Levy Economics Institute of Bard College

Strategic Analysis

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THE US ECONOMY AMID RISING GLOBAL UNCERTAINTY

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Contrary to upbeat announcements on the prospects for the US economy from the current administration in Washington, economic conditions are softening for this year.

The market for labor is increasing anemically after the significant downward adjustments to the earlier months of 2025 and the disappointing reports in recent months (July and August 2025) that showed small numbers of new jobs. The unemployment rate ticked up as did jobless claims for August. The Federal Reserve Bank of New York's Survey of Household Spending showed a broad-based decrease in the rate of growth: from 4.5 percent in April to 4.1 percent in August—the lowest level since April 2021. The same survey, however, showed that the share of consumers making large purchases (electronics, home appliances, furniture, home repairs, and vehicles) increased from 53.5 to 60.8 percent from April to August of this year, perhaps due to worries that American tariffs would cause price increases. In the same survey, the expected year-ahead growth in necessary spending decreased from 4.9 to 4.7 percent from April to August (FRBNY 2025a). This is in concert with the consumer confidence decline reported in September (Conference Board 2025).

Though most commentators refer to the resilience of consumer spending, there seem to be economic headwinds ahead. Inflation is hovering around the accepted range, but the Federal Reserve remains reluctant to decrease interest rates, maintaining that demand will create inflationary pressures—despite the overwhelming evidence of supply chains being influenced by geopolitical instability and climatic changes together with a weakening labor market. The latest Empire State Manufacturing Survey issued by the New York Fed reports that business activity (i.e., new orders, shipments, inventories, etc.) declined in New York State in September (2025), with the "headline general business conditions index dropping twenty-one points to –8.7, its first negative reading since June" (FRBNY 2025b).

Real GDP growth, after contracting by –0.5 percent in Q1, grew by 3.3 percent in Q2, the result of decreasing imports and increasing consumer spending and investment. As reported,

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however, the negative result of Q1, taken together with the positive one of Q2, may be due to President Trump's ever-shifting tariff announcements causing wide movements in trade and inventory build-up (Casselman 2025). If and when tariffs become fully effective, supply chains would be adversely affected while the stricter immigration laws and deportations of foreign-born skilled workers will cause hardships in the technology sector and other industries relying on them. Growth rates are dependent on the growing size of the labor force and increases in labor productivity. From the early 2000s, immigration has played a significant role in labor growth and labor productivity, filling gaps in services and in many cases spurring innovation in tech industries. The latest non-farm business productivity numbers—and especially manufacturing productivity—show increases in Q2 of this year driven by output growth and a smaller increase in hours worked as compared to last year (BLS 2025).

The latest real GDP growth projections (Table 1) for this year vary, from the Fed's median of 1.6 percent to OECD's 1.8 percent, while for 2026 their respective projections move in opposite directions—that is, 1.8 percent (the Fed) and 1.5 percent (OECD). It should be noted that OECD's most recently projected growth rate for 2025 represents an increase from its June projection of 1.6 percent, attributing the increase to the greater-than-expected resilience of the US economy. The CBO's latest forecast projects a growth rate of 1.4 percent for this year, a decrease from its earlier projection of 1.9 percent while, for next year (2026), CBO's projection has increased to 2.2 percent, from its previous projection of 1.8 percent. Other private forecasts—Goldman Sachs, for example—are more optimistic, accelerating the 2025–29 average growth rate to over 2 percent, citing increased labor productivity from further diffusion of AI together with augmented residential construction activity for at least the current year (2025a, b). Our own stock-flow consistent (SFC) model growth projections for both the baseline and alternative scenarios differ from the Fed, the OECD, and private forecasts, for the reasons and behavioral assumptions we believe are crucial in affecting the three institutional sectors of the macroeconomy.

Table 1. United States: Real GDP Projections

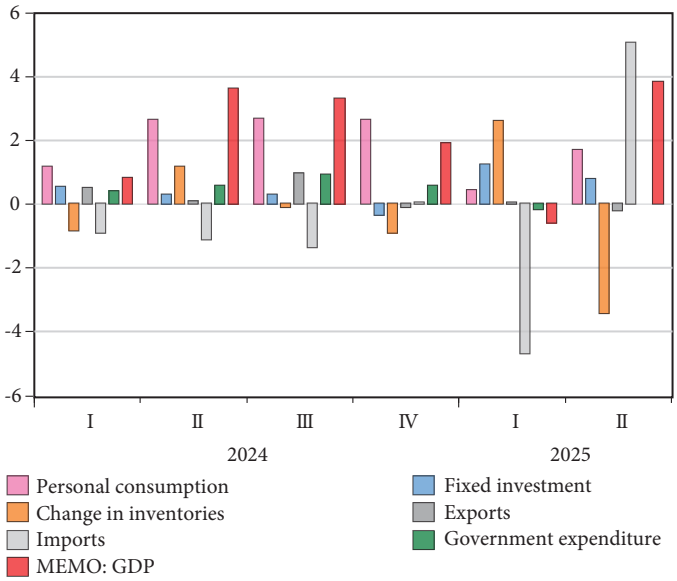
Annual Growth Rates	2025	2026	2027
Federal Reserve (FED 2025 September)	1.6	1.8	1.9
CBO (September) (CBO 2025 September)	1.4	2.2	1.8
CBO (January) (CBO 2025 September)	1.9	1.8	1.8
OECD (2025 September)	1.8	1.5	NA
IMF (2025 WEO April)	1.8	1.8	1.7
Levy Economics Institute	1.9	1.9	2.4

The US Economy Thus Far

An analysis of the drivers of growth in the previous year (2024) and the first half of this year shows how important private consumption is for the growth dynamics of the economy; notice in Figure 1 the differences in personal consumption and the related GDP growth especially in Q1 of 2025—the lowest private consumption with negative growth.

In Q2 (2025), the increase in private consumption is associated with higher growth even though services—especially health care—accounted for the largest share of private expenditures while consumption of goods contributed much less. Nevertheless, private consumption is the motor of growth in all economies and is, in turn, dependent on employment growth and labor income. To be sure, there are other growth drivers with positive contributions—exports, government expenditures, and investment—and negative ones such as is the case with imports. The drop of imports in Q2 is larger than their increase in Q1—a major cause of the US

Figure 1. US Contributions to Real GDP Growth (percent)



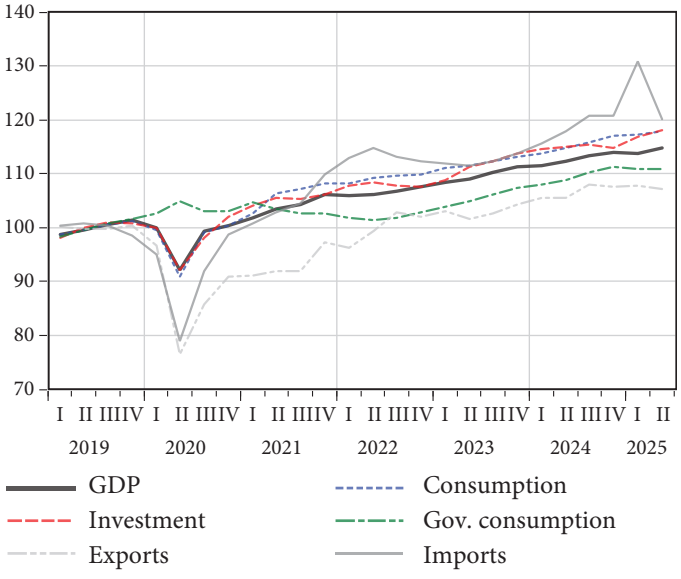
Source: BEA

economy's Q1 contraction. In Figure 1, we also observe the very significant drop in gross private investment about –2.66 percent, mostly due to the decrease in inventories by -3.44 percent (more than offsetting their growth of 2.58 percent in Q1), while fixed private investment accounted for moderate increases in software and equipment and small investment decreases in residential and other structures.

The erratic behavior of imports and inventory adjustments, most probably the result of the Trump administration's on and off tariff impositions, make projections rather difficult, since the behavior of these variables affects private expenditures, especially consumption. Lastly, federal government expenditures continued to be negative in Q2 as in Q1, despite the small positive expenditures from state and local governments. The continuing shrinking of government will not bode well for the prospects of the economy and may engender forces of economic contraction as we suggested elsewhere (Papadimitriou et al. 2025a).

In Figure 2, the post-COVID trends of the components of GDP growth denote the contribution of each, illustrating once again the importance of private consumption. Another important trend is that of investment (including inventories), which has been steadily increasing and is above the level of the pre-COVID period. Similarly, in Figure 2, government expenditures (consumption and investment) show an increasing trend stabilized in the latter part of 2024, but began declining in 2025 as was also illustrated in Figure 1.

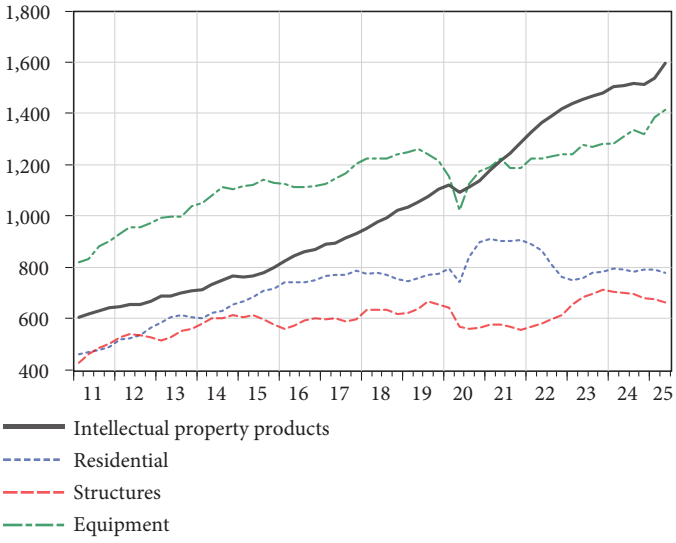
Figure 2. US GDP Components (2019=100)



Source: BEA

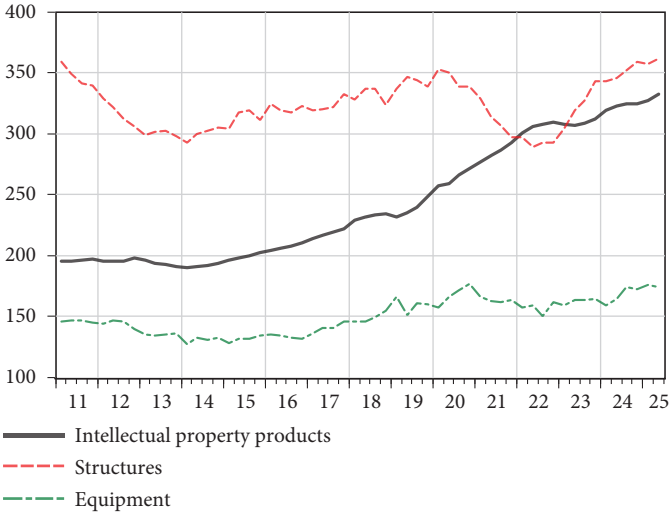
We analyze private fixed investment (excluding inventories) further in Figure 3, denoting the acceleration of investments in intellectual property products (e.g., software, AI) and other equipment. Meanwhile the residential and structures investment trends, although increasing, are at much lower levels and are even declining slightly in 2025—due to the Federal Reserve's insistence on keeping unnecessarily high interest rates. Government investment exhibits similar trends as their private counterparts, with acceleration in intellectual property products (research and development) and equipment,

Figure 3. Fixed Investment (billions, $2017)



Source: BEA

Figure 4. Gross Government investment (billions, $2017)



Source: BEA

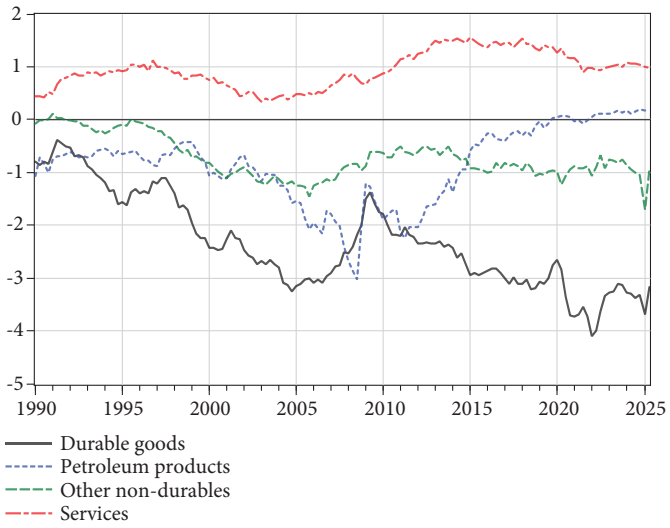
but deviates when it comes to investment in structures (infrastructure), which indicates an anemically increasing trend as illustrated in Figure 4. Government investment increased a bit in 2021–22, declining subsequently and still remaining a small percentage of GDP from years past. We will have more to say about the infrastructure deficit in the US when we consider an alternative growth scenario for rebuilding the country's infrastructure.

Net exports—another component of GDP growth—have been trending negatively in the US for decades, with detrimental impact. As shown in Figures 1 and 2, imports have been much higher than exports, creating an ever-increasing trade deficit, despite the insistence of President Trump that stricter and higher tariffs would narrow the gap.

Exports of services have been positive for a very long time and, together with increased fracking over the last decade or so, the US has been able to act as a net exporter of LNG and petroleum products (see Figure 5, detailing the US balance of trade). Even though product exports are lagging, it should be noted that exports of intellectual property products (software) are booming. This increase in software notwithstanding, the ever-increasing importation of goods continues unabated, especially in non-durables, yielding in turn continuously increasing trade and current account deficits (Figure 6).

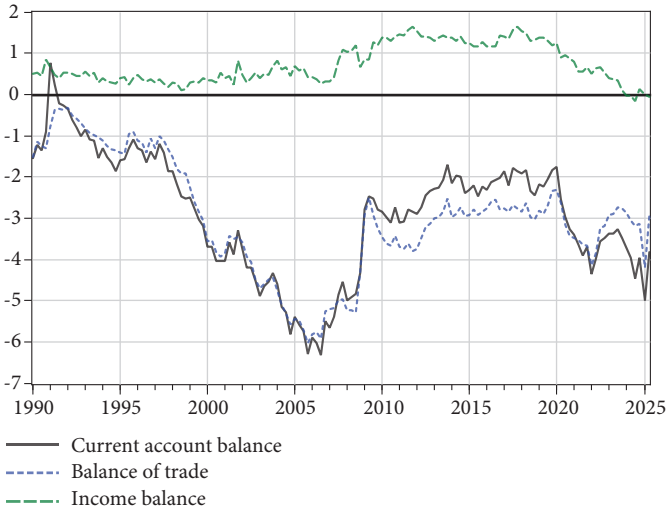
The net financial investment income from abroad, shown in Figure 6, has been declining since 2016. Figure 7 shows that the decline is due both to the drop in net return from foreign direct investment (Figure 7 considers jointly the net income from FDI and the dividends paid in portfolio investment) and the increase in net payments for interest on securities. For decades, the US has had the privilege of a net inflow of US dollars in the balance-of-payments income account, as the return on US foreign direct investment abroad was larger than the payments to foreigners holding US public debt. Figure 7 shows that this privilege is probably no longer in effect.

Figure 5. US Balance of Trade (percent of GDP)



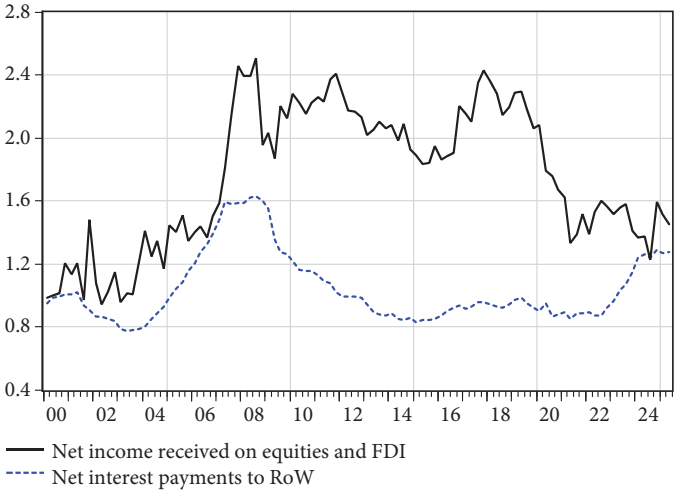
Source: BEA

Figure 6. US Balance of Payments (percent of GDP)



Source: BEA

Figure 7. US Balance of Payments: Investment Income (percent of GDP)



Source: BEA

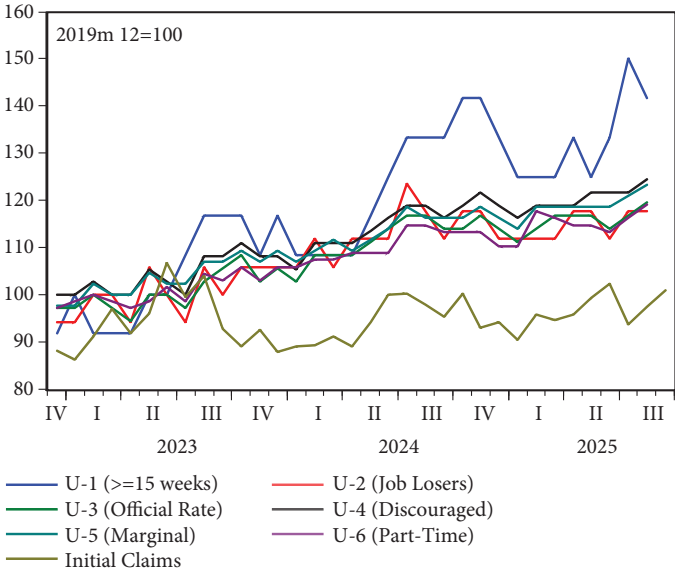
In our previous strategic analysis (Papadimitriou et al. 2024) and elsewhere (Papadimitriou et al. 2025b), we analyzed the effects of the Trump administration's proposed tariffs and concluded that they would not deliver the desired result of the US economy's reindustrialization and decrease of the trade deficit.

Before turning to monetary policy and the financial conditions of the US economy, it will be useful to review and consider the prevailing employment conditions and wage structure in the US. The official unemployment rate is low despite the recent uptick to 4.3 percent. The various unemployment rates (U-1 to U-6), as measured by the BLS, show upward trends, while initial jobless claims also indicate an upward but unstable trend as illustrated in Figure 8.

It is encouraging to see the trending increase in real average weekly production and nonsupervisory earnings since 2010. These are, however very much below the level of the 2020–22 period, as indicated in Figure 9.

Troubling are the low labor force participation and employment population rates, at 62.3 percent and 59.6 percent respectively, showing a 0.4 percent decline from a year ago in August 2025. We consider this quite important, as pointed out in our last strategic analysis (Papadimitriou et al. 2024), as it in turn reflects the unstable, but still declining wage share of the GNI, demonstrated in Figure 10.

Figure 8. Unemployment Rates and Jobless Claims



Source: BLS, ETA

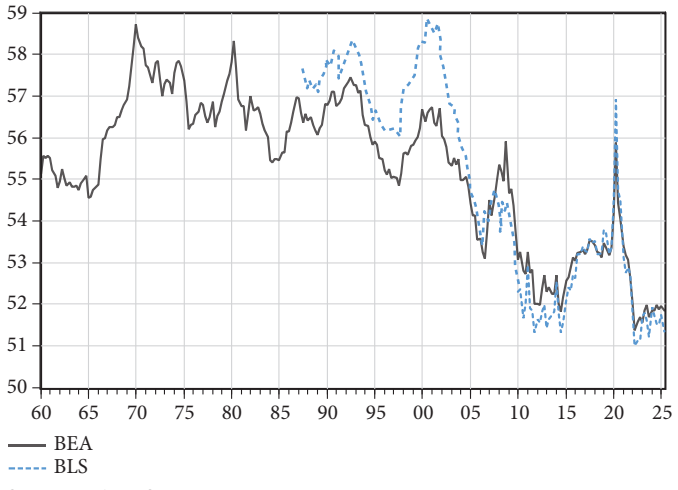
Monetary Policy and Financial Conditions

The Federal Reserve's continuing tight monetary policy has been incapable of bringing inflation down to the 2 percent target rate, for the reasons explained in Papadimitriou and Wray (2021). Inflation has been stubbornly maintained above the target, while GDP "growth has moderated" and "the risks to both sides of our dual mandate have shifted" (Jefferson 2025). Speeches by Fed governors, as the one recently delivered by Vice Chair Jefferson, acknowledge the softening demand for new jobs and the increasing risk of further unemployment while President Trump's tariffs surface in the inflated prices of some goods. All in all, the recent adjustment of interest rates was too little and too late, and the continued tightness will

Figure 9. US Real Average Weekly Earnings (Production and Nonsupervisory Employees; 2015 prices)

Source: BLS

Figure 10. US Labor Share (percent)



Source: BEA; BLS

most likely exacerbate the downside risks of GDP growth and employment without bringing inflation down any further.

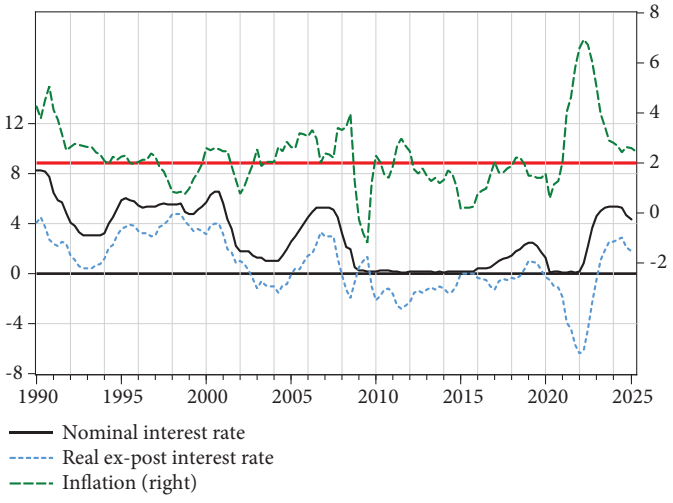
Nominal and real interest rates are still elevated (Figure 11) given the declining prospects of economic growth and the weakening of employment.

Private sector debt (i.e., non-financial corporations and households) seems to have stabilized, as documented in Figure 12. The evolving US trade policy has caused global uncertainty to rise, as analyzed in a recent IMF Report (Ahir et al. 2025), especially affecting business expectations in regard to tariff costs and prices (Federal Reserve Bank of Boston 2025). Residential dwelling investment seems to have stabilized despite the small decrease in Q2 (2025) and small increase of new homes in August (2025), as mentioned earlier. Given the declining capital gains in household real estate (Figure 13), this seems to explain the shifting of investment toward the equity markets, which are experiencing extraordinary overvaluation in relation to the Case-Shiller Index (Figure 14) and despite the recent warnings from the Fed's Board of Governors Chairman Jerome Powell.

The other more pronounced reason for the buoyant increase in the stock market is the boom in AI-related investment activities, which some commentators relate to the dot-com bubble of the 1990s (Letzing and Sung 2025). It is early to predict whether the huge investment in data centers and related technologies by the few companies with dominant positions in AI will prove sustainable and justified by future profits. More likely only a smaller number of competitors will survive. Different from the 1990s bubble, we are not witnessing an increase in the net liabilities of the non-financial corporate sector.

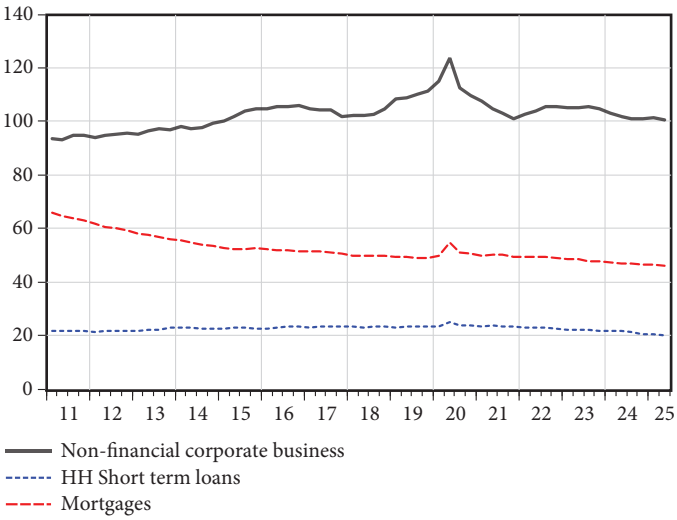
Tight monetary policy together with shrinking government expenditure is exactly what is necessary for a severe economic contraction. We hope the present government shutdown will not continue for long, averting an economic and financial crisis that will take some time to reverse. In what follows, we present our own projections for the 2025–27 period based on reasonable and neutral assumptions on the behavior of the most important economic variables for a baseline scenario.

Figure 11. US Inflation and Interest Rates, Annual Percentages



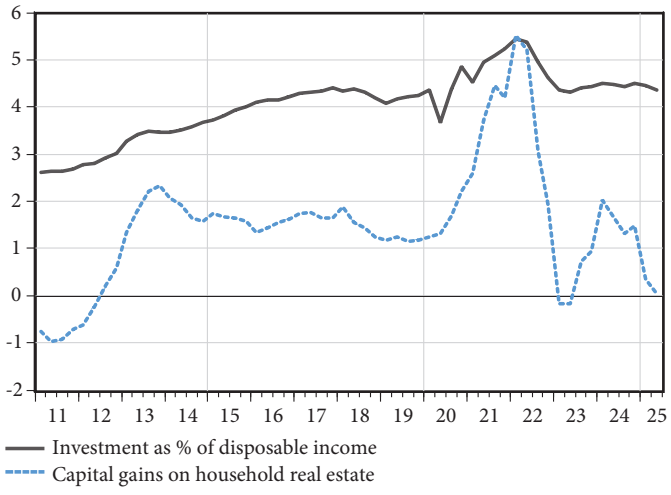
Source: BEA

Figure 12. Private Debt (percent of GDP)



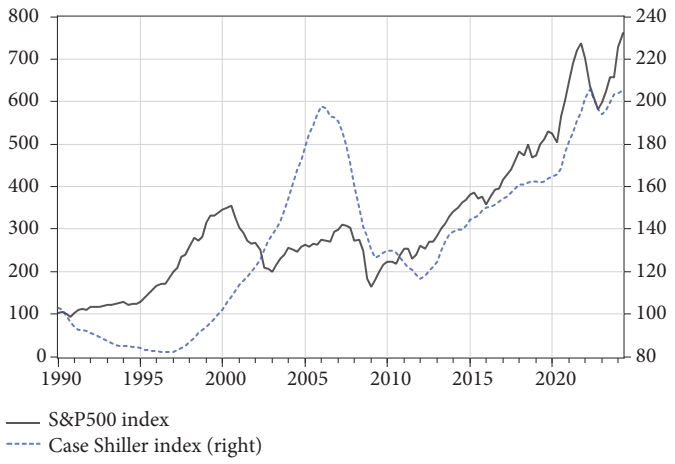
Source: BEA, Federal Reserve

Figure 13. US Households: Residential Investment and Capital Gains (percent)



Source: BEA, IMA

Figure 14. **US Real S&P 500 and Case Shiller Indices (1990 = 100)**



Source: BEA, FRED

We subsequently propose an alternative scenario focusing on needed expenditure for both physical and social infrastructure (including AI education and training), much needed in the US.

Our Baseline Projection

Our projections are anchored in the Congressional Budget Office's (CBO) (2025) baseline for revenues and outlays, ensuring consistency with established fiscal expectations. Within this framework, we adopt a cautious and neutral set of assumptions regarding fiscal policy, the external sector, asset markets, and monetary policy.

On the fiscal side, we maintain a constant outlook for government expenditure, reflecting offsetting trends: on the one hand, a reduction in government consumption, particularly linked to the downsizing of the federal workforce; on the other, an increase in federal investment, both in defense and in nondefense infrastructure. The net effect is a broadly stable expenditure path.

The current set of tariffs are assumed to remain in place at historically high levels, as we pointed out elsewhere (Papadimitriou et al. 2025b). Thus, we allow for an implicit adjustment: in 2025 and into 2026, private demand components (especially investment and durable consumption) face a modest headwind. This acts as a dampening factor within the model's dynamics, tempering what would otherwise be more exuberant growth, given the strength of domestic demand. According to Ahir et al. (2025), a surge in uncertainty in 2025 is likely to slow growth by weakening investment, hiring, and durable goods consumption—effects that tend to materialize over a horizon of 6 to 18 months.

External conditions play a critical role in shaping the near-term outlook. As mentioned at the beginning of this report, recent data reveal substantial volatility in imports and inventories during the first half of 2025: imports rose sharply relative to GDP in the first quarter and then fell abruptly in the second, while inventories displayed a similar pattern of buildup followed by drawdown. To address this, we have modified our assumptions to treat the change in inventories separately. At the same time, the baseline assumes that the recent underestimation of imports will persist into the coming quarters. This aligns the model more realistically with recent data.

Asset markets are treated conservatively. Housing prices are assumed to remain broadly stable, while equity prices grow modestly in line with underlying fundamentals. Finally, monetary policy is assumed to follow a modest easing and then return to steadiness in line with longer-run objectives.

Table 2 presents the growth rates of major aggregate demand components in real terms over the 2025–27 period. In 2025, private spending expands significantly—over 3 percentage points to growth—far outweighing the overall expansion of 1.9 percent. Although the growth of public spending declines somewhat over time, to just below 3 points in 2026 and around 2 points in 2027, it remains the important factor contributing to GDP expansion.

Table 2. **United States: Baseline Projections**

Annual Growth Rates	2025	2026	2027
GDP	1.9	1.9	2.4
Private expenditure	3.2	2.8	2.3
Net exports	7.4	–4.3	2.3
Government expenditure	1.6	1.1	1.0
Exports of goods and services	0.8	1.4	2.6
– Non-oil exports	1.1	1.3	2.5
– Oil exports	–2.7	2.4	3.0
Imports of goods and services	8.2	5.6	0.3
– Non-oil imports	16.7	13.2	0.5
– Oil imports	–5.4	2.2	2.3
Percent of GDP			
Total government surplus/deficit	–7.7	–7.7	–7.7
Trade balance	–3.8	–4.0	–3.4
Current account balance	–5.0	–5.2	–4.3

Source: Authors' calculations

The external sector moves in the opposite direction, acting as a major drag in the near term before gradually turning more neutral. In 2025, imports increase sharply, growing more than 8 points. Even though exports increase slightly that year, the growth in net exports is strongly negative by more than 7 points. The imbalance narrows somewhat in 2026 as import growth eases and exports strengthen modestly, though the net increase remains negative. By 2027, the external position shifts, with import growth nearly flat and exports providing a stronger boost, allowing net exports to contribute positively for the first time in the horizon.

Our simulation produces results that align broadly with the CBO's projections for the medium run, but diverge more clearly for this year. As shown in Table 2, our estimate for growth in 2025 is stronger than the more conservative figure presented in the September Budget and Economic Outlook. This difference reflects the structure of our model, which follows the New Cambridge tradition (Cripps and Godley 1976; Godley 1997) and places aggregate demand at the center of the analysis. The resilience of demand components during the first two quarters of 2025, as discussed above, is particularly important in driving this divergence.

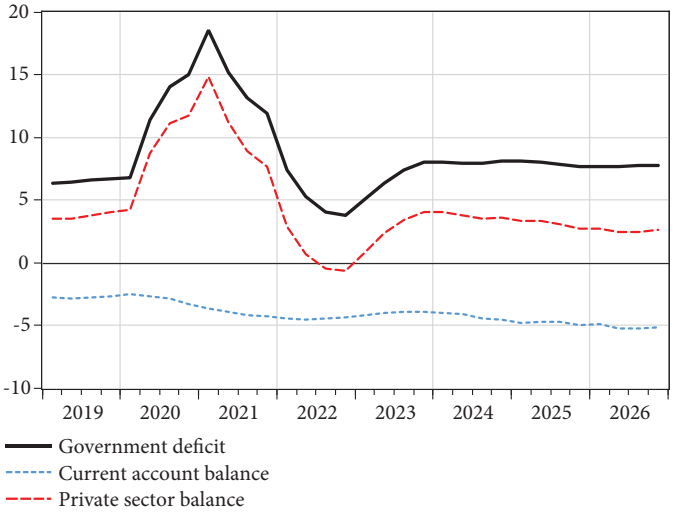
Taken together, domestic demand led by private expenditure remains a steady source of expansion across the forecast period, as the external sector introduces significant drag before moving into better balance. The contrast between the strong support from household and business spending and the deterioration in the trade balance is a central feature of our simulation, shaping the overall growth profile for 2025 through 2027. The financial balances of the three institutional sectors are presented in Figure 15, illustrating their actual paths to-date and the stability of the public sector deficit with private and external sector increases/decreases in the simulated period.

Table 3. Alternative Scenario: Infrastructure Spending

Annual Growth Rates	2025	2026	2027
GDP	1.9	3.3	4.9
Private expenditure	3.2	3.0	3.3
Net exports	–7.4	–4.7	0.3
Government expenditure	1.6	1.1	1.0
Exports of goods and services	0.8	1.4	2.6
– Non-oil exports	1.1	1.3	2.5
– Oil exports	–2.7	2.4	3.0
Imports of goods and services	8.2	6.0	2.2
– Non-oil imports	16.7	14.1	4.4
– Oil imports	–5.4	2.4	3.2
Percent of GDP			
Total government surplus/deficit	–7.7	–8.5	–9.5
Trade balance	–3.8	–4.0	–3.6
Current account balance	–5.0	–5.1	–4.7

Source: Authors' calculations

Figure 15. Financial Balances, Baseline (percent of GDP)



Source: BEA

An Alternative Scenario: Higher Expenditure in Infrastructure

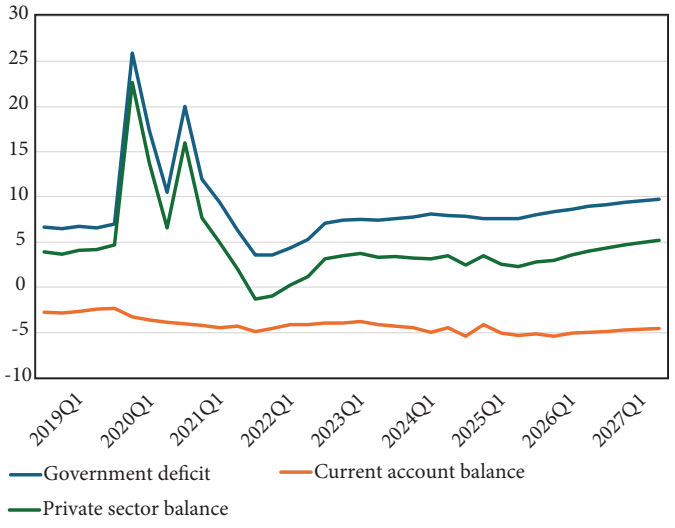
Table 3 presents the results of our first policy experiment, in which government raises infrastructure expenditure steadily beginning in the first quarter of 2026, while Figure 16 illustrates the alternative trajectories of the three macroeconomic sectoral financial balances.

In Figure 17, we estimate the stock of government structures. As the figure shows, the stock is at an historical low, and the gap with the previous peak in 2010 is more than 4 percent of GDP, serving as our reference for the size of the policy intervention.

Compared with the baseline, this scenario produces a noticeably stronger growth profile over the projection horizon. Real GDP growth accelerates to 3.3 percent in 2026, and then rises to 4.9 percent in 2027, a marked improvement relative to the baseline trajectory.

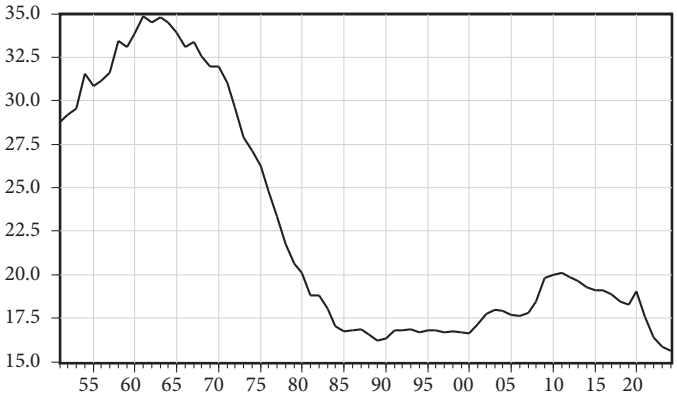
The most visible difference from the baseline is the stronger and more sustained contribution of domestic demand. Private expenditure rises steadily across the period (from 2.8

Figure 16. Financial Balances, Baseline (percent of GDP)



Source: BEA, Own Estimates

Figure 17. US Government Structures (percent of GDP)



Source: BEA

to 3.0 percentage points in 2026, and from 2.3 to 3.3 in 2027), reflecting both a direct stimulus from higher public investment and the indirect crowding-in effects on business spending. Government expenditure follows a steadily rising path in this scenario; while this does not add directly to growth rates, the higher level of spending exerts a broader impact on the economy, reinforcing private demand and supporting overall activity.

The external sector continues to weigh on growth as imports expand in 2026. However, the negative contribution of net exports gradually diminishes: from –7.4 points in 2025 to almost neutral by 2027. This pattern is broadly consistent with the baseline but occurs against a stronger domestic demand backdrop, leaving overall GDP growth higher each year.

The rationale for this experiment is grounded in the widely acknowledged US infrastructure gap. According to the 2025 Report Card for America's Infrastructure (ASCE 2025), investment needs over the next decade total $9.1 trillion, while current public and private commitments amount to $5.4 trillion, leaving a shortfall of $3.7 trillion. Addressing even a fraction of this gap could yield significant macroeconomic dividends by boosting demand in the near term while expanding productive capacity over time. This illustrates how sustained infrastructure investment could lift the growth trajectory above the baseline by reinforcing private expenditure.

Conclusions

In this report, we review, analyze, and discuss the current economic and financial conditions of the US economy, including primary sector behavior: households, non-financial institutions, and government. We consider the fiscal and trade policy stances with the continuing tight monetary policy highly inappropriate. We also note the disappointing results of this year's growth moderation thus far, as compared to the previous year (2024), the softening conditions in demand and employment, and declining consumer confidence. The Trump administration's on-and-off strict tariffs have begun to show in the prices of goods, and businesses' expectations indicate the effects may become severe, affecting inflation, employment, and economic activity. Some businesses absorbed the additional tax burden, but in light of profit margin deterioration, their earlier stance to keep prices stable is being reversed and tariffs are being passed to consumers. The financial market, however, seems to think differently. As was pointed out, however, many equity analysts and Fed official voices have been warning of the over-valuation of equities.

The forecasts of many organizations mentioned above, including our own projections for the next two years, show that the insistence on trade protection policies will neither revive the long-lost manufacturing sector nor bring jobs lost back to the US. Our own projections of the baseline scenario show a small improvement in both the trade and current account

balances in 2027 with no assurance of sustainability without deterioration of economic growth prospects.

The state of the US economy is reminiscent of previous times. The recent tax cuts proposed by President Trump and passed by Congress will not alone give a significant boost to the US economy, because the main structural problems of the US economy persist as government tightens expenditures, risking serious contraction. Moreover, tax cuts directed at the upper end of the income distribution ladder will worsen the ever-increasing income maldistribution.

On the other hand, the alternative scenario projections derived from our SFC macroeconomic model show the lifting of growth if an increase in the government deficit is invested in a large public physical and social infrastructure plan, including AI training. Such a plan would restore and improve quality of life, increase aggregate demand, and lead to more productivity gains, causing permanent growth effects and making the US economy more competitive.

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