THE BEACON OUTLOOK
UNITED STATES

Winter 2026

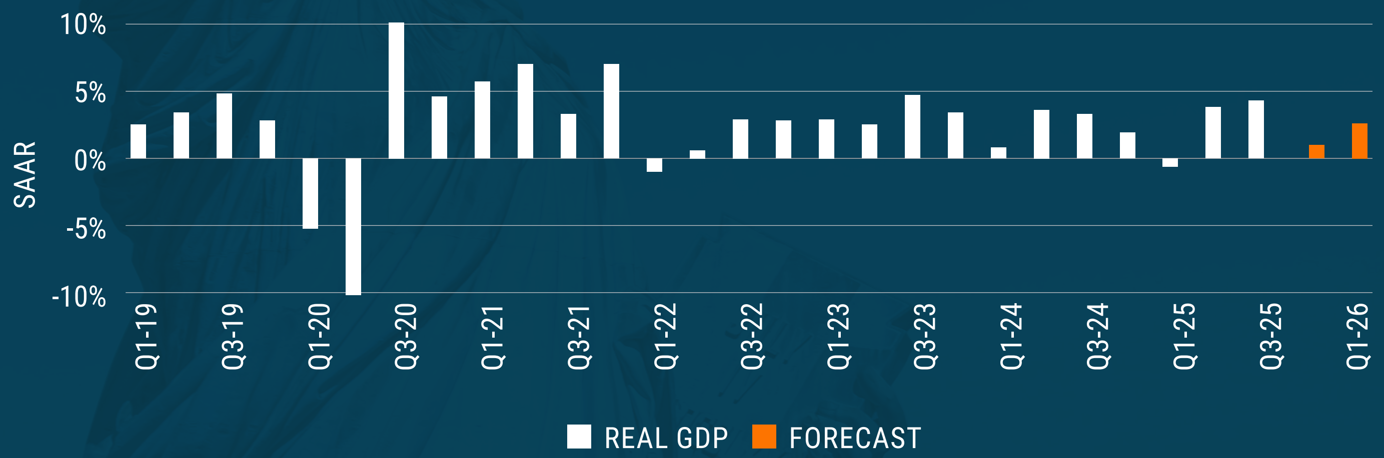
Christopher Thornberg Ph.D, Founding Partner

WILL 2026 BE THE YEAR THE BUBBLE FINALLY POPS?

Happy New Year America! As we begin 2026, it's almost impossible not to wonder (worry) about what's coming next. The past year has been a wild ride, with each policy reversal, political scandal, financial outrage, or regulatory offense following so hard on the heels of the last one that it was difficult to keep up. And the new year has now started with a foreign policy shock in South America. Policy uncertainty remains elevated, and consumer confidence has plunged to near record lows. The headlines are full of stories about struggling families and job losses

Yet when you tune out the noise and focus on the big picture, it becomes clear that very little actually changed in the U.S. economy over the last year. The government shutdown left much of the core data lagging, but what did filter through points to more of the same—decent economic growth despite soft labor markets. Negative growth in the first quarter of the year was offset by strong second and third quarters, leaving overall growth at about 2.5%. The U.S. economy remains stable, with remarkably little to distinguish between Biden year four and Trump year one, despite the administration's rhetoric to the contrary.

REAL GROSS DOMESTIC PRODUCT GROWTH AND FORECAST



SOURCE: US BUREAU OF ECONOMIC ANALYSIS. FORECAST BY BEACON ECONOMICS

There is plenty of other economic stability to celebrate as well. There are few signs of financial distress in either the banking system or among households, business profits continue to rise, and industrial production remains steady.[1] When it came to real policy changes, most of the chaos in Washington turned out to be mostly smoke and not much fire, at least in the short term. Even tariffs have become almost a footnote, despite the confident predictions—both glowing and dire—about their impact. Real trade flows have remained stable, and inflation—up 2.7% over the past year, according to the most recent count—still stems mainly from services, particularly insurance and medical care, rather than from imported goods.[2]

Not all the news is good. The nation has added only 100,000 jobs in seven months, and the nation's unemployment rate has drifted up to 4.6%. Why such soft labor markets if the economy is still growing? Uncertainty is partly to blame, preventing employers from pursuing aggressive expansion plans, and AI may have slightly reduced demand for certain jobs. The concentration of softness at the entry level (younger workers) seems to support that claim. But the deeper truth is that labor markets aren't actually that soft. Claims for unemployment insurance remain very low, and the job-openings rate is still 4.5%—a perfectly normal level. It will eventually become clear that the real issue is flat or even contracting labor supply due to policy shifts regarding undocumented migrants, and the resultant halt in immigration into the United States, a challenge being masked by these short-term fluctuations in labor demand.

But regardless, these sluggish numbers mean that the economy will now get an added boost, with the Federal Reserve and Congress moving to stimulus mode. While inflation remains higher than its 2% target, the Fed has gone ahead and reduced the funds rate three times since September. More significantly, they slowed the pace of quantitative tightening, allowing the money supply to grow faster and making credit easier to get. In addition, the passage of the OBBB Act ensures that the federal deficit will also continue to grow in the current fiscal year. Little wonder that the Wall Street Journal's 'Economic Forecasting Survey' now rates the probability of a recession below 25%.[3]

Heading into 2026, the U.S. economy appears set for a modest acceleration—given all the new juice. But that doesn't mean everything is fine. Quite the opposite, in fact. We live in very dangerous times, beset by the false narratives that are driving populist politics and financial excess. The year started with two recklessly wide narrative-vs-reality contradictions, one excessively negative and the other excessively positive. The first of these is that American households are struggling financially despite a plethora of evidence that shows the exact opposite. On the other hand, equity prices continue to climb, even as those at the center of the AI boom are calling it out as a financial bubble. These two false narratives are linked: miserabilism keeps the country from addressing the budget deficit politically, while the AI bubble delays the economic consequences of that inaction.

[1] https://www.newyorkfed.org/microeconomics/hhdc/background.html
[2] https://www.bls.gov/news.release/cpi.nr0.htm
[3] https://www.wsj.com/economy/central-banking/economist-survey-jobs-economic-growth-f76381f8?mod=article_inline

At some point, circumstances will force the narratives to align with reality. The process will likely begin with the AI bubble: when it bursts, the economic consequences of excessive federal borrowing will finally be revealed—most visibly through rising interest rates and a weakening dollar. How policymakers respond to that will determine the eventual fallout, both to the current economic expansion and the long-run stability of the U.S. political system. The central question for 2026 is whether this is the year that the bubble finally pops, causing the first domino to fall.

THE AFFORDABILITY FALLACY

Miserabilism has been a consistent part of our economy since the Great Recession. But, judging by the fall in consumer confidence and the headlines describing the struggles of the American middle class, American self-pity hit new lows in 2025. What makes this so startling is that the data is clear: inflation-adjusted disposable household income hit a new high in the third quarter of 2025, as did inflation-adjusted per capita consumption. Both have grown at roughly 2.8% per year since 2022, which is slightly faster than between 2014 and 2019. That households are doing well is also evident in how much they're spending. Restaurant sales are growing faster than supermarket food sales; airline travel remains at record levels, with 2025 holiday traffic the busiest ever; and new-car sales are on track for their strongest year since 2019.

The standard retort to these statistics is that we live in a new Gilded Age, where all the gains are going to the richest households. Yet this is contradicted by recent Census data on the distribution of household incomes, which shows that while the gains are slightly tilted to the upper crust, they are still up significantly for everyone else as well. The top 5% have seen a 34% increase in their real (inflation-adjusted) incomes from 2014 to 2024, compared to 25% for the bottom 40% of households. And, of course, these figures ignore the near $4.5 trillion in government transfers that were doled out primarily (although not exclusively) to lower income families in 2024, not to mention the uncounted benefits of modern life, such as unlimited access to entertainment and information via the supercomputer called a smartphone that 95% of Americans now carry with them at all times.

President Trump exploited the miserabilism masterfully in his 2024 election campaign. But false narratives are a double-edged sword, and there is a delicious irony in the pressure now placed on the Trump administration by the very stories it sold us a year ago. Consider food prices, which became a major part of Trump's campaign, highlighted by the now-famous August 2024 press conference featuring a table full of supermarket groceries. [4]Trump promised to bring down prices on Day One of his new administration. Unsurprisingly, given that the executive branch has no real control over market prices, this didn't happen and it's become a non-stop source of negative news stories.

But according to the U.S. Bureau of Economic Analysis's price indexes, food prices rose by only 1.6% from November 2023 to November 2024[5] and 1.9% from November 2024 to November 2025, much slower than both nominal income growth and the overall rate of inflation. The price of restaurant food is rising much faster—but even so, restaurants account for a growing share of food consumption in the United States. Nevertheless, the Trump administration has found itself on the defensive and is having to cut tariffs on some food imports to counter a food cost crisis the nation doesn't actually have.[6]

That such rhetoric was going to come back to bite the administration seems logical, since it is hard to make things better when they are already at a record high. Ironically, miserabilism seems to have intensified in the final months of the year, partly because the government shutdown left the news cycle dominated by a steady drumbeat of decline from media and social platforms. In the event of another shutdown, the Trump administration may decide that keeping the agencies that track the real economy open is a politically prudent move.

---

[4] https://www.nytimes.com/2024/08/16/us/politics/donald-trump-campaign-2024-economy-prices.html
[5] https://www.bls.gov/news.release/archives/cpi_12112024.htm
[6] https://www.ttnews.com/articles/trump-cuts-food-tariffs

THE FINANCIAL BUBBLE

Just as Americans fail to appreciate how good we have it, financial investors seem oblivious to the growing risks of investing in U.S. asset markets. Despite government shutdowns, anxiety about the consumer economy, a massive federal deficit problem, and even prominent AI figures openly calling the sector a bubble, the NASDAQ still managed a 20% gain over the past year and looks ready to carry that momentum into 2026. The S&P rose 13.5%, gold surged 63%, and so on. Only crypto is lagging, with Bitcoin down over the year—though still, IMHO, roughly 100% overvalued. Yes, the markets have given up some ground in recent days, but we've seen several versions of this head fake over the past couple of years. I'll believe it's over only when Wall Street traders start jumping off the roof. Instead, they seem to be lining up for a record year of bonuses—always worrisome.[7]

That AI is a bubble is hardly worth debating. The second-highest P/E ratio, the sudden binge of borrowing by industry players, and the fact that U.S. markets are zigging when globally they are zagging all show this to be true. And to be clear, this isn't to say that AI isn't a transformative technology; of course it is. But the real question is whether the companies at the center of the boom will ever make the profits necessary to back up the current eye-popping valuations. On this front, the answer so far is a resounding 'No.' It turns out that it's harder to implement AI into real business operations than anticipated (less revenue), while it is easier than anticipated for new companies to jump into the market with their own new AI technology (more competition), both of which suggest that few windfall profits will be going to any of the key players anytime soon. Little doubt, this is a bubble.

Animal spirits driving asset prices to record levels is hardly news; there are books detailing centuries of such boom-and-bust cycles. The more important question is how the AI bubble will affect the broader economy once it does pop. And here history offers a wider range of outcomes, from severe downturns (the Great Depression or the Great Recession) to barely a ripple (the mild 2001 dot-com recession) to the absence of any recession at all (the 1987 Black Monday crash). The difference depends on how closely the inflated assets are tied to the debt markets. Margin lending on stocks in the 1920s turned that crash into a full-scale meltdown, while the collapse of mortgage-backed securities in 2008–09 triggered the Great Recession.

[7] https://www.bloomberg.com/news/articles/2025-10-23/wall-street-bonuses-expected-to-hit-record-as-bank-profits-surge

The AI bubble, like the ABS market, is dangerous because it is connected to a debt problem—albeit this time that problem is on the public side of the economy, and the connection is more tenuous. Even so, the sheer scale of federal debt ($36 trillion and rising) means that even a tenuous link could have serious consequences for the broader economy. As Beacon Economics has noted in past reports, the real issue with the decline in the AI bubble is that it will likely coincide with a slowdown in the massive surge of foreign capital flowing into the nation. Over the past year, those inflows have approached $2 trillion—about 5% of GDP and close to the previous peak in 2006 during the ABS boom.

This pullback would push up U.S. interest rates and depress the value of the dollar, creating inflationary pressures. This is the key shock to the economy: it would put additional strain on rate-dependent sectors, such as real estate, but it would exert even more serious pressure on the carry costs of U.S. government debt—as noted, now $36 trillion and rising. To see how unstable the situation has become, consider the history of federal deficits and interest payments on existing debt. The table below shows debt-to-GDP ratios for the third quarter of 2025, and for the same quarter every ten years back to 1975.

Federal debt-to-GDP has been rising consistently over the years. But a corresponding decline in interest rates has allowed the federal government to avoid the interest payment shock of this large increase in overall debt levels. Consider that in 1985, the federal debt was 40% of GDP, with a blended annual interest rate of 12.1%. This meant that federal interest payments amounted to 4.9% of GDP. Today, the debt level is 116% of GDP, but because rates have fallen so far, the blended rate is a surprisingly low 3.3%, producing total annual interest payments of 3.9% of GDP—still below what President Reagan faced, despite the far smaller debt burden at the time.

But if the blended rate rises to just 4%, interest payments would jump to 4.7% of GDP—close to the Reagan-era peak. At 5%—still below anything seen from 1963 to 2002—interest payments by themselves, without even considering the core deficit, would hit a record 5.8% of GDP. At 6%, less than what a standard household would pay for a mortgage in today's market, the interest payments would become catastrophic at 7% of GDP—again, not including the core deficit. The key is how quickly this dynamic feeds back on itself: larger deficits imply a growing overall debt level, which in turn drives interest payments even higher. Once that vicious cycle takes hold, a public debt crisis is all but inevitable; it's then a matter of waiting for the bond markets to move into panic mode.

The spark from the AI bubble might be small, but the amount of fiscal tinder lying around should be cause for alarm in Washington. And with the OBBB now enacted, the Social Security Trust Fund beginning to run dry, and national labor-force growth slowing, the risks intensify with time. Yet Washington remains absorbed in other political narratives, and the bond markets seem as oblivious to the brewing federal debt crisis as equity markets seem blithely unaware of the AI bubble.

	Fed Debt / GDP	Blended Rate on Fed Debt	Fed Interest Payment / GDP	Fed Borrowing / % of GDP	Blended Rate Scenarios	Fed Interest Payment / GDP
1975	31.2%	9.9%	3.1%	-5.8%	4.0%	4.7%
1985	40.5%	12.1%	4.9%	-5.7%	5.0%	5.8%
1995	64.4%	7.2%	4.6%	-2.9%	6.0%	7.0%
2005	59.6%	4.5%	2.7%	-3.4%	7.0%	8.2%
2015	98.6%	2.4%	2.3%	-3.4%		
2025	116.5%	3.3%	3.9%	-6.3%		

Clearly, we're on the brink of a nasty reset, but it's worth stepping back to consider the broader miserabilist problem. We've already noted that per capita consumption is at an all-time high, and personal income is at a record level as well. But that income level is a function of the inherent subsidy that comes with government deficit spending. U.S. household income is roughly 10% higher than it would be if we had to cover all federal expenses with current revenues—the highest such gap ever recorded in a full-employment economy. The real shock comes when the federal government has to level with the public and tell the hard truth: households are not actually suffering or falling behind—but they will have to tighten their belts, pay higher taxes, and accept reduced benefits in order to close the federal deficit. The political fallout will be massive.

But this all lies in the future. For now, the U.S. economy has decent momentum moving into 2026. Raise a glass to that small mercy and prepare for another interesting year ahead.

U.S. FORECAST - OUTPUT

	Current	Forecast			
	Q3-25	Q4-25	Q1-26	Q2-26	Q3-26
REAL GDP ($ BILLIONS, $2012)	24,025.0	24,159.0	24,320.3	24,468.0	24,598.2
% CHANGE FROM PRECEDING PERIOD, SAAR	4.3	2.3	2.4	2.5	2.1
CONSUMPTION	16,589.1	16,675.5	16,762.4	16,862.1	16,955.4
% CHANGE FROM PRECEDING PERIOD, SAAR	3.5	2.1	2.1	2.4	2.2
FIXED INVESTMENT	4,391.7	4,458.5	4,501.00	4,557.7	4,608.6
% CHANGE FROM PRECEDING PERIOD, SAAR	1.0	6.2	3.9	4.6	4.5
NONRESIDENTIAL	3,685.0	3,718.6	3,760.1	3,802.4	3,843.9
% CHANGE FROM PRECEDING PERIOD, SAAR	2.8	3.7	4.5	4.6	4.4
RESIDENTIAL	768.3	765.9	771.5	778.7	787.0
% CHANGE FROM PRECEDING PERIOD, SAAR	-5.1	-1.3	3.0	3.8	4.3
CHANGE IN PRIVATE INVENTORIES	-29.6	-58.8	-85.2	-86.8	-100.7
GOVERNMENT	4,015.1	3,980.5	4,044.9	4,063.6	4,080.5
% CHANGE FROM PRECEDING PERIOD, SAAR	2.2	-3.4	6.6	1.9	1.7
EXPORTS	2,703.7	2,718.1	2,717.7	2,732.1	2,750.6
% CHANGE FROM PRECEDING PERIOD, SAAR	8.8	2.1	-0.1	2.1	2.7
IMPORTS	3,660.9	3,614.7	3,626.5	3,660.7	3,696.1
% CHANGE FROM PRECEDING PERIOD, SAAR	-4.7	-5.0	1.3	3.8	3.9

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

U.S. FORECAST - INFLATION

	Current	Forecast			
	Q3-25	Q4-25	Q1-26	Q2-26	Q3-26
CONSUMER PRICE INDEX (% CHANGE, YEAR-OVER-YEAR)	2.9	2.8	2.5	2.7	2.4

SOURCE: U.S. BUREAU OF LABOR STATISTICS, FORECAST BY BEACON ECONOMICS

U.S. FORECAST - KEY INDICATORS

	Current	Forecast			
	Q3-25	Q4-25	Q1-26	Q2-26	Q3-26
INDUSTRIAL PRODUCTION (INDEX)	101.7	101.8	102.0	102.3	102.4
TOTAL NONFARM (QUARTERLY CHANGE, 000S)	88.4	-55.7	101.3	38.1	61.4
UNEMPLOYMENT RATE (%)	4.3	4.4	4.5	4.5	4.4

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.

Learn more at www.BeaconEcon.com

Project Team

Christopher Thornberg PhD.
Founding Partner (Project Advisor)

For further information about this report, or to learn more about Beacon Economics please contact:

Sherif Hanna
Managing Partner
Sherif@BeaconEcon.com

Victoria Pike Bond
Director of Marketing and Communications
Victoria@BeaconEcon.com