therefore, we are moving to a more constructive forecast for 2026 (Exhibit 1).

Exhibit 1: We expect 4Q/4Q growth of 2.4% in 2026 and 2.2% in 2027. Inflation should remain above 2% throughout our forecast horizon

Summary of our economic outlook

	3Q 25	4Q 25	1Q 26	2Q 26	3Q 26	4Q 26	1Q 27	2Q 27	3Q 27	4Q 27
Real GDP (% q/q saar)	2.7	1.4	2.5	2.8	2.3	2.0	2.0	2.0	2.3	2.3
Real GDP (% y/y)	1.9	1.8	2.6	2.4	2.3	2.4	2.3	2.1	2.1	2.2
Final domestic sales (% q/q saar)	2.0	1.0	2.5	2.6	2.2	1.8	1.8	1.8	2.1	2.1
Private consumption (% q/q saar)	3.2	1.8	2.1	3.0	2.5	2.0	2.0	2.0	2.5	2.4
Nonres investment (% q/q saar)	0.7	2.8	3.2	3.2	2.7	2.3	1.9	1.9	1.9	1.9
Residential investment (% q/q saar)	-6.0	-1.0	1.5	1.5	3.0	3.0	2.0	2.0	2.0	2.0
Unemployment rate (%)	4.3	4.5	4.5	4.5	4.4	4.3	4.3	4.2	4.2	4.2
Nonfarm Payrolls (avg m/m chg, 000s)	62	-5	33	42	60	65	65	65	65	65
PCE inflation (% y/y)	2.7	2.8	2.7	2.9	2.8	2.6	2.4	2.3	2.3	2.3
Core PCE inflation (% y/y)	2.9	3.0	3.1	3.1	3.1	2.8	2.6	2.5	2.5	2.4
Federal funds target (%)	4.00-4.25	3.75-4.00	3.75-4.00	3.50-3.75	3.00-3.25	3.00-3.25	3.00-3.25	3.00-3.25	3.00-3.25	3.00-3.25

Source: BofA Global Research

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Growth: above trend... or a stronger trend?

The Fed's median forecast of "longer run" (i.e., trend) GDP growth has been stuck at 1.8% for the last five years and has never exceeded 2.0%. Yet in the 12 years since 2013, 4Q/4Q GDP growth has averaged 2.5% and has dipped below 2% just twice: 2020 (pandemic) and 2022 (6.0% PCE inflation).

This chronic pessimism appears to extend to the private sector too. The Bloomberg consensus was gloomy at the start of 2023 and 2024, though growth turned out to be strong in both years. This year, despite much larger-than-expected Liberation Day tariffs (which pushed some to briefly call for a recession) and the mechanical drag in 4Q from the government shutdown, we're tracking around 1.8% 4Q/4Q GDP growth (Exhibit 1 and Exhibit 2).

In 2026, five factors should push growth back up to 2.4%. First, we expect the OBBBA to add 0.3-0.4pp to GDP growth in FY26, compared to a roughly flat fiscal impulse in 2025 (see the report: [US Viewpoint: One step closer to fireworks](#)). Business investment should benefit from the restoration of the TCJA (Tax Cuts and Jobs Act) tax benefits that sunset a few years ago.

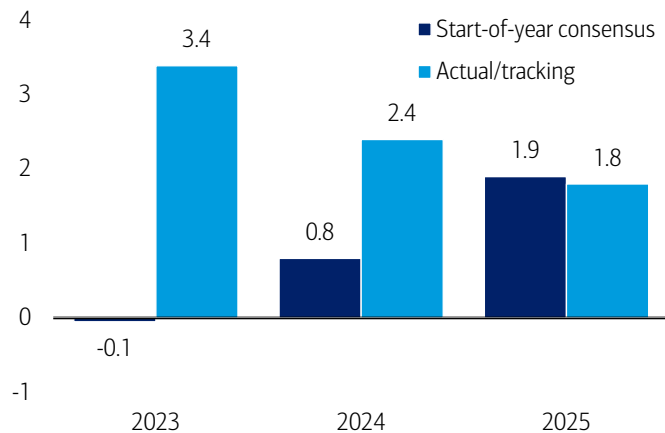
And consumers will get around \$100bn (0.3% of GDP) in fiscal stimulus. Of this, ~\$65bn will be a tax-refund "windfall" due to favorable treatment of tip and overtime income, and a larger standard deduction for seniors. Refunds mostly get paid out in Feb-Apr. Our forecast assumes that the resulting spending boost will peak in 2Q-3Q 2026.

Second, the lagged effect of ongoing Fed cuts is likely to buoy activity in 2H26. In fact, we think the (real) policy rate could be in accommodative territory next year, because i) inflation is stuck a few tenths above target, even ex of tariffs, ii) potential growth, and therefore r^* , are higher than the Fed thinks, and iii) financial conditions suggest policy isn't very restrictive (Exhibit 3). Easy financial conditions are likely supporting economic activity via the equity wealth effect, and we expect that impulse to continue next year.



Exhibit 2: Consensus growth forecasts for 2023 and 2024 were remarkably pessimistic

GDP growth, expected vs. actual (% 4Q/4Q)

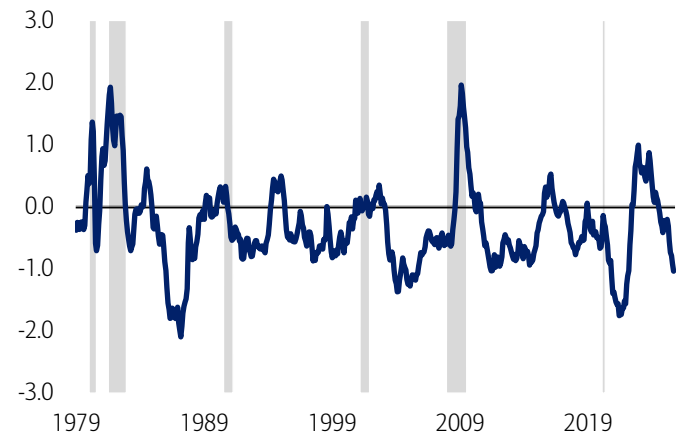


Source: Bloomberg, Census Bureau

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Exhibit 3: Financial conditions are easy and a tailwind for growth

Federal Reserve Board Financial Conditions impulse on growth (3-yr lookback, + = headwind, - = tailwind)



Source: Federal Reserve Board

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The third tailwind is related to trade policy. The Supreme Court is likely to rule on the IEEPA (International Emergency Economic Power Act) tariffs in late 2025 or early 2026. If the tariffs are struck down, the stance of fiscal policy would implicitly ease due to refund payments and an expected decline in the effective rate.

The degree of easing would depend on i) the extent to which policy uncertainty increases as the administration moves to replace the IEEPA tariffs with other measures, ii) how much revenue can be recovered from those measures, and iii) the bond market response to higher deficits (see [Remember, remember the 5th of November](#)). But we think the net effect on economic activity would be positive.

If the Supreme Court upholds the tariffs, we'd expect trade uncertainty to dissipate considerably as the administration prioritizes trade deals over new tariff announcements going into the midterms. The combined effect of the above tailwinds should help stabilize the labor market around full employment and keep equity markets strong. In turn, consumer spending growth is likely to stay solid.

Fourth, we think AI-related investment will continue to grow at a solid pace next year, despite already-elevated levels (Exhibit 4). Finally, 1Q 2026 growth should get a one-off boost from the end of the shutdown, which will add over 0.1pp to 4Q/4Q GDP growth.

We also raise our 4Q/4Q 2027 forecast to 2.2%. On the one hand, we expect the fiscal impulse to turn negative, and the AI investment cycle might have run its course by then. Trade tensions also could resurface after the midterms, like in 2019. On the other hand, deeper Fed cuts (which we expect in 2H 26) and fading tariff inflation should underpin growth.

Inflation: stuck above target

We continue to expect inflation to remain above the Fed's target throughout our forecast horizon. Relative to our most recent forecast, our outlook for stronger growth next year has led us to bump up our 4Q/4Q 2026 headline and core PCE inflation forecasts to 2.6% and 2.8%, respectively (Exhibit 5). Then we expect headline inflation to fall to 2.3% by yearend 2027, and core to decline to 2.4%.

In the near term, we expect supply-driven inflation due to tariffs to remain a significant source of inflationary pressures. This is a major factor behind our expectation that core PCE inflation will remain stuck above 3% y/y through 3Q 2026. We anticipate pass-through will extend into 2026 as businesses continue to slowly shift costs towards consumers (see the report: [Tariffs: passing the buck to the consumer](#)). Some retailers



might do larger-than-usual annual price increases next year, as a way of passing on tariffs. Others might capitalize on the expected pickup in aggregate demand due to fiscal stimulus in 2Q.

Speaking of opportunistic inflation, we also bake in some one-off price level adjustments in services due to the men’s soccer World Cup. Services prices are likely to spike during the event. In an environment where inflation has overshot for five years, our base case is that they won’t fully retrace.

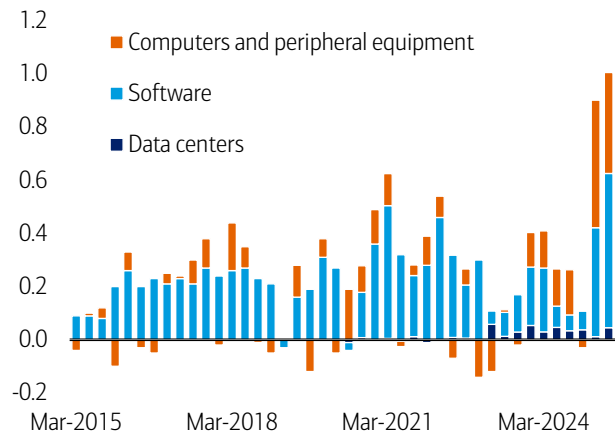
While we expect inflationary pressures from tariffs to fade, there are a few reasons why we do not anticipate inflation returning to 2% in 2027. First, we believe underlying inflation is above 2% based on progress stalling before tariff effects took hold. Second, our forecast implies a positive output gap in the near term, which should generate more demand-driven inflation. Third, the Fed cutting to neutral when inflation is above its target will limit downward pressure on demand and delay inflation returning to 2%.

We see risks in both directions to our forecast. The major downside risks are from services. Specifically, there is a risk that housing inflation cools even more than we anticipate given the lack of asking rent inflation and cooling housing prices. Meanwhile, an equity market pullback and soft labor demand could result in more disinflation in non-housing services.

On the upside, the administration and Congress may pursue more stimulative fiscal policy (e.g. tariff rebates, changes to mortgage markets) ahead of next year’s elections. Additionally, there may be more scope for pass-through from tariffs than we currently estimate as firms may more aggressively defend margins. Labor supply shortages could also translate into more upward pressure on wages next year especially if labor demand recovers broadly. Last, the longer we see inflation above 2%, the more likely inflation expectations are to de-anchor to the upside.

Exhibit 4: AI and technology-related investment has been positive source of growth this year

Contribution to % q/q GDP growth by category

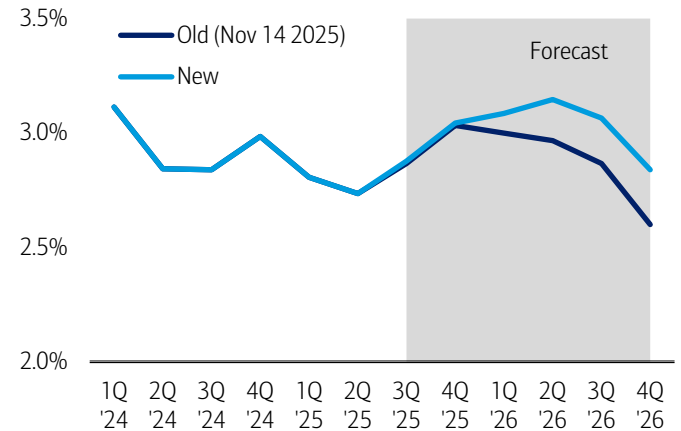


Source: Bureau of Economic Analysis

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Exhibit 5: Our revised forecasts see stickier inflation next year

Core PCE inflation (quarterly, % y/y)



Source: Bureau of Economic Analysis, BofA Global Research

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Labor market: stabilizing around full employment

Over the summer, downside risks rose in the labor market as demand softened due to tariff uncertainty and some AI/DOGE layoffs. Payrolls slowed and the u-rate ticked up, though it remains historically low. In our view, the supply shock from tighter immigration policy is likely to be the bigger driver of soft job growth next year, especially as labor demand starts to recover on the back of fading tariff uncertainty and a positive impulse from fiscal policy.

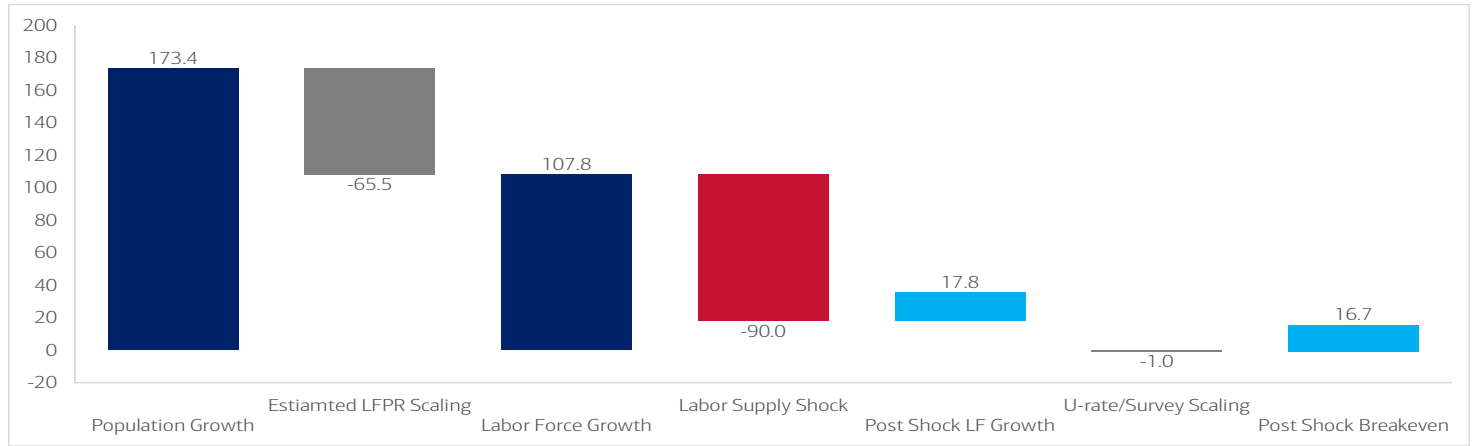


The labor market is cooling, but not in the non-linear fashion that is characteristic of cyclical downturns. Despite weak hiring, layoff rates have been low. And consumer spending certainly isn't reflective of a weakening economy. Spending surged in June-August after a soft start to the year. The BAC credit and debit card spending data and the air traffic figures for the shutdown period both point to continued consumer resilience.

Going forward, we expect the labor market to realign with the strength in spending. Also, business investment should benefit from the OBBBA, easier financial conditions and fading tariff uncertainty. Hence, we have payrolls averaging 30k in 2H25 (partly due to end of the DOGE buyout program) and 50k in 2026. Immigration tightening likely lowers breakeven job growth to about 20k (Exhibit 6), keeping payrolls close to full employment (see the report [Supply, supply, supply: Lower breakeven & full employment](#)). Indeed, we see the unemployment rate ticking up to just 4.5% in 4Q25, where it should remain in 1H26 before dropping to 4.3% by 4Q26.

Exhibit 6: We think tighter immigration policies will reduce the breakeven pace of employment growth to about 20k

Decomposition of breakeven job growth (thous)



Source: BLS, Haver Analytics, BofA Global Research

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Fed: FOMC composition matters as much as data

If our macro forecast is correct, there should be clear evidence of a stabilizing labor market by early 2026. With the Fed having done 50bp of insurance cuts this year and with policy potentially already in accommodative territory, our base case is that rates will stay on hold for the rest of Chair Powell's tenure (through April). However, the jump in the unemployment rate in the September jobs report makes a December cut a very close call.

Forecasting Fed policy under the next Chair is much more difficult. They will have a clear mandate to lower rates significantly further. Whether they can get the FOMC on board will depend on not only the data flow, but also the composition of the committee. There are many permutations, depending on whether Cook is removed, Powell decides to stay on as a Governor, regional Fed Presidents are replaced or there are other unexpected departures from the FOMC. For now, we assume limited turnover on the committee.

In this scenario, we think the doves on the FOMC will be willing to get the policy rate down to 3.0-3.25%. That would mean two or three more cuts (in June, July and possibly September 2026), depending on whether the Fed cuts in December 2025. But we are skeptical that any Chair will be able to convince an FOMC like the current one to get rates below 3%, if our economic forecasts are correct.



Risks: large and two-sided

Downside risks: labor, AI and credit

We see risks to our forecasts in both directions. The proximate risk is that, in shutdown fog, we've picked the wrong side in the consumer-labor conundrum. It's possible that labor demand weakens sharply, and we move from a low-hire, low-fire to a low-hire, high-fire environment (Exhibit 7). That could lead to a collapse in spending under the weight of labor income losses, triggering further job cuts and potentially a recession.

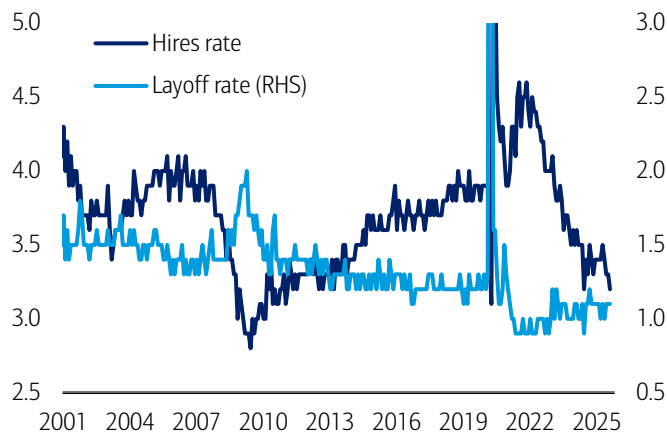
In this scenario the Fed would keep cutting, under both Powell and the next Fed Chair, sending policy rates deep into accommodative territory. And those cuts would be warranted as inflation would be less of a concern given weak aggregate demand.

Another downside risk is that we're too bullish on AI. For example, AI investment could slow if power supply turns out to be a major bottleneck. In this case there might also be upside risks to our headline inflation forecasts. If an AI investment slowdown (or any other factor) causes a big sell-off in tech stocks, that will probably have knock-on effects for consumption, given the K-shaped nature of consumer spending (Exhibit 8, see the report [BofA on USA: Weekly spending update through Nov 15](#) for methodology, limitations, and disclaimers related to BAC aggregated credit and debit card data) and the fact that higher-income spending appears to be partly driven by equity wealth effects.

It's also possible that investment could contract if credit conditions deteriorate rapidly. Like the 90s tech boom, we think it's likely that the AI cycle will end with a few winners and many losers. This could be disruptive for credit markets, and financial market shocks typically have substantial knock-on effects. But this is a very hard risk to time. Markets brushed aside October's mini credit shock, but that wasn't AI related. It would probably take until at least 2027 for winners and losers to clearly emerge in the AI space.

Exhibit 7: The layoffs rate remains below pre-pandemic levels, but hiring has slowed much more dramatically

Hires and layoff rates (%)

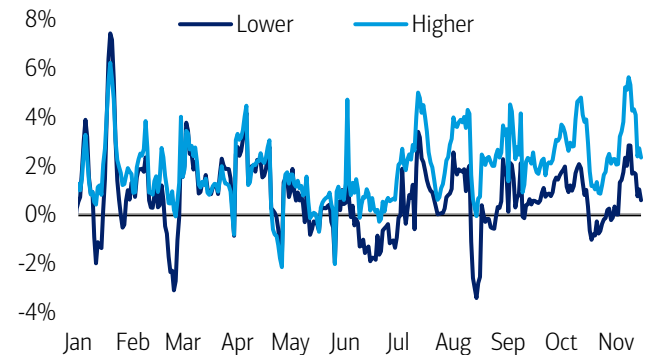


Source: Bureau of Labor Statistics, Haver

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Exhibit 8: Higher-income spending growth has outperformed since the spring

Aggregated daily credit and debit card spending growth per HH, by income (y/y % change of the seven-day moving average of spending levels)



Source: BAC internal data.

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Upside risks: even easier policy

On the upside, policy could be even easier than we expect. We see risks of additional fiscal easing via another reconciliation package in 2026. The administration has floated the idea of refunding a part of the tariff revenues to consumers via stimulus checks.

So far, the fiscal conservatives in the Republican Party (e.g., the House Freedom Caucus) have pushed back against any further easing. But the political calculus could change if the party is polling unfavorably as the midterms approach. In our view, "tariff checks" would pose clear upside to both growth and inflation.



Moreover, the Fed might cut rates as low as 2% despite a resilient economy, if there is considerable turnover on the FOMC. This could create upside risks to long-end rates, likely through higher inflation expectations, due to market concerns about Fed independence (see the report [FAQ: US institutions & inflation risk](#)).

That's why, in either case, some form of financial repression could be part of the policy mix. For example, Treasury might cut coupon issuance and do buybacks at the long end, knowing that the Fed would intervene if the resulting increase in Bill issuance were to cause disruptions in funding markets (see the report [Bill demand gap: Fed help likely needed](#)). Direct Fed QE is also a possibility to support "moderate long-term interest rates". Both we and our rates strategists see this as a low-probability outcome, reserved primarily to address acute US Treasury market functioning issues.

Financial repression would help achieve the administration's stated goal of lowering long-end rates, to spur the housing market and cap the government's ballooning interest costs. However, we'd expect substantial reflation if the most rates-sensitive sectors of the economy (e.g., housing) were to accelerate with inflation already above target.



Economic forecast summary

Exhibit 9: We expect growth to top 2% in each of the next two years and for inflation to remain stuck above the Fed's target

BofA US economic outlook

	1Q 25	2Q 25	3Q 25	4Q 25	1Q 26	2Q 26	3Q 26	4Q 26	1Q 27	2Q 27	3Q 27	4Q 27	2025	2026	2027
Real Economic Activity, % SAAR															
Real GDP	-0.6	3.8	2.7	1.4	2.5	2.8	2.3	2.0	2.0	2.0	2.3	2.3	2.0	2.4	2.1
% Change, Year Ago	2.0	2.1	1.9	1.8	2.6	2.4	2.3	2.4	2.3	2.1	2.1	2.2			
Final Sales	-3.2	7.3	2.7	1.2	2.3	2.6	2.1	1.8	1.9	1.8	2.1	2.1	2.1	2.5	2.0
Domestic Demand	1.4	2.4	2.0	1.0	2.5	2.6	2.2	1.8	1.8	1.8	2.1	2.1	2.3	2.1	1.9
Consumer Spending	0.6	2.5	3.2	1.8	2.1	3.0	2.5	2.0	2.0	2.0	2.5	2.4	2.6	2.4	2.2
Residential Investment	-1.0	-5.1	-6.0	-1.0	1.5	1.5	3.0	3.0	2.0	2.0	2.0	2.0	-2.0	-0.1	2.3
Nonresidential Investment	9.5	7.3	0.7	2.8	3.2	3.2	2.7	2.3	1.9	1.9	1.9	1.9	3.8	2.9	2.2
Structures	-3.1	-7.5	-4.0	0.0	2.0	2.0	1.5	1.5	1.5	1.5	1.5	1.5	-4.7	0.1	1.5
Equipment	21.3	8.5	0.0	3.0	3.0	3.0	2.5	2.0	2.0	2.0	2.0	2.0	7.5	2.8	2.1
Intellectual Property	6.5	15.0	4.0	4.0	4.0	4.0	3.5	3.0	2.0	2.0	2.0	2.0	5.4	4.5	2.5
Government	-1.0	-0.1	0.0	-3.0	3.5	0.4	0.4	0.4	0.4	0.4	0.4	0.4	1.0	0.4	0.4
Exports	0.2	-1.8	-0.5	0.5	1.0	3.0	1.0	1.0	2.0	2.0	2.0	2.0	0.6	0.9	1.8
Imports	38.0	-29.3	-5.0	-1.0	2.0	2.0	1.5	1.0	1.0	1.0	1.0	1.0	2.6	-2.0	1.1
Net Exports (Bil 12\$)	-1381	-1058	-1014	-1002	-1013	-1012	-1019	-1021	-1016	-1011	-1006	-1001	-1114	-1016	-1009
Contribution to growth (ppts)	-4.7	4.8	0.6	0.2	-0.2	0.0	-0.1	0.0	0.1	0.1	0.1	0.1	-0.3	0.4	0.0
Inventory Accumulation (Bil 12\$)	172.0	-18.3	-18.3	-8.3	1.7	11.7	21.7	31.7	41.7	51.7	61.7	71.7	31.8	16.7	56.7
Contribution to growth (ppts)	2.6	-3.4	0.0	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.1	0.1	0.0	-0.1	0.2
Nominal GDP (Bil \$, SAAR)	30042	30486	30855	31187	31604	32028	32407	32766	33106	33466	33861	34255	30642	32201	33672
% SAAR	2.9	6.0	4.9	4.4	5.5	5.5	4.8	4.5	4.2	4.4	4.8	4.7	4.6	5.1	4.6
Key Indicators															
Fed Funds Rate (midpoint, % EOP)	4.375	4.375	4.125	3.875	3.875	3.625	3.125	3.125	3.125	3.125	3.125	3.125	3.875	3.125	3.125
Nonfarm Payrolls (Avg mom ch, 000s)	111	55	62	-5	33	42	60	65	65	65	65	65	56	50	65
Civilian Unemployment Rate (%)	4.1	4.2	4.3	4.5	4.5	4.5	4.4	4.3	4.3	4.2	4.2	4.2	4.3	4.5	4.2
Civilian Participation Rate (%)	62.5	62.4	62.3	62.2	62.2	62.2	62.1	62.1	62.1	62.0	62.0	61.9	62.4	62.2	62.0
Current Account (% of GDP)													-3.9	-3.5	-3.5
US Budget Balance (\$bn, Fiscal Year)													1775	1875	1925
Inflation															
GDP Price Index (% SAAR)	3.6	2.1	2.2	2.9	2.9	2.6	2.4	2.5	2.2	2.4	2.4	2.4	2.6	2.6	2.4
% Change, Year Ago	2.6	2.5	2.6	2.7	2.5	2.6	2.7	2.6	2.4	2.4	2.4	2.3			
PCE Chain Prices (% SAAR)	3.4	2.1	2.7	3.1	3.0	2.6	2.4	2.4	2.0	2.3	2.4	2.3	2.6	2.8	2.3
% Change, Year Ago	2.6	2.4	2.7	2.8	2.7	2.9	2.8	2.6	2.4	2.3	2.3	2.3			
Core PCE Chain Prices (% SAAR)	3.3	2.6	2.9	3.4	3.4	2.8	2.6	2.5	2.3	2.5	2.6	2.4	2.9	3.0	2.4
% Change, Year Ago	2.8	2.7	2.9	3.0	3.1	3.1	3.1	2.8	2.6	2.5	2.5	2.4			
CPI, Consumer Prices (% SAAR)	3.8	1.6	3.1	3.4	3.7	2.0	2.8	2.4	2.7	1.6	2.8	2.4	2.8	2.9	2.4
% Change, Year Ago	2.7	2.5	2.9	3.0	2.9	3.0	2.9	2.7	2.4	2.4	2.4	2.4			
CPI ex Food & Energy (% SAAR)	3.5	2.1	3.3	3.4	3.4	2.7	2.5	2.5	2.5	2.6	2.7	2.5	3.0	3.0	2.6
% Change, Year Ago	3.1	2.8	3.1	3.1	3.0	3.2	3.0	2.8	2.5	2.5	2.6	2.6			

Source: BofA Global Research estimates

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Research Analysts

US Economics

Aditya Bhawe
US Economist
BofAS
+1 646 855 9929
aditya.bhawe@bofa.com

Stephen Juneau
US Economist
BofAS
+1 202 442 7429
stephen.juneau@bofa.com

Shruti Mishra
US Economist
BofAS
+1 646 855 1040
smishra44@bofa.com

Matthew Yep
US Economist
BofAS
+1 646 556 2970
matthew.yep@bofa.com

