

THE BEACON OUTLOOK UNITED STATES

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STRONG CONSUMERS, FRAGILE FOUNDATIONS

Over the past year, there has been significant concern about U.S. economic growth due to substantial volatility in Federal policy. Consumer and business confidence has taken a big hit from the combined force of U.S. Department of Government Efficiency (DOGE) driven spending cuts, tariff scares, and the brief sag in the equity markets back in May. Indeed, the year started with a negative growth rate, driven by a sharp increase in imports and a large slowdown in consumer spending. Then this summer brought a sharp cooling of U.S. job growth, and a large downward revision to the estimates of total payroll employment. The growth estimate for the nation in the 2nd quarter of the year was initially below 3% despite the lift from the sharp drop in imports.

As it turns out, things weren't quite so grim. Even as the U.S. Bureau of Labor Statistics (BLS) revised their employment estimates down, the Bureau of Economic Analysis (BEA) revised their economic growth numbers up to almost 4%, with a stronger rebound in consumer spending than originally estimated adding almost 1.6 percentage points to growth in the 2nd quarter. Moreover, the strength in consumer spending has extended into the 3rd quarter and GDPNow suggests overall growth will once again be close to 4%, with consumers adding a full 2.3 percentage points to that growth. Whatever is happening in the labor markets doesn't appear to be dampening the mighty American consumer as we move into the second half of the year.

There are also plenty of other indicators showing decent economic growth. Industrial production numbers still look good, and business inventories are declining, which is a leading indicator of future production. While housing permits have fallen slightly, housing starts remain solid and there has been a jump in new home sales since mortgage interest rates dropped slightly. Credit conditions have also eased and suddenly there is credit available for borrowers.

Beacon Economics has said for some time that the tariffs that have been enacted to date won't seriously affect the overall U.S. economic expansion. Current estimates suggest that the United States will collect about \$200 billion more in revenues in 2025 than in 2024, roughly 7% of total imports, and less than 1% of household disposable income. These numbers are simply not large enough to move the collective needle on prices or demand. There is, however, potential for additional trade turmoil with next year's negotiation over the renewal of the USMCA agreement, but we'll have to cross that bridge when we come to it.

THE CHILLY LABOR MARKET

So, what is happening with the labor market numbers? The recent downward revisions in the employment data are not job losses; they are simply jobs that were estimated to have been added but never were. While these kinds of downward revisions sometimes suggest the economy is tipping into a downturn, that typically occurs after other economic signals are blinking red because employment is a lagging indicator of economic activity. Those other indicators are not setting off alarms and instead suggest that while the U.S. labor market is clearly cold, there isn't the sort of widespread dislocation that is the hallmark of a recession, such as increases in the unemployment rate, job openings rate, layoffs, and unemployment insurance claims. Businesses aren't hiring, but they aren't firing either.

There is also another weight pressing on the labor market, the likelihood that there has been a downturn in labor supply, as immigration has not only dried up, but by some accounts, has actually reversed in response to aggressive enforcement by the Trump administration.¹ The most glaring long run problem for the economy, of course, is that the United States has experienced a slowdown in domestic population and labor force growth in recent decades – issues that can be easily offset by foreign migration. For the last 15 years foreign-born workers have constituted the majority of U.S. labor force growth, a total of between 9.5 and 7.5 million.

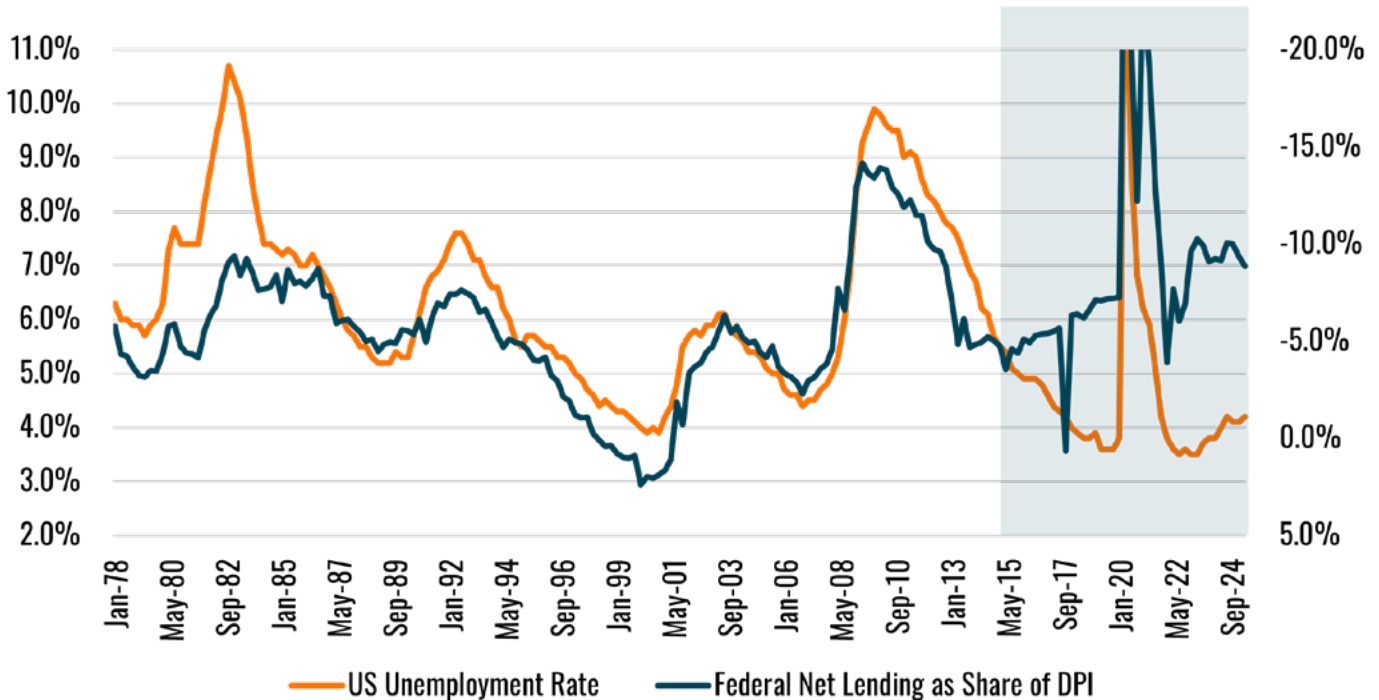
There was a particularly large surge of new entrants, many undocumented, in 2022 and 2023. The California Budget Office estimates that up to 3.5 million migrants entered the United States in each of those years, while the Pew Charitable Trust estimates the number of undocumented migrants went from 10 to 14 million between 2019 and 2023. We simply don't know exactly how many people entered the nation, which means the official labor force numbers are also suspect. We may have to wait until the 2030 Census before we have an accurate understanding. But regardless of the specific number, the high level of immigration was undoubtedly part of the strong economic growth the United States experienced during these years. Reversing that flow will ultimately serve to slow long-run growth, which is not a good path for a nation with trillions of dollars in outstanding public debt to take – but it won't cause a recession in the short run.

A CRISIS OF DEBT

The continued strength of American consumers clearly paints a more optimistic picture of the U.S. economy in the short run but does little to dispel Beacon Economics' fears about the nation's medium-term economic health. Recessions start with imbalances, and the imbalances currently shrouding the U.S. economy are plain to see: yawning government deficits, excessively high asset prices, and a widening current account deficit – all of which are connected at some level. The net result is that the United States is a nation in the midst of yet another consumption binge, with the trade deficit running -3.5% of GDP, a level only exceeded by pandemic era spending and the inflation surge of 2022, and by the housing bubble in the years leading up to the Great Recession. All parties must come to an end. But if this one ends rapidly, that will mean one nasty recession.

At the core of this binge sits the Federal budget deficit. Economists have been warning about the U.S. deficit for decades, but circumstances have become more unglued in recent years. Historically, there tends to be a strong correlation between Federal deficits and the unemployment rate, counter-cyclically in the Keynesian appropriate way. But this historic pattern broke down in 2015 (see figure below) as the age of 'miserabilism' and the Tea Party took over. This structural break saw deficits widen secularly and steadily through the last two years of the Obama administration, through the first Trump administration, and through the Biden administration, despite the decline in unemployment to near record low levels. As noted, the COVID-19 pandemic created a massive temporary surge in borrowing before the nation dropped back to its secular trend. In one short decade we have seen an explosion in Federal debt, from \$18 trillion in 2014 to \$36 trillion in 2025.

U.S. Deficits and Unemployment



Source: US Bureau of Economic Analysis. US Bureau of Labor Statistics; Analysis by Beacon Economics

This level of debt is exceedingly expensive and clearly unsustainable in the long run. Interest payments alone on the nation's existing debt have soared from \$600 billion in 2019 to over \$1.1 trillion in 2025, half the size of the overall deficit itself. Despite alarm bells going off, Congressional Republicans still passed the 'One Big Beautiful Bill' act, which among other things, extended the 2017 tax cuts passed under the first Trump administration. Those cuts were due to expire and would have started the process of shrinking the deficit. Now, the steady expansion of public borrowing will continue for the foreseeable future.

As of this writing the Federal government has shut down as lawmakers deadlock over the nation's budget and spending levels. But the Democrats' strategic goal in the tussle is not to close the deficit, but to spend more, particularly on healthcare. Neither side of the aisle is talking about closing the deficit, particularly not in the lead up to what is sure to be an extremely contentious midterm election.

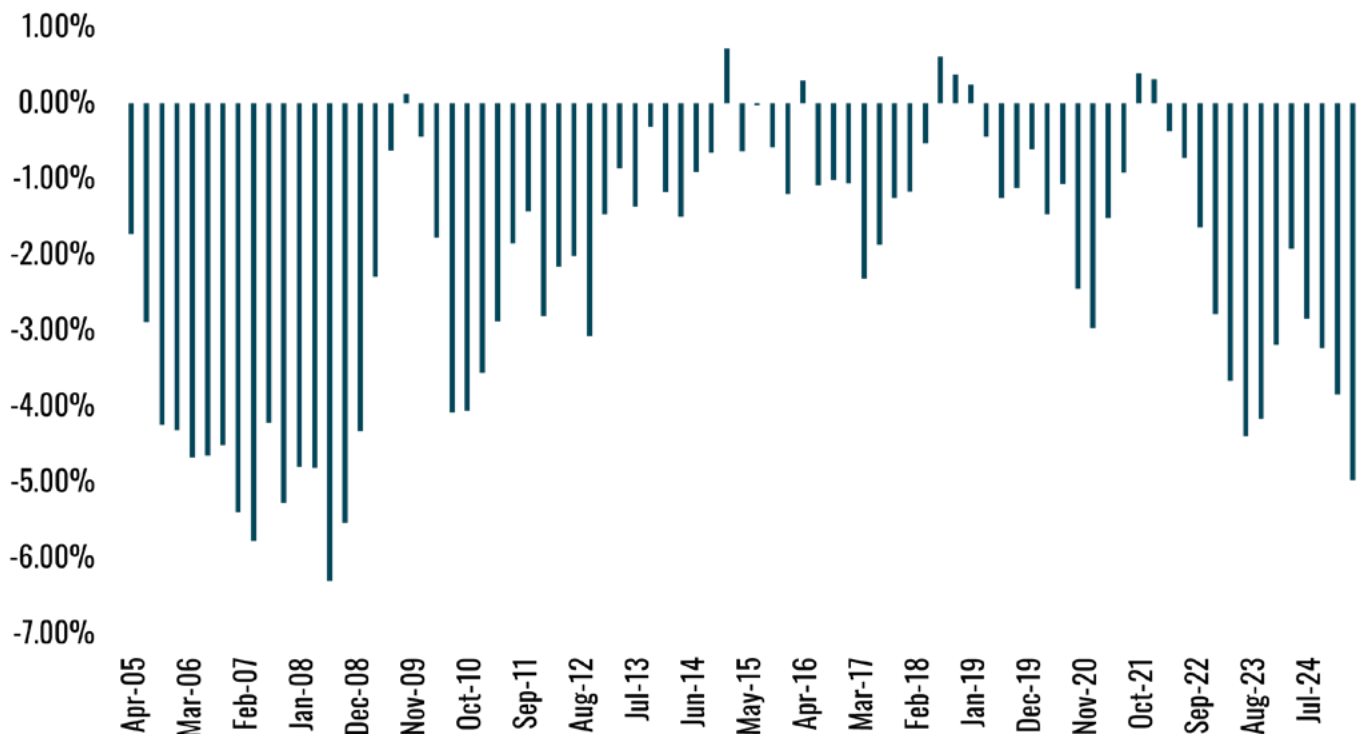
The key here is just how much U.S. households are being subsidized. Average disposable income of U.S. households is currently being artificially boosted by \$17,000 per year due to Federal borrowing. That's almost 10% of disposable household income. Herein lies the danger: At some point Congress will have to put the brakes on borrowing, and this will mean a hit to U.S. incomes. If this forced adjustment comes rapidly, that is the obvious source of a recession. The trillion-dollar question is what will actually spark the government borrowing crisis that will force this outcome. In Beacon Economics' estimation, the likely spark will come from the nation's other brewing crisis — the outsized financial bubble and the inflow of hot money it is attracting.

AN ASSET BUBBLE FOR THE AGES

In addition to inflation, the other major impact of the Federal Reserve’s excessive pandemic-driven stimulus in 2020 was an enormous leap in asset values, from homes to bonds to equities... and worst of all, cryptocurrencies, which Beacon Economics doesn’t label as an asset, since crypto has no earnings. P/E ratios are surging, as are IPOs. The equity markets judged the labor market reductions to be a positive, correctly predicting that the downgraded numbers would finally force the Federal Reserve to cut interest rates. Indeed, Fed Chairman Jerome Powell and company are back on a loosening track, with one cut already made in September and the promise of more by year’s end. The market leapt to new record highs in response to the news. Putting aside the debate over whether a bubble has formed or not (it has), this surge in asset values has attracted a flood of foreign capital into the United States, investors chasing the outsized returns only U.S. equity markets can deliver.

Over the past four quarters the U.S. economy has seen a net inflow of \$1.5 trillion dollars in portfolio investments, what economists typically refer to as “hot money” for its tendency to flee as fast as it arrives. This flow is currently running at 5% of U.S. GDP. The only time it has been larger in the past 50 years was in the run up to the Great Recession. This flood of money into the nation is one of the reasons for the sharp increase in the value of the dollar in recent years. But while this cash comes in seeking hot investment assets, due to the wonders of fungibility, the money is more or less going to pay for a large part of the Federal deficit. This is one of the reasons the U.S. government has been able to borrow so much so rapidly without having a material influence on interest rates. But that will not be the case if these foreign investors suddenly become disinclined or unwilling to invest in the United States.

Net Financial Inflows: Portfolio Investment as Share of U.S. GDP



Source: US Bureau of Economic Analysis, US Bureau of Labor Statistics; Analysis by Beacon Economics

Earlier this year, Beacon Economics was very worried about the current administration's tariffs. We weren't too concerned about the tariffs per se, as we have been saying all along, these trade taxes are simply not large enough to derail the current U.S. economic expansion. Rather, we were worried about how the tariffs had rattled so many businesses who believed they would cause substantial economic harm. The ensuing panic, no matter how off base, drove a brief pullback in the stock market, which in turn caused a brief pause in the capital that had been flowing into the nation; that was quickly followed by declines in the \$US and the bond market. That dangerous trio of declines, had it continued, would have quickly reduced the liquidity that has functionally allowed the U.S. government to borrow so massively without driving up interest rates. Cut off that liquidity and watch interest rates rise again sharply.

While that particular panic has ended, the external imbalances it threatened to destabilize remain firmly in place. The responsible policy path would be to try and cool things off gently. But the Trump administration has been throwing more stimulus into the economy through fiscal and monetary policy, while its deregulatory efforts in finance are boosting the market ever higher (reaching for the moon!). As long as foreign cash continues flowing into the United States, heavy borrowing isn't too concerning. But when that changes, interest rates will start to rise sharply and put increasing pressure on the Federal budget deficit. At some point something drastic will have to occur, although what that looks like is difficult to foresee.

The nation's imbalances could break in months, or could last years, but the risks are clearly growing. While we do have a chance to take a sensible approach, that seems unlikely given the political narratives driving today's economic decision making. Even as the current administration seeks to add more stimulus and inflate the bubble further, it has made chaotic maneuvers on immigration, tariffs, foreign relations, and market regulation, which could destabilize the global order in ways that spook the financial markets and set off the rout. The sky is still clear but beware of dark clouds on the horizon.

U.S. FORECAST -OUTPUT

	Current	Forecast			
	Q2-25	Q3-25	Q4-25	Q1-26	Q2-26
REAL GDP (\$ BILLIONS, \$2012)	23,703.8	23,843.6	23,985.2	24,104.2	24,224.2
% CHANGE FROM PRECEDING PERIOD, SAAR	3.3	2.7	2.4	2.0	2.0
CONSUMPTION	16,355.4	16,485.6	16,537.4	16,609.7	16,692.1
% CHANGE FROM PRECEDING PERIOD, SAAR	1.6	3.2	1.3	1.8	2.0
FIXED INVESTMENT	4,379.8	4,441.3	4,479.9	4,527.0	4,563.2
% CHANGE FROM PRECEDING PERIOD, SAAR	3.3	5.7	3.5	4.3	3.2
NONRESIDENTIAL	3,650.1	3,695.2	3,732.6	3,769.6	3,794.3
% CHANGE FROM PRECEDING PERIOD, SAAR	5.7	5.0	4.1	4.0	2.6
RESIDENTIAL	784.9	773.5	773.3	782.0	792.4
% CHANGE FROM PRECEDING PERIOD, SAAR	-4.7	-5.7	-0.1	4.6	5.4
CHANGE IN PRIVATE INVENTORIES	-32.9	-38.9	-58.6	-81.4	-95.0
GOVERNMENT	3,988.7	4,003.5	4,019.9	4,036.9	4,054.2
% CHANGE FROM PRECEDING PERIOD, SAAR	-0.2	1.5	1.6	1.7	1.7
EXPORTS	2,631.1	2,632.2	2,608.7	2,598.5	2,600.0
% CHANGE FROM PRECEDING PERIOD, SAAR	-1.3	0.2	-3.5	-1.6	0.2
IMPORTS	3,660.1	3,637.4	3,623.2	3,601.2	3,600.6
% CHANGE FROM PRECEDING PERIOD, SAAR	-29.8	-2.5	-1.6	-2.4	-0.1

SOURCES: U.S. BUREAU OF ECONOMIC ANALYSIS, FORECAST BY BEACON ECONOMICS

U.S. FORECAST - INFLATION

	Current	Forecast			
	Q2-25	Q3-25	Q4-25	Q1-26	Q2-26
CONSUMER PRICE INDEX (% CHANGE, YEAR-OVER-YEAR)	2.5	2.8	3.1	2.8	2.8

SOURCES: U.S. BUREAU OF ECONOMIC ANALYSIS, FORECAST BY BEACON ECONOMICS

U.S. FORECAST - KEY INDICATORS

	Current	Forecast			
	Q2-25	Q3-25	Q4-25	Q1-26	Q2-26
INDUSTRIAL PRODUCTION (INDEX)	103.8	103.5	102.0	102.1	102.5
TOTAL NONFARM (QUARTERLY CHANGE, 000S)	280.3	102.4	61.7	71.7	194.9
UNEMPLOYMENT RATE (%)	4.2	4.3	4.4	4.3	4.3

SOURCES: U.S. BUREAU OF LABOR STATISTICS, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM (US),
FORECAST BY BEACON ECONOMICS



About Beacon Economics

Founded in 2006, Beacon Economics, an LLC and certified Small Business Enterprise with the state of California, is an independent research and consulting firm dedicated to delivering accurate, insightful, and objectively based economic analysis. Employing unique proprietary models, vast databases, and sophisticated data processing, the company's specialized practice areas include sustainable growth and development, real estate market analysis, economic forecasting, industry analysis, economic policy analysis, and economic impact studies. Beacon Economics equips its clients with the data and analysis required to understand the significance of on-the-ground realities and to make informed business and policy decisions.

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