

# 2026 *SPRING* ECONOMIC FORECAST

WOODS CENTER FOR ECONOMIC ANALYSIS AND FORECASTING



**CSUF**

COLLEGE OF  
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and Economics



**2026 / SPRING**  
**ECONOMIC FORECAST**  
 WOODS CENTER FOR ECONOMIC ANALYSIS AND FORECASTING

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# EVERYTHING EVERYWHERE ALL AT ONCE: AMERICA AT 250: PROSPECTS FOR PROSPERITY IN A RISKIER WORLD

## The Nation, Southern California, and Orange County

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## A SONG OF ICE AND FIRE

**“They danced through the day and into the night  
Through the snow that swept through the halls,  
From winter to summer then winter again,  
‘Til the walls did crumble and fall.”**

– *Jenny of Oldstones, Game of Thrones*

### Overview

**“What do we say to the God of death?”**

**“Not today.”**

– *Game of Thrones*

Precisely a decade and a half ago this month – April 2011 – dragon eggs cracked, direwolf pups were found in the snow, white ravens took flight, and beyond an ancient wall that had stood for 8,000 years, something ominous stirred in the darkness. Thus, was born the world of Westeros and beyond – the sprawling universe of *Game of Thrones*: the sweeping, haunting saga that has enthralled audiences and captivated critics ever since. A world of eerie, ice-locked silences beyond the Wall; brooding northern keeps rising from frozen mist; the teeming, golden filth of King's Landing; sun-scorched Dornish sands and the lush, golden fields of the Reach; storm-wracked Dragonstone and scorched Harrenhal; the jeweled spice markets of Qarth and the grassy seas of Vaes Dothrak. It tells harrowing, unforgiving tales of power and corruption ("*Power is power*"), of love and betrayal ("*The things I do for love*"), of redemption and revenge ("*The North remembers*"), of honor and sacrifice ("*I grew up with soldiers; I learned how to die a long time ago*"), of wisdom and knowledge ("*A mind needs books like a sword needs a whetstone*") – where the most deserving are not always triumphant, the most moral often perish, and the cunning and ruthless sometimes prevail. Yet though happy endings are not its fare, the finale was nothing short of a wistful, bittersweet symphony: a realm ruled by a broken boy who never sought the throne, guided by a small council shaped by honor, wisdom, and even a lovable rogue; a Northern Queen forged by hardship and fire; a girl who ended the Long Night sailing toward distant, unknown horizons; and a man of unyielding honor walking beyond the Wall into the white silence – free at last in the only wilderness vast enough to match his goodness. A world of ice and fire, finally settling into fragile peace, emerging from its struggles scarred and battered, and yet improbably – and perhaps fittingly – beautifully alive.

The world of Westeros has never felt more alive than it does in 2026. A high-stakes *Game of Thrones* is afoot, as America redraws the rules and rejiggers a world order it no longer deems working in its favor, seeking to preserve its global dominance and hold on to the unipolar moment — its grip on the Iron Throne — that briefly flourished between the fall of the Soviet Union and the slow, grinding aftermath of the Global Financial Crisis. The message increasingly seems to be that the liberal international order America built after World War II — grounded in free trade, open markets, and the unfettered flow of goods and capital — has hollowed out its industrial base, forced it into persistent and widening trade deficits, exposed supply chains to geopolitical risk, and placed critical strategic capabilities in the hands of rivals. It now frets that the very system that once underpinned American strength has, over time, diluted it — much like chaining its dragons until they shrank to the size of house cats foreshadowed the fall of House Targaryen. It also worries that the emerging post-unipolar world is neither bipolar nor multipolar, but something messier, more unstable, and in many ways more dangerous: a world of a dominant power and a serious challenger in China, surrounded by a cast of regional players — a nuclear-armed Russia; a Europe of formidable economic weight and striking strategic weakness; an India navigating deftly between poles; and a Global South increasingly unwilling to choose sides.

Thus, the United States is deploying an expanding arsenal of economic tools — tariffs, sanctions, export controls, and financial instruments — alongside military and political power, in what amounts to a broader strategy of economic statecraft aimed at addressing what it sees as longstanding and lopsided imbalances. Tariffs, in particular, were the dragonfire of last year — blanketing the globe and wielded strategically against friends and foes alike — aimed at extracting investment pledges, prying open long-shuttered markets, lowering barriers for U.S. firms while raising them for foreign competitors, securing energy commitments, and encouraging the relocation of critical supply chains closer to American shores. Winning the AI race and maintaining technological supremacy has emerged as another central objective, with semiconductors, artificial intelligence, quantum computing, and critical minerals increasingly viewed — in the words of the Night's Watch oath — as “the shield that guards the realms of men.” And control of critical trade and energy chokepoints appears firmly on the agenda for this year, beginning in the Western Hemisphere — Greenland, the Panama Canal, and Venezuela — and stretching across the globe. “I’m not going to stop the wheel; I’m going to break the wheel,”—Daenerys Targaryen’s words may well capture the spirit of an administration intent not merely on managing the existing global order but fundamentally reshaping it.

But perhaps its boldest, riskiest, and most consequential move since World War II is the decision to strike Iran — a military operation now in its seventh week— in a campaign grandly named Operation Epic Fury, which eerily — and somewhat uncomfortably — echoes the words of House Baratheon: “*Ours is the Fury.*” *Ours is the Fury*, indeed — but so is theirs. Iran has managed to transform a conventional kinetic war, which it was losing badly, into an asymmetric, guerrilla-style conflict — one that is far harder to end and even harder to win. It has targeted energy infrastructure across the Gulf states, closed shipping lanes, struck civilian sites, and strangled one of the most vital chokepoints of global energy: the Strait of Hormuz. This is the stuff of nightmares — old tales of White Walkers stirring beyond the Wall, of summer’s end, and of the Long Night slowly descending.

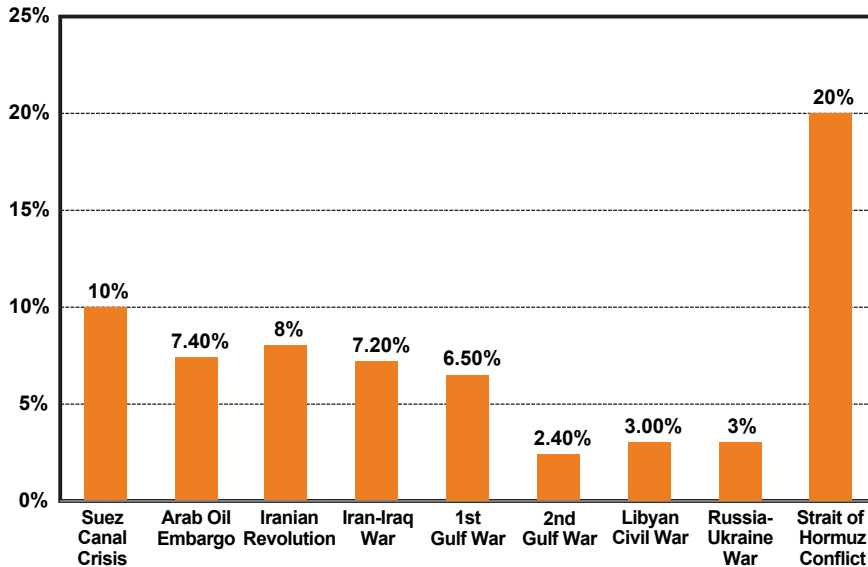
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The blockade of the Strait has sent chills across the global economy. In terms of sheer energy disruption, it represents the largest oil supply shock in modern history — stranding nearly 20 million barrels per day of oil and petroleum products in the narrow waterways of the Persian Gulf (Figure 1). That is roughly twice the scale of the oil shocks of the 1970s and the disruption during the First Gulf War, and nearly three times larger than the combined supply losses from the Iraq War, the Libyan civil war, and the Russia–Ukraine conflict.

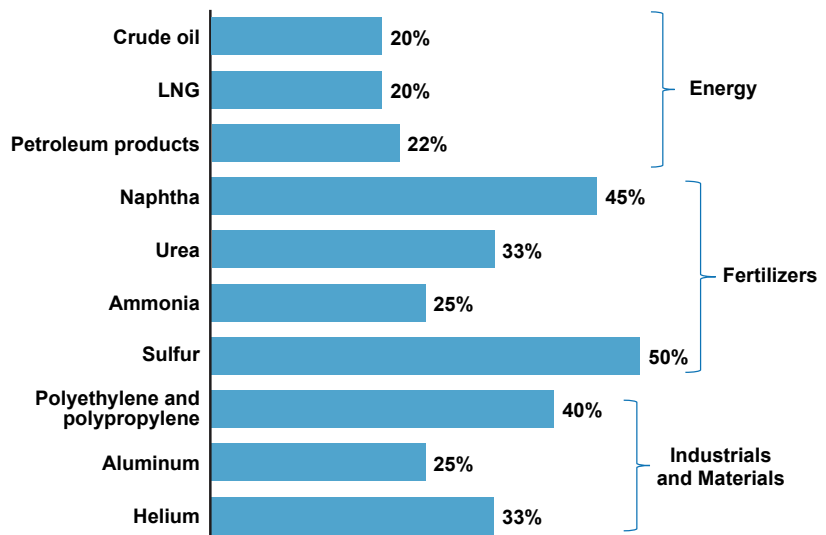
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**FIGURE 1**  
**A Historical Shock: World Oil Disruption**  
**(percent of world oil supply)**



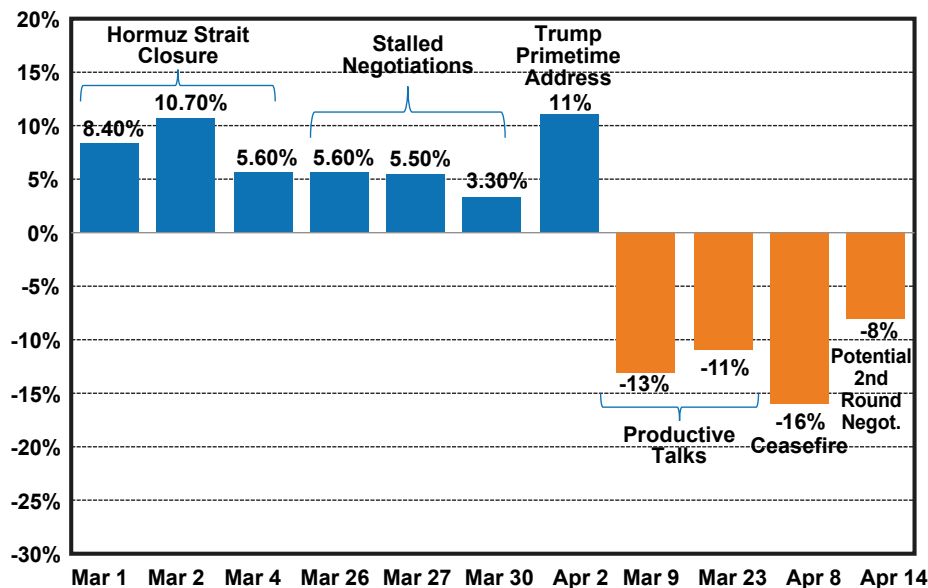
It isn't just oil. An additional 5 to 6 million barrels of oil equivalent in liquefied natural gas — representing 20% of global LNG trade, almost entirely from Qatar and the United Arab Emirates — passes daily through the narrow strait. So does 22% of global petroleum product exports, including jet fuel and diesel. Roughly a third of globally traded urea, a quarter of ammonia, and half of all globally traded sulfur — the building blocks of the fertilizers that feed the world (Figure 2). Nearly 45% of globally seaborne naphtha flows and 40% of globally traded polyethylene and polypropylene — the raw materials of the plastics that package, pipe, and protect nearly everything we produce. A quarter of the world's aluminum. And one third of the world's helium — from Qatar alone — the irreplaceable coolant for the superconducting magnets that power semiconductor manufacturing. If it's any consolation, the supply of alcohol appears safe — at least we can still drown our sorrows properly. After all, as Tyrion Lannister reminds us, "Everything is better with some wine in the belly."

**FIGURE 2**  
**Hormuz Strait: An Important Chokepoint Not Just for Energy**  
**(percent of global supply)**



Not surprisingly, the oil market has been on a wild, drunken-like ride — swinging violently with every tweet and Truth Social post, driven by headlines and haunted by rumors. As of this writing, The West Texas Intermediate (WTI) is up 66% since Feb. 28, when the strikes first began, and nearly double the price at the start of the year. It has risen or fallen by double digits in a single day on no fewer than four separate occasions: surging on March 9, when Israeli strikes hit Iranian oil depots, and again on April 2, when President Donald Trump's prime-time address to the nation dashed hopes of imminent de-escalation; and crashing on March 10 and March 23, when Mr. Trump first declared the war would be "over very soon" and then postponed strikes on Iranian energy infrastructure (Figure 3).

**FIGURE 3**  
**On a Whim and a Tweet: Daily Oil Price Changes and the Shifting Tides of War**  
**(Brent oil price, percent change)**



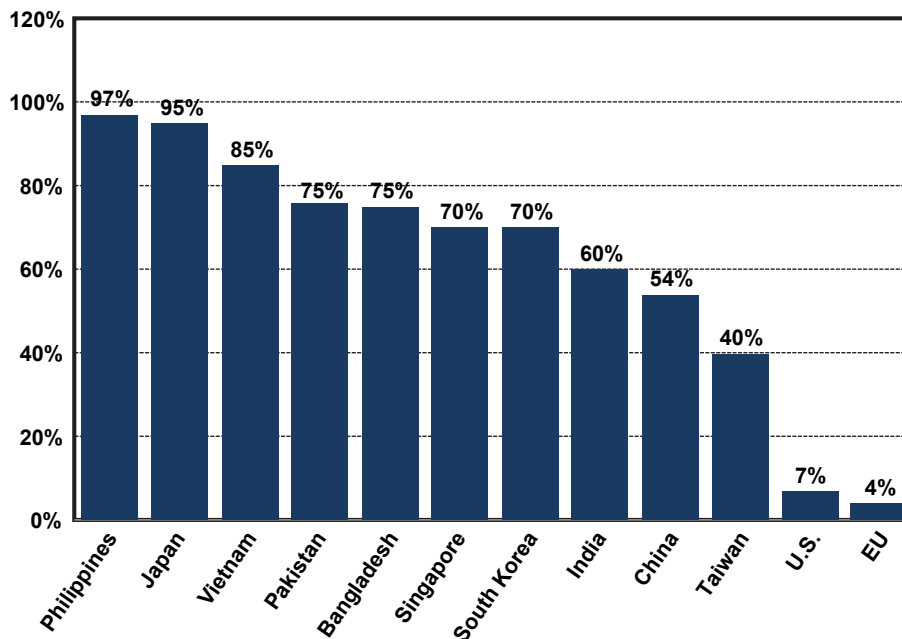
Mr. Trump's pronouncements on the war have been even more confounding than his usual standard fare. At times, he has described the conflict as "a little excursion" or a "short-term stay," while simultaneously declaring that the "war is essentially over," that it is "very complete," that "we've won," and that "we're roaming free" — even as he promises to "finish the job." In the same prime-time address to the nation, he vowed to "hit them extremely hard over the next two to three weeks...bring them back to the Stone Age," while also insisting that "discussions are ongoing." At other times, he has claimed that "Iran is begging for a deal," only to add, in the very next breath, that "Iran does not have to make a deal." Some of the rhetoric has been particularly vivid. The latest warning that "all Hell will rain down on them" bears an eerie resemblance to *Rains of Castamere* — a blood-curdling ballad recounting the ruthless extinction of a rebellious house by the Lannisters after an ill-timed revolt: "And now the rains weep o'er its halls, with no one there to hear."

Perhaps this is strategic ambiguity — Mr. Trump's version of controlled chaos. After all, as *Game of Thrones* reminds us, "Chaos isn't a pit. Chaos is a ladder." Or perhaps these improvisations reflect the shifting tides of a fluid and unpredictable conflict. Either way, the damage to the global economy is real — and likely to snowball the longer this drags on. On a much smaller scale, but no less relevant for this report, the shifting moods and contradictory pronouncements also make divining the fate of the U.S. economy — a Herculean effort even in good times — particularly tricky. We therefore ask you to spare a thought — and perhaps a generous glass of Dornish wine — for your humble economists grappling with formidable "unknown unknowns," as a U.S. Defense Secretary once put it in a different time, about a different war, though under circumstances not altogether dissimilar.

And the pain is far from evenly distributed, with Asia bearing the brunt of the disruption — overwhelmingly, and in some cases, existentially. Japan sources roughly 95% of its crude oil imports and 11% of its LNG from the Middle East; South Korea, about 70% of its crude and 35% of its LNG; India, roughly 60% of crude and 40–53% of LNG (Figure 4). Taiwan draws about a third of its LNG from Qatar alone, while Singapore sources roughly 70% of its crude and a staggering 90% of its LNG from Qatar and the UAE. Pakistan and Bangladesh import 70–80% of their crude and 60–72% of their LNG from the Gulf. Vietnam sources roughly 85% of its crude imports from the Middle East, while the Philippines imports 95–98% of its petroleum needs from the region. China — the world’s largest crude importer — sources roughly 54% of its seaborne crude and 27% of its LNG from the Middle East. Europe fares considerably better — only about 4% of its crude and 7% of its LNG transit Hormuz — though, having replaced Russian diesel with Middle Eastern supplies after 2022, it now finds that lifeline increasingly vulnerable. The United States, however, remains the most insulated. A net energy exporter since 2020, it sources a mere 7% of its crude imports from the Gulf and none of its LNG, leaving it far less exposed than much of the rest of the world.

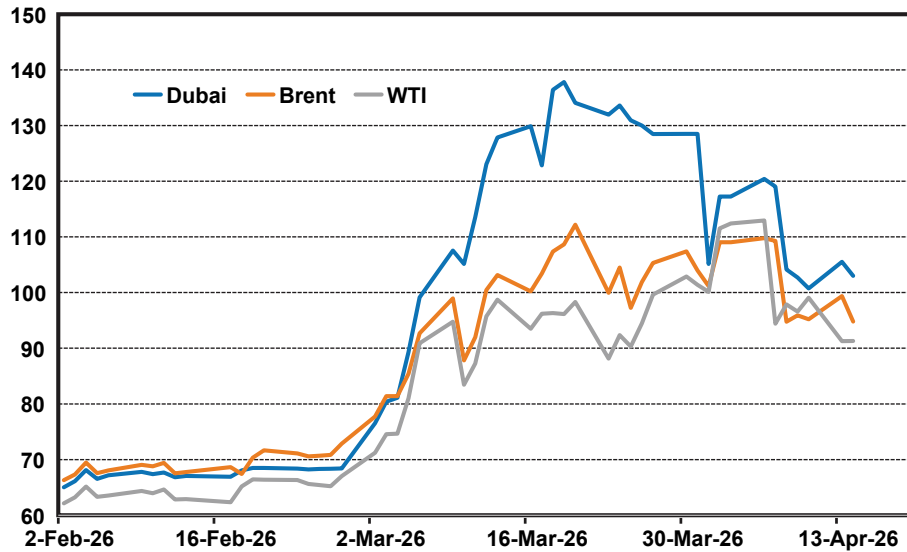
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**FIGURE 4**  
**The Pain is Not Evenly Distributed: Asia Much More Dependent on the Strait**  
**(oil imports, percent of total)**



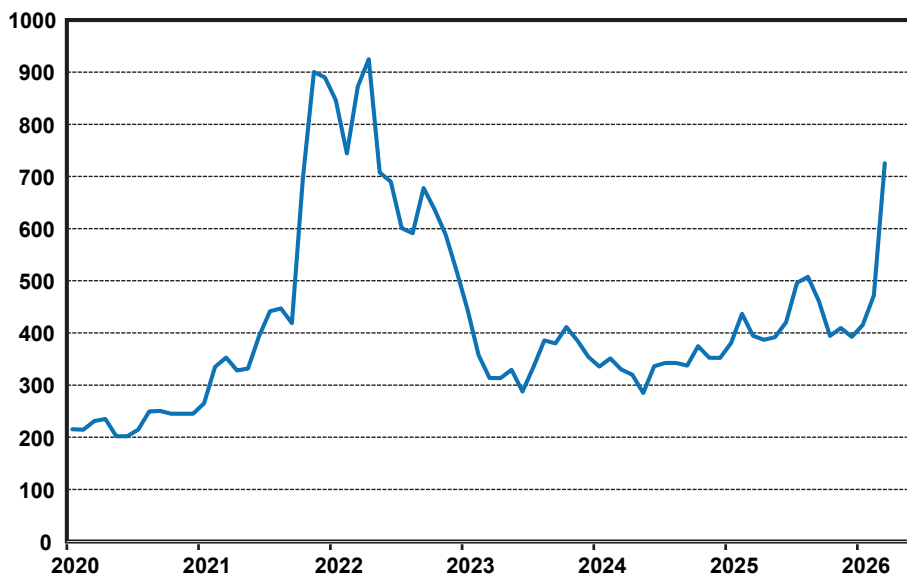
Throughout the six weeks of hostilities, oil prices have reflected, almost mechanically, the geography of pain. WTI — the landlocked American benchmark priced at Cushing, Oklahoma — traded at an average discount of roughly \$10 per barrel to Brent, the global seaborne benchmark. But both have been dwarfed by dramatic surges in Dubai (or Omani) crude — the physical benchmark used to price the roughly 20 million barrels per day destined for Asian refineries from the Gulf — which, at its peak on March 19, touched \$137 per barrel (Figure 5). The yawning gap captures the gulf between sentiment and physical scarcity: Brent reflects what traders think the next post on Truth Social might bring; Dubai reflects what Asian refineries must pay to secure a barrel of oil today. Of course, such a divergence cannot persist indefinitely. Indeed, as of mid-April, all contracts have edged lower as a fragile ceasefire continues to hold and hopes remain for a negotiated end to the conflict. Fertilizer prices have also surged. Urea is up roughly 50%, climbing from \$482 per ton to around \$700 since

**FIGURE 5**  
**Oil Prices Reflect Geographical Pain**  
 (dollars per barrel)



the start of the conflict, while ammonia prices have jumped by about 24% (Figure 6). Sulfuric acid — a critical input used to convert phosphate rock into DAP and other phosphate fertilizers — has risen roughly 30%, further tightening an already strained phosphate market. Potash prices, by contrast, have remained largely unchanged, rising only about 2%, reflecting their sourcing from regions outside the Gulf — primarily Russia, Canada, and Belarus. Mercifully, fertilizer prices remain well below the peaks reached during the Russia–Ukraine war of 2022, when urea touched \$1,050 per ton, DAP hit \$1,132, and anhydrous ammonia surged above \$1,600. The key difference lies in the nature of the shock. Then, supply itself was disrupted, pushing prices sharply higher. Now, the supply largely exists — it simply cannot move. This is a chokepoint disruption rather than a production shortfall. This distinction matters: should the Strait reopen, prices are likely to normalize relatively quickly.

**FIGURE 6**  
**Fertilizer Prices on the March**  
 (urea prices, dollars per metric ton)



Asia is also, by far, the most exposed to fertilizer disruptions from the Strait blockade. India, the world's largest urea importer, sources roughly 80% of its urea, 61% of its ammonia, and 60% of its phosphate fertilizer imports from the Gulf. With all 32 of its ammonia-urea plants gas-based and LNG feedstock disrupted, the country has already lost an estimated 800,000 tons of monthly urea production — just as the monsoon planting season approaches. Pakistan and Bangladesh, both heavily dependent on Qatari LNG for fertilizer feedstock, have seen plants shut down entirely. Australia, which sources more than 60% of its urea from the Middle East, expects current stocks to run out by mid-April, with few viable alternatives at manageable logistics costs. Brazil, the world's largest fertilizer importer, sources roughly half its urea from the region and faces a 30% gap in phosphate supply, threatening soybean and corn harvests. Even the United States is not entirely immune: it sources about 13% of its overall fertilizer supply from the Middle East, including roughly 35% and 40% of its urea and phosphate imports, respectively — just as spring planting reaches peak demand.

Some countries have taken even more radical steps to cope with energy supply disruptions. In the Philippines, government offices have moved to a four-day workweek. In Thailand and Vietnam, officials have been encouraged to work from home and limit travel; Myanmar has imposed alternating driving days; and Bangladesh and Pakistan have closed universities and moved instruction online. South Korea has gone further still, urging citizens to “save every drop of fuel,” imposing a license plate–based rotation system to restrict public-sector vehicle traffic and encouraging households to take shorter showers. As *Game of Thrones* reminds us, “The common people pray for rain, health, and a summer that never ends. They don't care what games the high lords play.” In 2026, that list may also include praying for normal shower times.

The concern is that the current supply shock is layered on top of an already existing one: the tariff wall erected last year. In fact, supply shocks have come to define the past few years. Unlike the past decade — characterized largely by persistent demand shortfalls in the wake of the Global Financial Crisis — the current one, emerging in the aftermath of COVID, is shaping up to be an endless parade of supply shocks. First came the pandemic in 2020, followed by the gnarling of global supply chains in 2021. Then, in 2022, the Russia–Ukraine war. In 2023–2024 came the Houthis disruptions in the Red Sea and a historic drought that constricted traffic through the Panama Canal. Last year ushered in tariffs — a cold war of sorts, primarily between the United States and China, but also between America and much of the rest of the world. And now, a hot war with Iran.

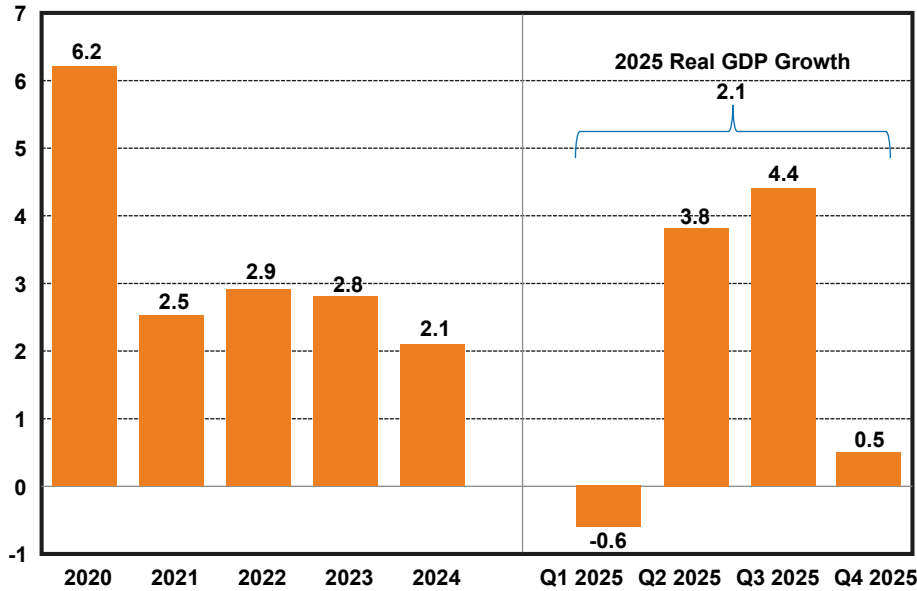
You would be forgiven for thinking that these formidable blows would spell doom for the U.S. and global economy. Yet, somewhat miraculously, that has not been the case. U.S. real GDP grew at a robust average of 2.7% between 2022 and 2024, following a blockbuster 6.2% rebound in the immediate aftermath of COVID in 2021 (Figure 7). Despite all the handwringing, growth last year also came in at a respectable 2.1%. It would likely have been considerably higher were it not for two unusual quarters: a 0.6% contraction in the first quarter, driven largely by a surge in imports ahead of impending tariffs, and a weak fourth quarter — just 0.5% — reflecting the government shutdown, which shaved roughly one percentage point off growth, with effects likely amplified by second-order impacts on consumption and private investment. “People have been swinging at me for years; they always seem to miss,” Jaime Lannister once proudly crowed. Many forces have swung at the economy over the past few years; yet, at least for now, it has remained — in the words of House Martell — “*Unbent, Unbowed, Unbroken.*”

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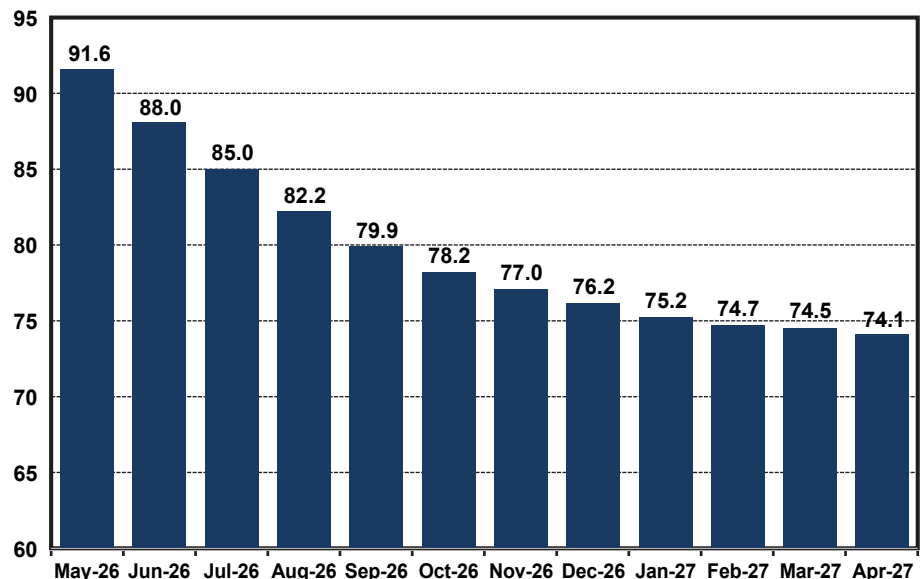
**FIGURE 7**  
**U.S. Growth: Resilient...But Erratic**  
**(real GDP growth, annualized rate)**



The question is whether this resilience will hold. In real estate, the three most precious words are “location, location, location.” In wars, it is “duration, duration, duration.” Should the conflict end soon, the dent to growth and the impending surge in inflation will likely prove a blip — a temporary shock rather than a lasting scar.

The question is whether this resilience will hold. In real estate, the three most precious words are “location, location, location.” In wars, it is “duration, duration, duration.” Should the conflict end soon, the dent to growth and the impending surge in inflation will likely prove a blip — a temporary shock rather than a lasting scar, and, in time, little more than a footnote in history. For now, markets appear to be pricing precisely this outcome. Oil prices are currently trading in extreme backwardation — with near-term prices significantly higher than those for future delivery, signaling expectations that current shortages will ease over time (Figure 8). WTI for May delivery is currently around \$91 per barrel but falls to \$85 for July delivery and \$74 for December. Equity markets, perennially prone to dramatic fits and the occasional case of the vapors, have also taken a relatively sanguine view. The biggest drawdown due to the war for the S&P500 was 9%; for the Dow and NASDAQ it was 10% and 12.8%, respectively, from all-time highs in January. All these are modest and, most importantly, orderly downdrafts, especially compared with the sharp “Liberation Day” collapse a year ago. Most importantly, the S&P500 and the NASDAQ have reversed these losses as of this writing (mid-April), setting fresh new highs. Treasury markets have been somewhat less forgiving: the 10-year yield has risen by about 45 basis points since the conflict began, largely on inflation concerns. But even here, the mood appears to be one of extreme caution rather than outright panic.

**FIGURE 8**  
**Crude Oil Futures Are Pricing A Relatively Quick Resolution to the Conflict**  
**(dollars per barrel)**

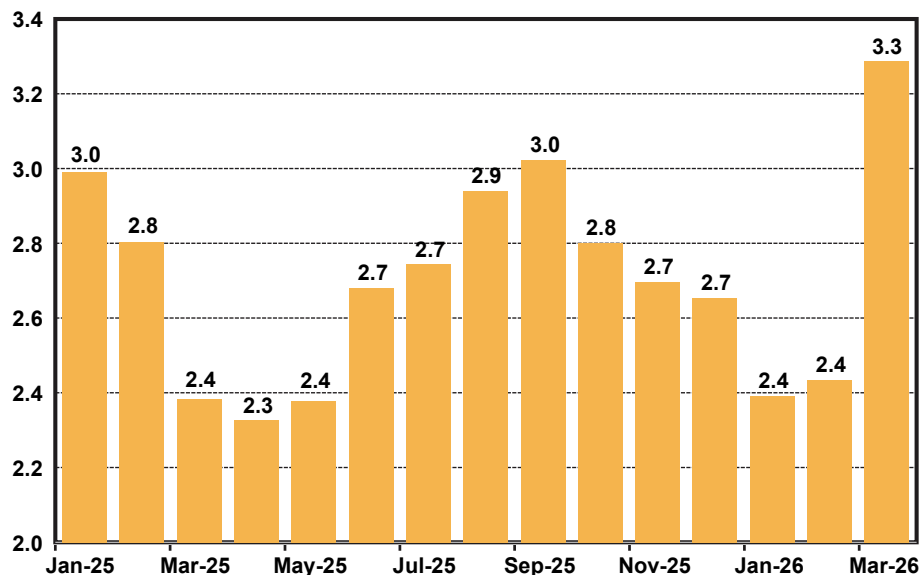


This has brought on its own set of concerns. A new consensus view is emerging — complete with its own army of financial analysts, the Watchers on the Wall — fretting that markets may be underestimating or miscalculating risks. Market complacency, it seems, is the word *du jour*. Wars, this thinking goes, have an inherently unpredictable quality. And risks rise exponentially when the range of outcomes is not only wide, but when several of them appear to be unfolding simultaneously — a multiverse of possibilities, if you will, reminiscent of *Everything Everywhere All at Once* — the award-winning film and the title and inspiration of this forecast. Indeed, three seemingly mutually exclusive paths now appear to be playing out all at once: the war could end quickly; it could escalate further — potentially drawing in ground forces; or it could devolve into a prolonged quagmire, with neither a resolution nor a decisive knockout. “Night gathers, and now my watch begins” — aptly encapsulate this more cautious way of thinking, which tends to focus on the myriad things that could go wrong in a hot war unfolding against the backdrop of an already fragile economy.

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And fragility abounds. The first-order effect of the Iran War will, unquestionably, be on inflation. As we expected, the much-dreaded tariff-induced price-level shock never fully materialized last year, in part because firms absorbed some of the cost increases rather than passing them on to consumers, and in part because price hikes were rolled out gradually rather than in one fell swoop. Indeed, CPI inflation rose to a high of 3% in September of last year, from around 2.4% prior to tariffs, but had settled back to roughly that same level by February of this year, just before the war (Figure 9). Core CPI — which strips out volatile food and energy prices — was running at a 2.5% annual pace as of February, the lowest in over five years.

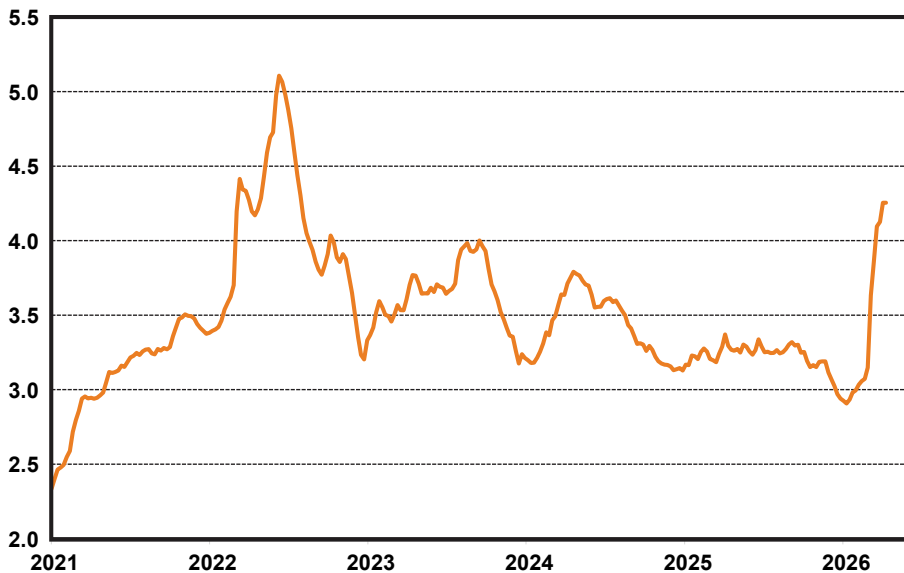
**FIGURE 9**  
**Inflation is Heating Up...Again**  
**(CPI index, y-o-y percent change)**



Prices of durable goods, where most tariffs were expected to land, rose by around 2% year-over-year in August of last year (from outright declines the year prior), but price appreciation has since slowed and is now back to roughly zero. The Harvard Pricing Lab — which tracks daily prices on roughly 350,000 products across five major retailers — paints a similar picture: tariffs raised prices only modestly at the margin, by about 3.8% for imported goods and roughly 3.2% for domestic items relative to a pre-tariff baseline — higher, to be sure, but far from a calamity.

All this is about to change if the conflict with Iran is not settled soon. Even prior to the war, inflationary pressures were quietly building. Headline PPI came in at 3.3% year-over-year in February — a full half-percentage point higher than the prior month and the hottest reading since Mr. Trump took office in January 2025 — driven largely by service prices, including sharply higher portfolio management and securities brokerage fees. But none of these figures yet reflect the inflationary cost of the war, which is now firmly embedded in gasoline prices. The national average has surged from \$2.97 per gallon before the conflict to roughly \$4.12 today — a \$1.15 increase in a matter of weeks (Figure 10). In California, where prices are perennially, and often heartbreakingly, higher, the pump now reads \$5.87, up from about \$4.50 before the war began. The only consolation is that these figures remain, for now, below the peaks of spring 2022, when Russia's invasion of Ukraine pushed the national average above \$5 and California prices briefly touched \$6. But it is not difficult to envision darker scenarios in which those levels are breached once again. And unlike tariffs — where price increases tend to arrive gradually, in dribs and drabs — energy shocks land quickly, unapologetically, and dramatically in headline inflation.

**FIGURE 10**  
**Gas Prices Have Skyrocketed...Though Still Below 2022 Levels**  
**(gas prices, national average, dollars per gallon)**



The inflation shock could not have come at a worse time. Real disposable income growth has slowed steadily in recent years — from an average pace of around 5.7% in 2023, to nearly 3% in 2024, and to just 1.7% in 2025 — with much of last year's weakness reflecting softening labor market conditions. A renewed bout of inflation will further weigh on consumers' spending power, as balance sheet stress continues to persist. Aggregate auto loan delinquencies have now risen to levels last seen during the Great Recession, while credit card delinquencies are only a hair below those peaks — both trending steadily upward over the past three years. The strain is particularly acute at the lower end of the income distribution. Delinquency rates for subprime credit card borrowers currently stand at around 16% — the highest since the financial crisis, when they peaked at near 23%. Subprime auto loan delinquencies, also hovering around 16%, are even more concerning: they now exceed the levels reached during the financial crisis.

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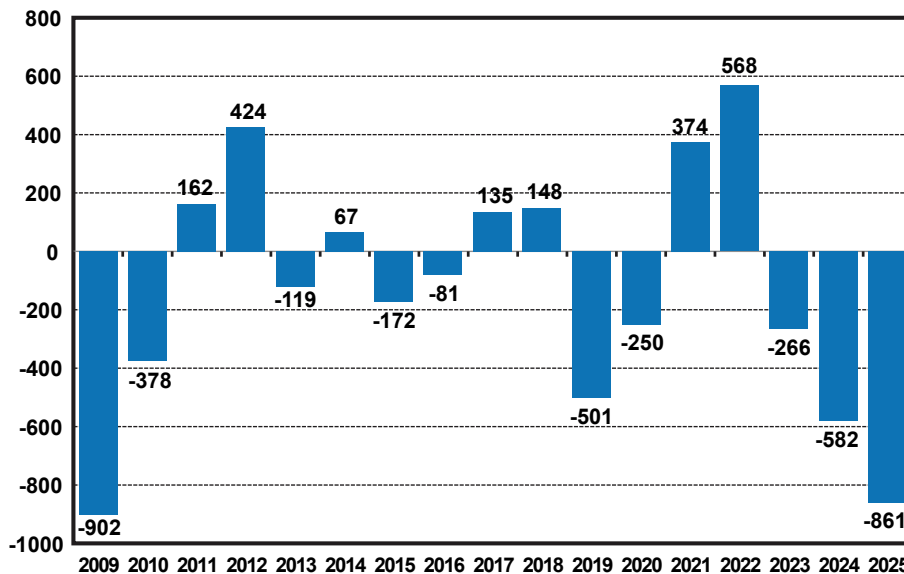
Woes in the labor market seem to compound with every revision from the Department of Labor — what was once a simple, pedestrian routine update has, of late, become a much-dreaded event. Over the past few years, revisions have been so outlandishly large and consistently — almost depressingly — to the downside that the Bureau of Labor Statistics (BLS) was forced to scrap its long-standing birth-death model, on which the monthly payroll estimates are based. The model simply buckled under the weight of pandemic-era distortions — waves of business openings and closures, and dramatic swings in immigration. In other words, a system built for gradual, steady, almost predictable changes, collapsed in the face of seismic, once-in-a-generation shifts.

But whatever the reason, the revisions have been bloodcurdling. The annual benchmark — which revises figures from March 2024 to March 2025 — wiped out a staggering 861,000 jobs from the overall employment tally. This was slightly less than the 911,000 preliminary figure announced last summer, but only barely (Figure 11). And once the benchmark shifted to a lower base, the entire payroll trajectory for last year was dragged down with it. In the end, a year expected to go down in history as a fairly lousy one for the job market turned out to be something closer to a near-catastrophe. The U.S. economy went from adding an originally estimated 585,000 jobs — already a pittance, and one of the weakest years outside a recession going back to 2003 — to a lamentable 116,000 jobs. We repeat: 116,000. Twice this pace used to be standard fare for a single month of job growth; now it is total job formation for the entire year. The labor market is, in essence, frozen—as still and icy as the tundra beyond the Wall.

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**FIGURE 11**  
**Endless Labor Market Revisions...to the Downside**  
**(thousands of jobs)**

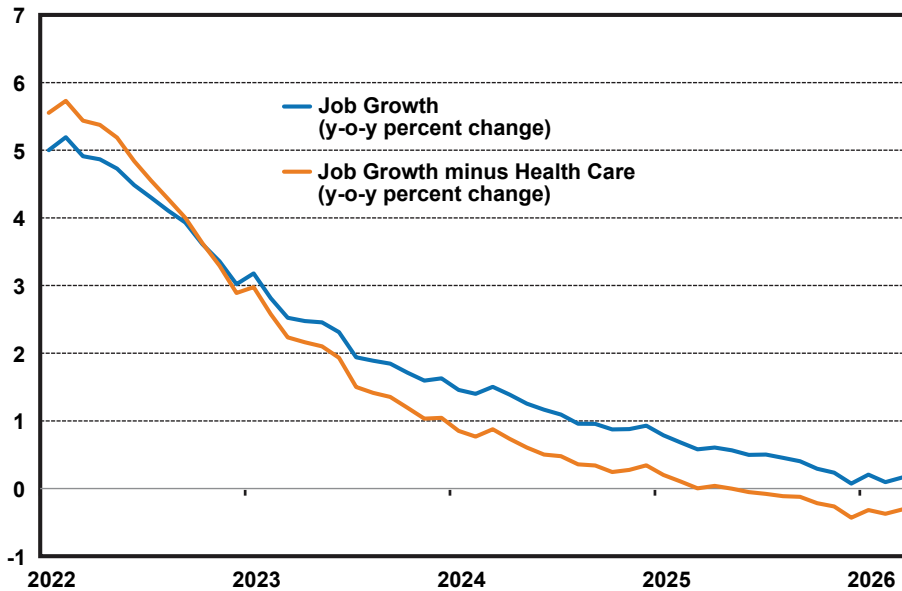


Other labor market indicators are equally disheartening. Job openings, as measured by Bureau of Labor Statistics (BLS) JOLTS data, fell by roughly 600,000 last year compared to the prior year and are now languishing at their lowest levels since the pandemic. The quits rate — a measure of worker confidence — has also declined. Some cooling was expected after the red-hot labor market of the past few years, but what is more concerning is that the quits rate has now fallen below the normal expansionary levels that prevailed before the pandemic. Consumer expectations on labor market prospects are even more dour. Respondents to a survey by the New York Fed now place their odds of finding a new job within the next three months at under 50% — worse even than in the midst of the pandemic.

The overall pace of job formation is running at an annualized rate of just 0.1% — essentially flat. But even that puts a rosy spin on the underlying trends: strip out Health Care and the picture turns considerably darker, with job growth falling to -0.31% (Figure 12). In fact, with the exception of Health Care — which added an astounding nearly 700,000 jobs last year — and Leisure and Hospitality, with roughly 100,000, nearly all other sectors shed jobs. The labor market diffusion index — a measure of how broadly job growth is spread across industries — currently stands at its lowest level since the depths of the pandemic. In other words, industries shedding jobs now outnumber those posting gains — a sign of an alarmingly lopsided labor market, increasingly powered by a handful of service sectors. The realm, it seems, is being held together by healers and innkeepers — and precious little else.

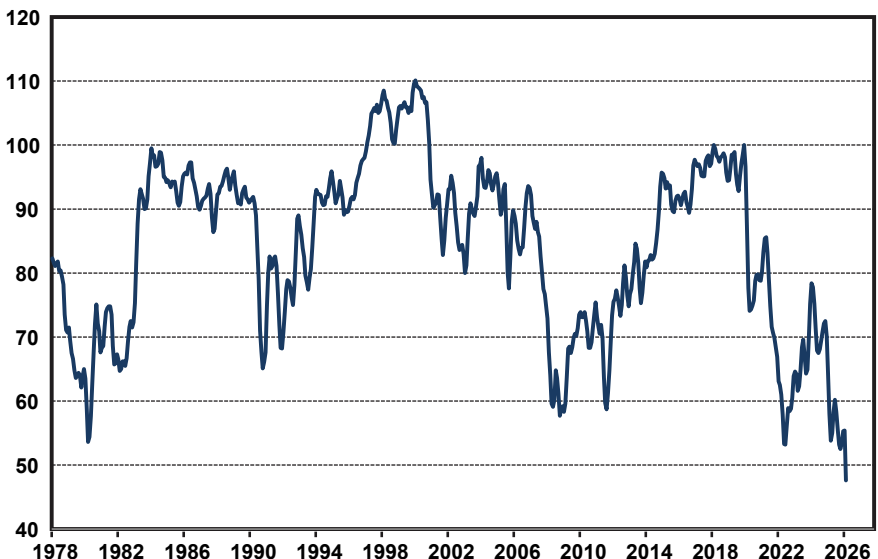
**Industries shedding jobs now outnumber those posting gains — a sign of an alarmingly lopsided labor market, increasingly powered by a handful of service sectors.**

**FIGURE 12**  
**Job Growth Has Stalled...and Would Be Worse if Not for the Health Care Sector**  
**(y-o-y percent change)**



Consumer confidence has shifted from gloomy to outright despondent. After plunging in April 2025 — following Liberation Day — the University of Michigan index lingered at depressed levels for the remainder of the year, only to sink to new depths this April, registering the lowest reading on record going back six decades (Figure 13). This latest shock has had a rare bipartisan effect: sentiment fell across the board in March — among Democrats (already at historically low levels), Republicans, and independents alike. Consumer confidence — as measured by the Conference Board — has fared somewhat better, with the index posting a modest increase in March even as the war raged on. Nonetheless, even here, the six-month trend has been unmistakably downward.

**FIGURE 13**  
**Consumers Have Never Been So Depressed**  
**(Michigan University consumer sentiment index)**



This fragile macroeconomic environment — and already frayed consumer confidence — was under strain from two additional factors even before the war. The first is AI, where sentiment has shifted dramatically: from concerns that a bubble was forming — that AI was overbuilt, oversold, and destined to underdeliver — to fears that it may instead prove so effective, so radical, and so widespread that it would replace large swaths of workers, including, potentially, your humble economists — though we sincerely hope that when that day comes, someone still values a *Game-of-Thrones-* or *Austin-Powers-*themed forecast, best consumed, of course, with a generous glass of Domish wine.

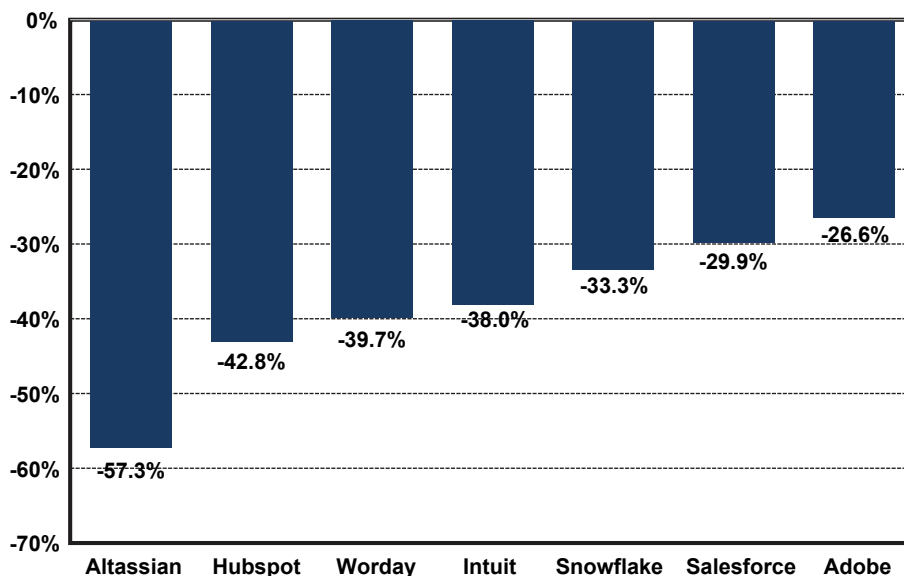
Depending on where one looks, AI is both everything and nothing, simultaneously exciting and terrifying: an existential threat for firms and a rounding error for the broader economy. A thought experiment framed as a June 2028 post-mortem from a little-known Wall Street shop, Citrini Research, circulated in mid-February, speculating that — unlike every other garden-variety recession — an AI-driven downturn could prove particularly severe because there are no natural brakes. Companies shed workers to fund AI investment; AI improves; companies need fewer workers still; displaced white-collar professionals flood the gig economy, compressing wages for everyone below them; consumer spending softens; firms facing margin pressure invest even more in AI to compensate — and the loop begins again.

Cue the panic. “Fear cuts deeper than swords,” *Game of Thrones* reminds us. In the days following the Citrini publication, markets shed a jaw-dropping \$300 billion in valuation, though the jitters had begun earlier with the release of increasingly sophisticated AI tools across a range of sectors — legal services, finance, and product marketing — many offered in open-source form, allowing firms to customize them without paying per-seat licensing fees to SaaS (software-as-a-service) providers. The SaaSocalypse, it seemed, had arrived. Software companies built on SaaS licensing models have taken a beating: Salesforce is down 30% since the start of the year, Snowflake 33.3%, Intuit 38%, and Workday 40%, while the broader IGV software index has fallen 22% year-to-date — its worst stretch since the financial crisis (Figure 14). The beneficiaries, meanwhile, have been the so-called HALO stocks — heavy assets, low obsolescence — including utilities, energy and commodity producers, consumer staples, and the tech firms manufacturing the very hardware on which AI runs.

**Sentiment has shifted dramatically: from concerns that a bubble was forming — that AI was overbuilt, oversold, and destined to underdeliver — to fears that it may instead prove so effective, so radical, and so widespread that it would replace large swaths of workers.**

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**FIGURE 14**  
**SaaSocalypse: Software Companies Are Taking a Beating**  
**(stock prices, year-to-date percent change)**



The second issue is private credit — the shadowy corner of private funding that flourished in the aftermath of the global financial crisis, as tighter bank regulations made it prohibitively costly for banks to underwrite certain business loans they had historically supported. Enter private credit funds. With no deposit base, lighter regulatory capital requirements, and no pressure to mark loans to market daily, they appeared to offer relative safety for regulators while delivering lofty returns to investors — typically 8%–12% in an era of near-zero interest rates. In return, gatekeeping provisions were put in place to prevent runs: only about 5% of a fund’s net asset value could be redeemed in any given quarter.

Over the past two decades, the largest private-equity firms have grown into financial behemoths. Apollo, Blackstone, Carlyle, and KKR now manage roughly \$3.4 trillion in assets, up from about \$800 billion just a decade ago. Their expansion has been particularly aggressive on two fronts. First, they became the lender of choice for mid-market technology and software companies — precisely the firms now facing the greatest disruption from AI. Second, they broadened their investor base beyond traditional institutional clients such as pension funds and endowments, increasingly tapping wealthy retail investors through semi-liquid vehicles like business development companies (BDCs). As a result, retail assets in the sector surged from just \$34 billion in 2021 to \$222 billion by the end of 2025.

Both developments are piling pressure onto a sector already on shaky footing. By late 2025, payment-in-kind (PIK) — the practice of rolling unpaid interest into loan principal rather than collecting it in cash — had surged across private credit portfolios, rising from about 5–6% in 2021 to roughly 13%, a clear sign of mounting stress. Nearly 40% of private credit borrowers were running negative free cash flow by 2025, up from 25% in 2021. And while official default rates remain low at around 2%, estimates suggest the true figure may be closer to at least double that — potentially around 5%. Layer in mounting software-sector disruption and more jittery retail investors, and a perfect storm begins to take shape. Indeed, this is precisely what unfolded earlier this year: heavy exposure to tech loans pushed Blackstone’s BCRED fund to post a rare 0.4% monthly loss — its first negative performance in more than three years — driven by mark-to-market declines in technology-related holdings.

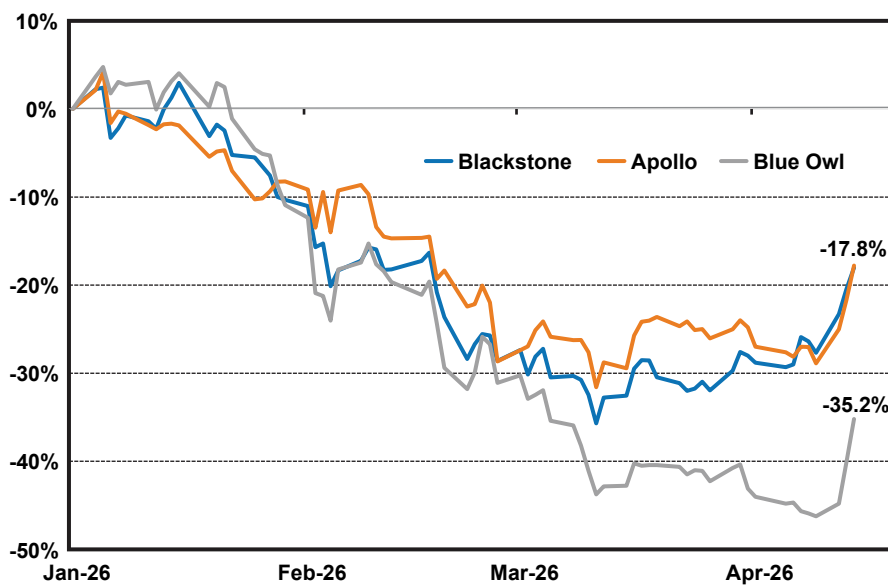
That proved enough to spark a stampede, particularly among retail investors, who tend to spook far more quickly under stress than institutional investors with longer horizons. Ares, Apollo, and BlackRock each received redemption requests of 11.6%, 11.2%, and 9.3%, respectively — well above the typical 5% quarterly cap designed to prevent precisely this kind of run. Blue Owl — a tech-focused lender that has grown from \$50 billion in assets in 2021 to more than \$300 billion today — allowed more than 15% of shares in one of its funds to be redeemed in January in hopes of stopping the bleeding. It did not. Redemption requests surged to nearly 41% in April in another of its funds. The gates — those 5% quarterly redemption limits meant to hold back the crowd — may be, as *Game of Thrones* reminds us, “four inches of cold, hard, rolled steel,” but even they can look flimsy when “giants riding mammoths” come charging.

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So far, the biggest casualties have been the share prices of the private-equity firms themselves. Roughly one fifth of their value has been wiped out this year: Blackstone's shares are down 17%, Apollo's and KKR's 18%, and Blue Owl has plunged 35% (Figure 15). Somewhere in the carnage lies a subtle irony — the kings of private markets being humbled in the public ones. More concerning, however, is whether these developments signal deeper systemic stress that could spread. Fauna metaphors — always a favorite of economists — are now flourishing. When Tricolor and First Brands declared bankruptcy last fall, talks of cockroach metaphors blanketed the airwaves: where there's one bad loan, there are likely many more. Now the language has shifted to potential canaries in the coal mine — harbingers of worse to come — or termites, deeper structural rot quietly gnawing at the system's foundations.

**FIGURE 15**  
**The Kings of Private Credit Undone By Public Markets**  
**(stock price, year-to-date percent change)**



None of this inspires deep confidence in the outlook for the U.S. economy — quite the opposite. The consensus view, which had turned ever so briefly and ever so slightly rosier at the start of the year, has reverted to its familiar default setting of doom and gloom. White ravens have been dispatched, their wings heavy with darker tidings. Threats to the economy appear to be multiplying rather than tamping down. Worse still, as one risk is vanquished — say, tariff uncertainty — others emerge in its place, much like the White Walkers who, after each slaying, rise again and again, relentlessly and terrifyingly.

The outlook now revolves around possibilities each more depressing than the next: stalled growth, stagflation, or outright recession. The recessionistas—and their cousins – the stagflationistas, are back. Recession probabilities have crept higher — *The Wall Street Journal* survey places them at 33%, JPMorgan at 35%–40%, and Morgan Stanley at 40%. Moody's Analytics pegs them at an absurdly precise 48.6%, with one of its long-standing indicators signaling the economy may have entered recession as early as January. More troubling still, predictions of the end of Pax Americana — America's eight-decade reign as the world's economic and military anchor — have resurfaced, particularly in the wake of the Iran conflict, where American dominance is said to have met its limits in the vast skies and arid deserts of the Middle East. Winter has come, it seems — not just for the U.S. economy, but perhaps for the very idea of American preeminence itself, just as the nation approaches its quarter-millennium birthday.

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Forgive us if we are not yet ready to bend the knee to this line of thinking. The U.S. economy may be battered by formidable shocks and weighed down by mounting risks, but in the immortal words of *Game of Thrones*, the world seems to “have a weak spot for cripples, bastards, and broken things.” We have been here before. The U.S. economy — battered and sometimes bruised — has repeatedly defied gloomy predictions, not just barely but spectacularly. It did so just last year. It is our firm belief that it will continue to do so not because the blows are inconsequential but because of the resilience that has long defined it. Perhaps the closest comparison is the Black Knight — the stubbornly defiant and slightly quixotic figure from the iconic *Monty Python and the Holy Grail* — released, coincidentally, in another era but in a world similarly beset by oil shocks — where losing limbs is dismissed as “just a scratch,” losing more as “just a flesh wound,” and even when reduced to a torso, calling it grudgingly “a draw”. The U.S. economy, too, has refused to yield, absorbing blow after blow, perhaps losing a few limbs along the way, but always pressing forward.

Our more upbeat outlook for a resilient — and yes, even an ultimately resurgent — economy stems from the realization that the U.S. economy has an unmatched capacity to shift, adapt, and reinvent itself more quickly than almost any other major economy. “If you accept your flaws, no one can use them against you,” *Game of Thrones* reminds us — and America, to its credit, is always quick to recognize its vulnerabilities — strategic dependence, supply-chain fragilities, and supply-side shocks from tariffs or wars — and just as quick to adapt. It also enjoys strategic advantages few countries can dream of: a continent-sized economy with enormous consumption power, abundant natural resources, energy independence, the deepest capital markets in the world, technological leadership, and a flexible, dynamic labor force. As we argue below, our view is that the U.S. economy will weather the current global supply shock stemming from the Iran conflict with fewer bruises than most. And while we expect inflation to rise into the high-3s and growth to slow to the low-2s in the middle of the year, the outlook for the fourth quarter and beyond appears brighter.

To start, the fog of war surrounding the Iran conflict appears to have lifted slightly in recent days — though only by a hair. After nearly six weeks of hostilities, a two-week ceasefire — a *détente* of sorts — has reportedly been agreed between the United States and Iran as negotiations continue. Now in its second day as of this writing, the truce remains uneasy and fragile, with many details still hazy and contradictory signals emerging from both sides. America insists that the Strait of Hormuz remains open during the ceasefire; Iran, by contrast, maintains that any passage should be coordinated with its military forces. “In wartime, truth is so precious that she should always be attended by a bodyguard of lies,” Churchill told Stalin during WWII— ironically, in Tehran. Indeed, the day following the ceasefire announcement saw some of the bloodiest fighting since the conflict began — with Israel continuing strikes against Lebanon (which it insists was not part of the ceasefire agreement) and Iran maintaining its assaults on Gulf states. Part of the confusion may stem from Iran’s “mosaic” approach, in which decentralized militia networks operate with significant autonomy from Tehran — meaning some field commands may not have been fully apprised of the temporary truce.

The ceasefire appears as brittle as they come, and high-level negotiations in Islamabad ended, predictably, without agreement. In a risky — and bold — move to reopen the Strait, the U.S. has now begun a “blockade of the blockade,” so to speak, with President Trump announcing that the U.S. Navy will patrol the narrow waterway, “seeking and interdicting” vessels that have paid the Iranian toll to pass through the Strait. This is surely an escalation, but ramping up and tempering

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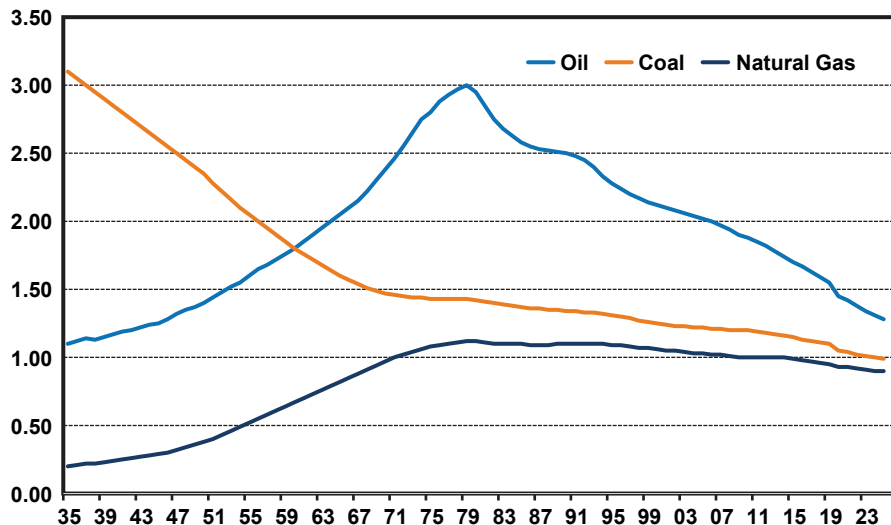
down — escalate to de-escalate — has been a constant feature of this conflict since the start. Even before these developments, our baseline scenario envisioned a limited engagement — roughly two months — followed by extended negotiations and behind-the-scenes wrangling stretching into late May or early June, with the Strait of Hormuz gradually resuming a semblance of normality by mid-summer. President Obama’s negotiations over the JCPOA lasted nearly two years, but Mr. Trump is a man in a hurry and lacks that sort of Olympian patience. Things, however, will almost surely get worse before a meaningful resolution emerges: we would not be surprised to see oil prices briefly surge north of \$120 in the interim.

Another reason to expect a resolution of the conflict measured in months rather than years is that fears of escalation through the deployment of ground troops appear overblown. The United States has deployed roughly 5,000 Marines and about 2,000 troops from the 82nd Airborne Division, on top of its approximately 50,000 forces already in the broader Middle East theater. That is a far cry from the nearly 700,000 troops mobilized during the First Gulf War and the roughly 300,000 deployed in the second. Even if current troop levels were sufficient to secure smaller islands — such as Kharg, Qeshm, or Abu Musa — they would likely be insufficient to hold them. Moreover, Mr. Trump has long held a deep and abiding aversion to “forever wars,” which this conflict would almost certainly become should the United States commit ground forces.

In the end, perhaps what matters most for the outlook — and especially for the global economy — is the reopening of the Strait. Whether this occurs through a negotiated agreement restoring free passage (as before the war), a toll system administered jointly by Iran and Oman (as proposed by Tehran but doubtful), a “joint venture” between the United States and Iran (as mused by Mr. Trump, even more doubtful), or a ‘coalition of the willing’ providing naval escorts, remains to be seen. What seems more certain is that the blockade will, at some point, come to an end. “If something cannot go on forever, it will stop” — the ever-wise words of economist Herbert Stein — have rarely rung more true.

Most importantly, the U.S. economy is far more resilient to energy shocks today than in the past. Energy intensity — measured as exajoules per dollar of real GDP — is now less than half what it was in the 1970s or during the First Gulf War. Oil intensity, in particular, has plummeted since its 1970s peak and now stands at roughly half the level prevailing during the first Gulf War. Even natural gas intensity has declined since 1980, despite natural gas consumption nearly doubling over that period (Figure 16).

**FIGURE 16**  
**U.S. Energy Intensity**  
**(exajoule per dollar of real GDP)**



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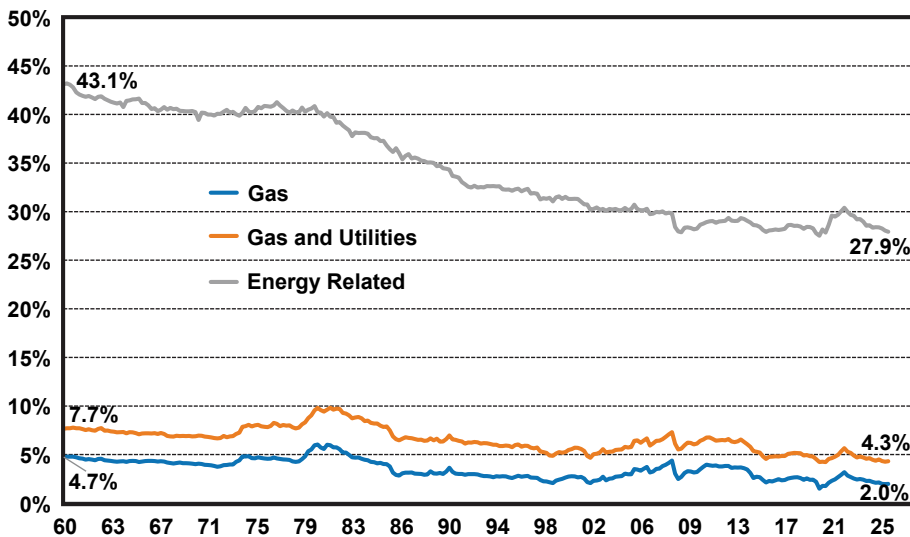
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The primary drivers of these dramatic improvements are substantial gains in energy efficiency. Back in the 1980s, cars averaged roughly 20 miles per gallon (mpg); today, the figure is closer to 30 mpg. Households are also spending far less on gasoline and energy-related products than they once did. The share of household consumption devoted to gasoline purchases has fallen from about 5% in the 1980s to below 2% today (Figure 17). Including gasoline and utilities, that share has roughly halved, from about 8% to around 4%. Even when accounting for a broader measure of energy-related expenditures — including motor vehicles, recreational vehicles, food, food services, and transportation equipment — household spending has declined dramatically, from roughly 43% in the 1960s to about 28% today.

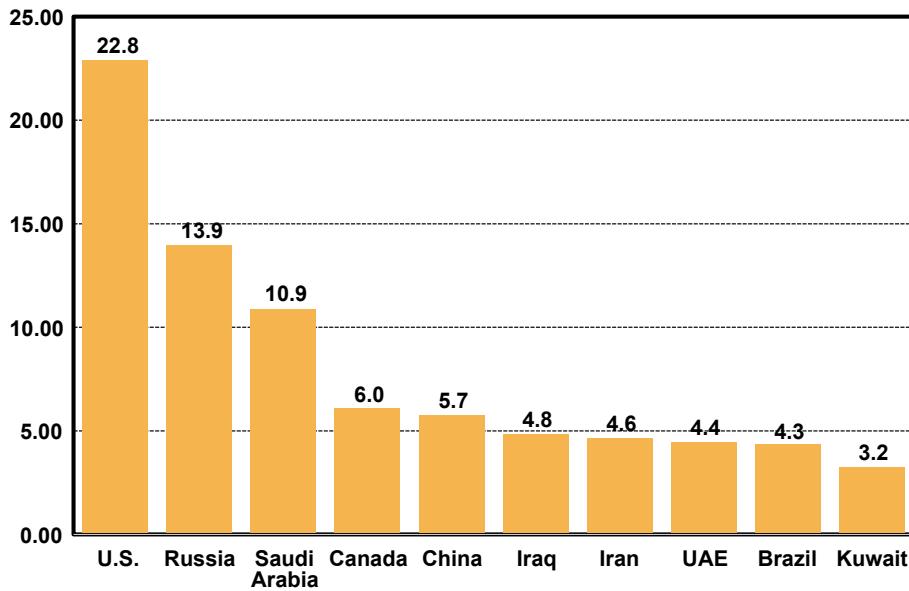
**FIGURE 17**  
**Household Spending on Energy and Energy-Related Products Has Fallen**  
**(spending on energy product, share of total spending)**



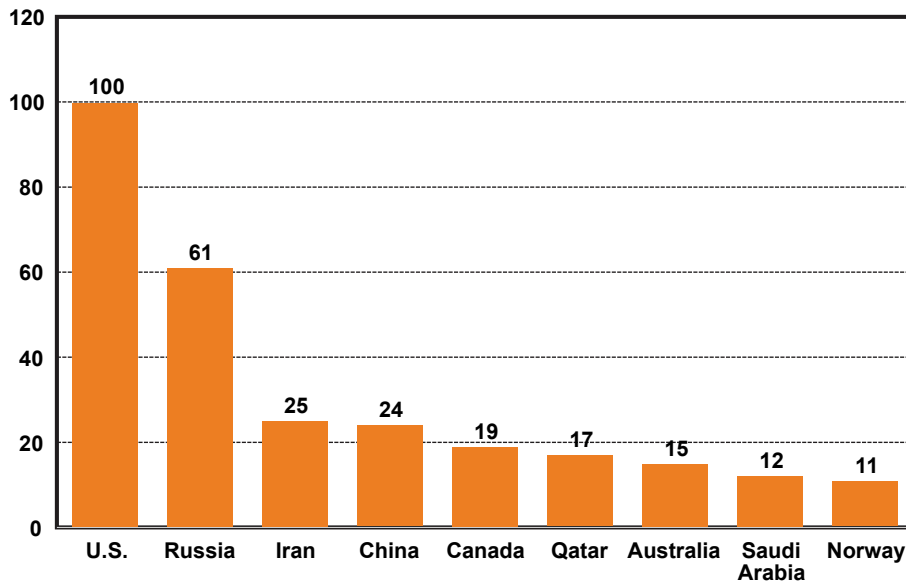
Moreover, the United States is now, for all intents and purposes, a petrostate. The shale-fracking revolution of the 2010s transformed America from a net energy importer into a net exporter by 2019 — for the first time in more than 60 years. Today, it is the world’s largest producer of oil and petroleum products in the world, pumping roughly 22.8 million barrels per day — more than twice the output of either Saudi Arabia or Russia (Figure 18). It is also the largest natural gas producer, with roughly 1,000 billion cubic meters of annual production, compared to about 700 billion cubic meters for Russia, the second largest (Figure 19). Last year alone, the America exported 2.6 quadrillion Btu of oil and 5.8 quadrillion Btu of natural gas. More than half of Europe’s LNG imports now come from the United States following its break with Russia.

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**FIGURE 18**  
**A Petrostate: U.S. is the Largest Producer of Oil and Petroleum Products**  
 (millions of barrels per day)



**FIGURE 19**  
**U.S. is Also the Largest Producer of Natural Gas**  
 (natural gas production, billions of cubic feet per day)



All this means that while the recent oil spike will not be painless, it is unlikely to inflict the same bruises as in the past.

This drag, however, is expected to be partly offset by two developments: higher tax refunds stemming from the One Big Beautiful Bill Act (OBBBA), and a boost to business fixed investment, driven primarily by increased energy-sector spending.

All this means that while the recent oil spike will not be painless, it is unlikely to inflict the same bruises as in the past. A five-month, 50% increase in oil prices — our baseline scenario, which keeps prices in the mid-\$90 range until mid-summer — would likely shave roughly 0.7 percentage points from household consumption and about 0.5 percentage points from real GDP growth. This drag, however, is expected to be partly offset by two developments: higher tax refunds stemming from the One Big Beautiful Bill Act (OBBBA), and a boost to business fixed investment, driven primarily by increased energy-sector spending. The latter is layered atop a broader structural capex

boom tied to the generative AI build-out, which has thus far proven relatively insensitive to energy costs and broader macro volatility. In other words, moderate increases in oil prices tend to reallocate growth rather than eliminate it: consumer spending slows, but energy investment accelerates, helping stabilize aggregate demand. The timing, however, does not align perfectly — consumption weakens almost immediately, while investment takes longer to ramp up — which is why we expect softer growth in the near term, followed by a pickup later on.

The other lingering supply shock — tariffs — though eclipsed somewhat by the ongoing war in Iran, continues to cast a pall over the outlook. Yet even here, as we argue below, things may be less dire than they appear at first blush. The Supreme Court’s decision to scuttle the IEEPA authority, on which much of the administration’s tariff architecture rested, has managed a rare feat: injecting greater uncertainty in the short run — as the administration scrambles to rebuild its framework — while creating more clarity in the long run by permanently curbing Mr. Trump’s ability to impose tariffs at will, on anyone, for any length of time, and for virtually any reason.

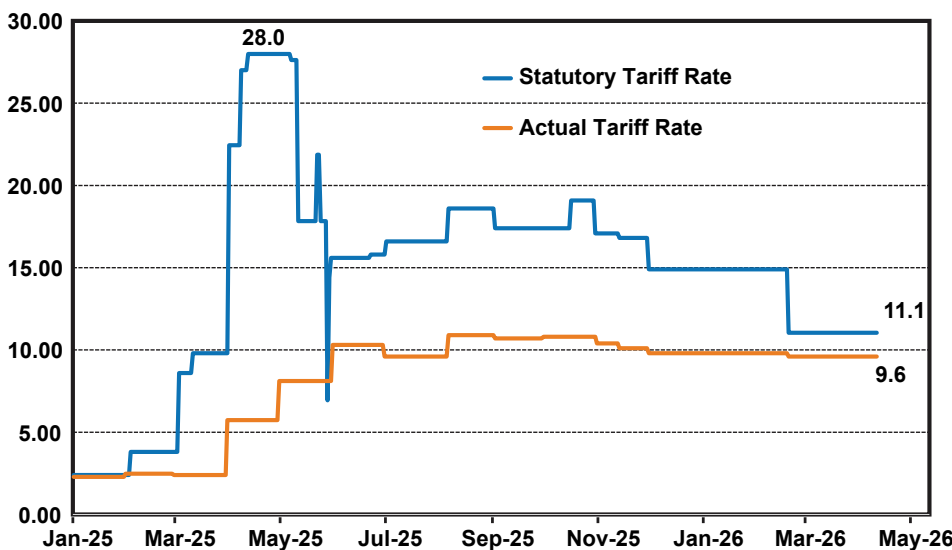
But even before the SCOTUS decision, tariffs proved less damaging than advertised — a sheep in wolf’s clothing, so to speak. The average effective rate prior to the ruling stood at around 16.7%, but the actual rate — calculated from levies on realized imports — was far lower, at roughly 10.5% (Figure 20). That gap reflects a proliferation of exemptions, adjustments, and substitutions, as the Trump administration fine-tuned its policy and firms shifted and adapted. Less than half of U.S. imports were subject to the higher IEEPA rates, even when they were in effect. Firms also adjusted sourcing away from high-tariff countries toward those with lower rates. The “first sale” rule, for instance, allows importers to pay duties on the price charged by the original manufacturer rather than the middleman. “Duty drawback” provisions allow companies to offset tariffs against equivalent goods they subsequently export. The past year, in short, has been bountiful for trade lawyers and consultants: it is far easier to hire a cadre of them to optimize customs classifications and finesse rules-of-origin definitions than to embark on costly, multi-year efforts to reshore manufacturing.

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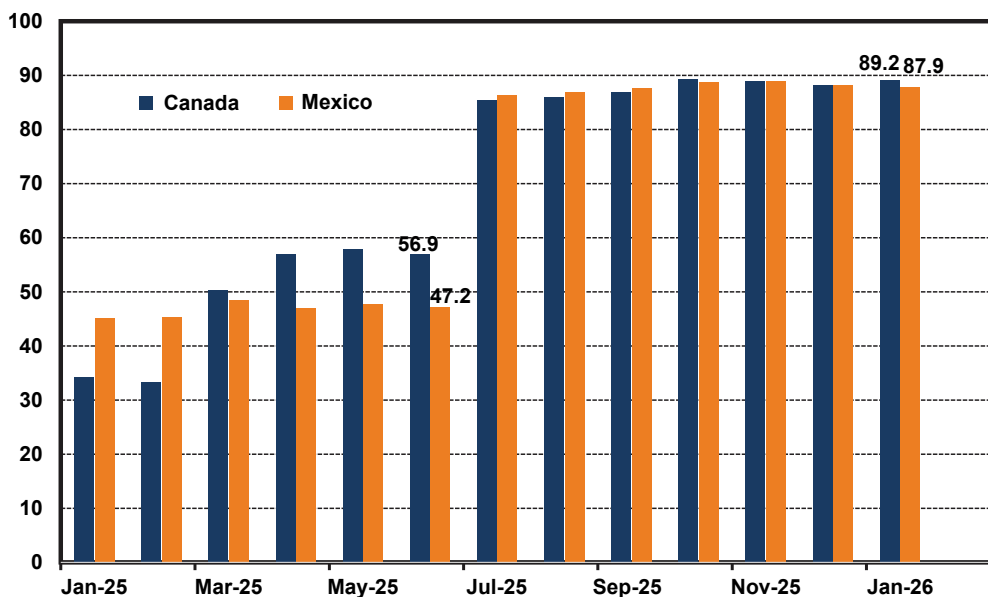
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**FIGURE 20**  
**A Sheep in Wolf's Clothing: Tariffs Less Harmful than Advertised**  
**(tariff rate, percent)**



A myriad of carveouts were already baked into the IEEPA tariffs — so much so that, depending on the country, only a small share of goods was subject to the most onerous levies. Less than 10% of imports from Canada were subject to the 25% tariffs, and less than 20% of goods from Mexico and Taiwan — the latter benefiting largely from sweeping exemptions for semiconductors and electronics. As a result, actual tariff rates on Canadian and Mexican goods remained below 5%, thanks in large part to USMCA, which itself is up for renegotiation later this year. Firms in these countries also moved quickly to adapt. Many rushed to certify USMCA compliance — something they had often not bothered with in the past — once the 25% IEEPA tariffs were imposed. The share of Canadian and Mexican imports claiming USMCA exemptions surged from roughly 35–40% before the tariffs to nearly 85–89% by late 2025 (Figure 21).

**FIGURE 21**  
**USMCA Compliance Has Skyrocketed Since Tariffs Were Imposed**  
**(USMCA goods compliance, percent of total imports)**



The IEEPA architecture has crumbled under the SCOTUS ruling, which held that the president's use of the statute to impose tariffs was unconstitutional — an encroachment on Congress's exclusive power to levy taxes. But the Trump Administration appears undeterred, aiming to rebuild the tariff wall — albeit with greater difficulty and likely with many more holes. As we discuss in detail below, the president retains ample authority under other statutes — some dating back to the Depression era (Section 338), some from the swinging 60s (Section 232) and yet others from the disco-and-vinyl era (Sections 122, 301). So far, the administration has opted for the latter. In the immediate aftermath of the SCOTUS decision, it imposed a universal 10% tariff, with plans to raise it to 15%. But this move is temporary: Section 122, under which the tariffs were applied, can only be used for up to 150 days without Congressional approval. In the meantime, the administration has launched investigations into roughly 60 trading partners under Section 301 — a more durable pathway for rebuilding the tariff regime.

The effective (actual) tariff rate after the SCOTUS decision should have fallen by roughly half — to about 7.2%. However, you would be forgiven for missing the drop: the immediate imposition of the new universal 10% tariffs has pushed the effective rate back close to where it stood before the Supreme Court had its say — around 9.8%. For most countries, this means tariff rates remain broadly similar to pre-ruling levels. For Mexico and Canada, the effective rate is still below 5%; for

**The president retains ample authority under other statutes — some dating back to the Depression era (Section 338), some from the swinging 60s (Section 232) and yet others from the disco-and-vinyl era (Sections 122, 301).**

the EU, around 10% (slightly lower than the roughly 12% prior); and for South Korea and Japan, about 13%, down modestly from roughly 15%. In contrast, the countries that come out ahead in the new regime are those that were hit hardest under IEEPA — a group that, right before the SCOTUS decision, had effectively narrowed to just two: China and Brazil. China's effective tariff rate has fallen from roughly 35% to about 25%, while Brazil's has been nearly halved, dropping from around 27% to roughly 13%.

We expect the Trump Administration to use a combination of Section 301 (country-specific) and Section 232 (sector-specific) tariffs, to reconstruct the previous tariff architecture if not exactly, at least to a close enough approximation, even after Section 122 expires. As such, we expect the actual tariff rate to be in the 10%-11% range and remain around that level through this administration's term — and likely beyond — generating roughly \$220–\$250 billion in annual revenue. The good news is that peak tariffs — and peak tariff volatility — appear to be firmly behind us. Rebuilding the tariff wall on more durable statutory foundations, while curbing the ability to impose tariffs at whim, should significantly reduce tariff policy uncertainty going forward. This matters: the current labor market doldrums are likely driven, at least in part, by firms' inability to plan amid shifting policy signals — with tariffs playing a central role.

Wars and tariffs aside, there are several reasons that point to a relatively robust economic performance, albeit one less spectacular than it might have been absent these shocks and marked by greater volatility — an outlook best described as resilience amid anxiety. An Ironborn economy, so to speak — forged of iron and fire and battered by storms. Indeed, strip away the fog of war and the haze of tariffs, and the foundations of the U.S. economy — the forces that genuinely propel growth — though a bit weaker now than a year ago, reveal an economy that though weathered, is still standing.

Household wealth continues to set record highs, rising by nearly 9% last year despite dramatic market turbulence earlier in the year. Since the pandemic, household wealth has surged by a jaw-dropping \$64 trillion, with roughly \$48 trillion coming from financial assets — thanks largely to the stellar performance of equities — and another nearly \$18 trillion from housing appreciation. To be sure, much of the wealth accumulation has accrued to the top of the income distribution, as higher-income households tend to hold a larger share of financial assets.

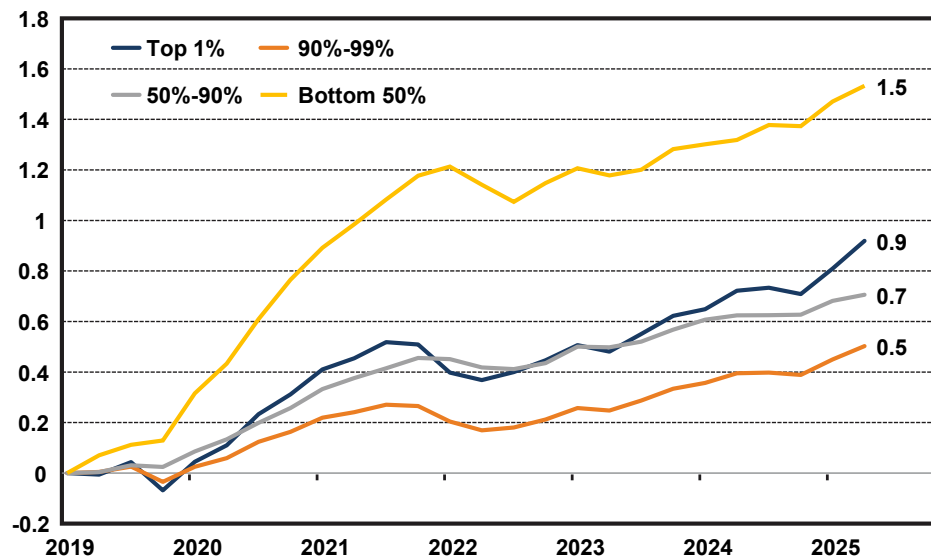
Yet wealth gains have been broad-based. Compared to pre-pandemic levels, the bottom 50% of the income distribution has seen net wealth rise by roughly 153% — far outpacing the roughly 90% increase for the top 1%, 50% growth for the 90–99% cohort, and about 70% for households in the 50–90% range (Figure 22). The outsized gains at the lower end of the income distribution reflect several factors: strong housing appreciation, rapid wage growth during the tight post-pandemic labor market — which disproportionately benefited lower-income workers — and

**The countries that come out ahead in the new regime are those that were hit hardest under IEEPA — a group that, right before the SCOTUS decision, had effectively narrowed to just two: China and Brazil.**

**We expect the actual tariff rate to be in the 10%-11% range and remain around that level through this administration's term — and likely beyond — generating roughly \$220–\$250 billion in annual revenue.**

**Household wealth continues to set record highs, rising by nearly 9% last year despite dramatic market turbulence earlier in the year.**

**FIGURE 22**  
**Net Wealth of Bottom 50% of the Income Distribution Has Risen Fastest Since COVID**  
**(cumulative growth compared to Q4 2019)**



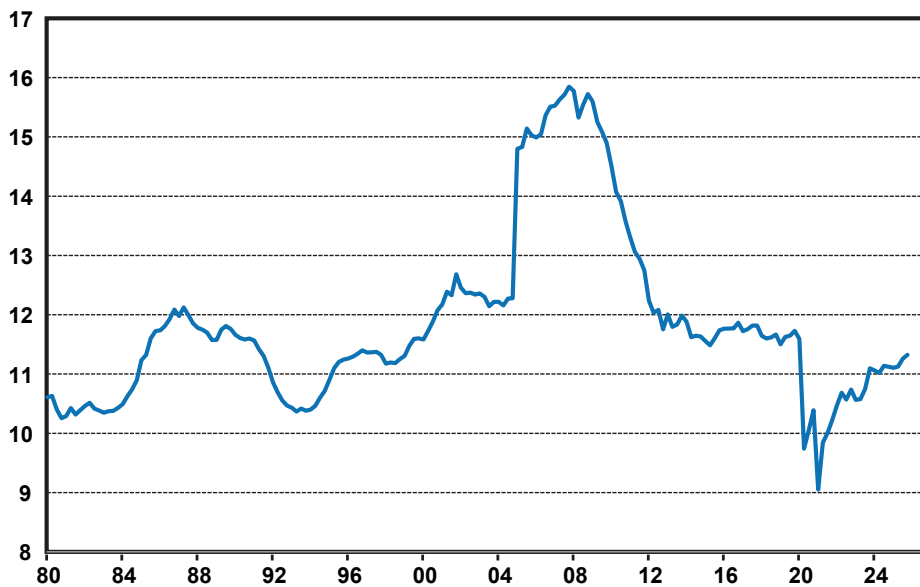
pandemic-era fiscal relief. Whatever the reasons, fatter cushions for this segment of the population are heartening as they will ease somewhat the pains of a cooling labor market, higher gas prices, and broader affordability pressures.

Real disposable income is now growing at roughly half the pace seen in 2024 and has edged down modestly from last year — from an average growth rate of 1.7% to about 1.4% currently — reflecting still-elevated cost pressures and a softer labor market. Nonetheless, growth remains positive, unlike in 2022, when sky-high inflation eroded purchasing power and real disposable income fell by a dismal 5.2%. Wage growth also remains solid, currently running at around a 3.8% pace — below the roughly 6% surge seen in the immediate aftermath of the pandemic, but still slightly above the historical average of about 3.4%. Prior to the war, real wages were rising at an annual pace of roughly 1.25% — slightly below the 1.3% registered in 2025, but meaningfully stronger than the 1.17% in 2024 and just 0.7% in 2023 — a modest but important tailwind for household spending.

Despite pockets of strain, consumer balance sheets remain—at least on aggregate— in fairly solid shape. Household debt as a share of GDP has continued to slide and now sits at its lowest in nearly three decades — back to levels last seen in the 1990s, one of the most prosperous periods in modern U.S. economic history. Household financial soundness — a measure tracking debt service and principal payments as a share of disposable income — remains equally benign, hovering near levels last seen in the mid-1980s (Figure 23). To be sure, credit card and auto loan delinquencies are rising — particularly among subprime borrowers — but overall delinquency rates remain below those seen during the 2015–2019 expansion prior to the pandemic. Much of this resilience comes from the fact that, unlike in the aftermath of the financial crisis, mortgage delinquencies—the lion’s share of consumer debt, continue to remain unusually low, helping keep household balance sheets on relatively firm footing.

**Household debt as a share of GDP has continued to slide and now sits at its lowest level in nearly three decades — back to levels last seen in the 1990s, one of the most prosperous periods in modern U.S. economic history.**

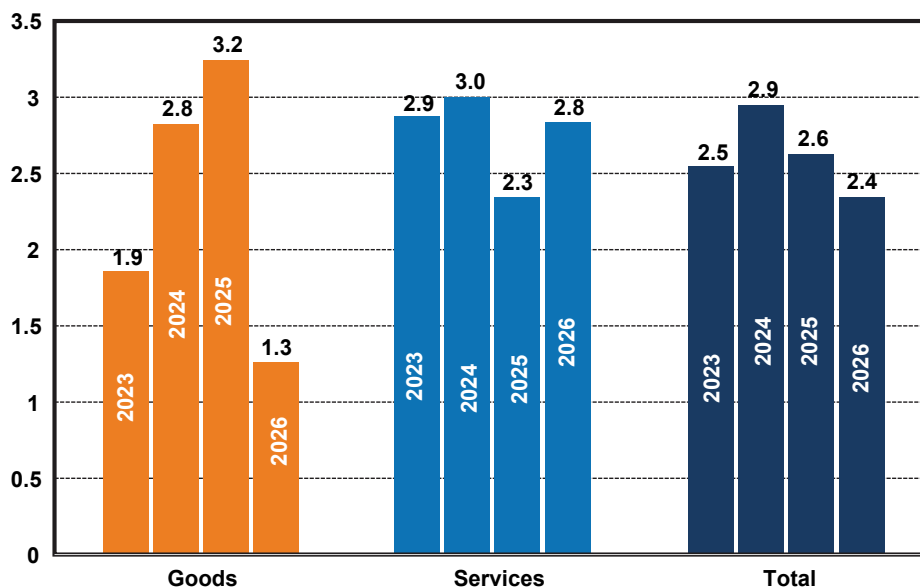
**FIGURE 23**  
**On Sound Footing: Household Balance Sheet Still Solid**  
**(debt payment as percent of disposable income)**



This relatively benign wealth and income backdrop may also help explain why consumers continue to spend even in an economy that they — fairly or not — already hated, long before the war in Iran began to lift prices and sap growth. “Americans hate the economy so much, they are buying \$22 smoothies,” a *Fortune* magazine article blared just a few days ago. We might recommend a much cheaper — yet still delicious — cup of Dornish wine, or perhaps a stronger jug of Wildling “sour goat’s milk,” but the point stands: Americans keep spending. For all the dire predictions surrounding last year’s tariff shock, retail sales grew by a sturdy 3.4%, more than a full percentage point higher than the previous year. Real consumer spending so far this year has risen at an average annual pace of 2.4% — just a hair below last year’s 2.6% pace (Figure 24). And unlike last year, when much of the growth was driven by purchases of goods — as consumers rushed purchases ahead of tariffs — most of the growth this year has come from services, which tend to be a more durable and consistent source of demand.

**This relatively benign wealth and income backdrop may also help explain why consumers continue to spend even in an economy that they — fairly or not — already hated, long before the war in Iran began to lift prices and sap growth.**

**FIGURE 24**  
**Consumers Are Depressed...But Still Spending**  
**(real consumption spending, y-o-y percent change)**



Real discretionary spending — one of the more reliable indicators of an impending recession — also grew at a healthy pace last year, rising by 3.4% compared with 3.1% the previous year. And although growth softened to 2.4% in the fourth quarter, much of the slowdown reflected the impact of the longest government shutdown in history. In over more than six decades, there has never been a recession without real discretionary spending declining on a year-over-year basis — and current data remain far from signaling such a collapse. Nor is the resilience confined to higher-income households. Data from the New York Fed indicate that consumers earning over \$125,000 increased spending by 4.1% last year compared with 2024 — nearly identical to the 4% increase among households earning less than \$40,000 — suggesting that spending strength remains broadly based across the income distribution.

It is true that many of these indicators reflect lagged data. The worry is that the current oil shock will likely lop off a sizable chunk of consumer spending, forcing households to redirect income toward higher energy costs at the expense of discretionary purchases. Though higher-frequency data are harder to come by, preliminary figures paint a more encouraging picture. OpenTable reservations — an online measure of restaurant dining — are running roughly 20% above last year’s levels. Weekly

Redbook retail sales — a gauge of same-store activity at major retailers — are growing at a 7% year-over-year pace, stronger than the 5.4% average over the past two years. Airport foot traffic, according to the TSA, is also holding firm, currently running about 7%–8% higher than the same period last year. “All happy families are alike; each unhappy family is unhappy in its own way,” Leo Tolstoy once famously wrote. For U.S. consumers, however, unhappiness seems to share a common thread: more spending.

Lost amid the drudgery of war and tariffs is another overlooked and underappreciated tailwind for the U.S. economy: the FIFA World Cup, which kicks off on American soil (co-hosted with Mexico and Canada) on June 11, for the first time in over three decades. Spanning 11 U.S. host cities and 78 matches over 39 days, the tournament is expected to draw roughly 1.2 million international visitors, with an estimated 742,000 traveling specifically to the United States. These visitors are projected to spend more than \$5,000 per person — roughly 1.7 times the typical international traveler’s outlays — with one in three planning to stay longer than two weeks. FIFA estimates the tournament could generate a \$17.2 billion boost to U.S. GDP alone. City-level projections are similarly upbeat: Los Angeles — hosting eight matches, including the U.S. opener — expects total economic activity of more than \$1.1 billion.

These figures are almost surely exaggerated — pre-event projections routinely overstate realized gains by at least 30–40%, especially when they originate from event organizers. Moreover, events of this scale often end up straining local and regional budgets. Each host city, for instance, is expected to shoulder between \$100 million and \$200 million in costs related to infrastructure, security, and logistics. Nonetheless, cost considerations are for another time and another day: the immediate effect will likely be a boost to local economies and overall U.S. GDP growth. As Game of Thrones reminds us, the people delight in the tourneys — even when they leave the realm deeper in debt, “six million gold dragons at a time”.

Businesses are also holding up relatively well. In contrast to dour consumer sentiment, business confidence is neither Pollyannaish nor excessively downbeat — instead occupying a cautious — and hopeful — space between resilience and uncertainty. Business fixed investment rose by a relatively uninspiring 2.7% last year, somewhat slower than the 3% growth in 2025 and 3.4% in 2024, but that performance is actually quite remarkable given the uncertainty surrounding tariff policy and fears of a broader trade war. Some additional hesitation at the start of this year would not be surprising as the Iran conflict unfolds. Encouragingly, however, both small and large businesses — as measured by the NFIB survey and the Duke CFO Survey — are planning to increase capital expenditures this year. Among large firms, roughly one-third plan to expand structures, while nearly two-thirds intend to boost spending on equipment.

Most importantly, the frenzy around all things AI has not abated — if anything, it has intensified. America’s five largest technology companies — Amazon, Microsoft, Alphabet, Meta, and Oracle — collectively poured more than \$400 billion into AI-related infrastructure in 2025, up 66% from the prior year and more than double what the group spent across the three preceding years combined. Projected investments for this year are expected to reach Valyrian heights — exceeding \$600 billion (Figure 25). Investors can’t seem to decide whether the AI boom will prove to be a passing fad, a civilization-defining transformation, or — in more dystopian corners — something closer to an extinction-level event, as hinted by the new Anthropic “Mythos” model reportedly withheld from public release due to its “striking leap” in capabilities. Either way, Big Tech is forging ahead, with growth emerging as the biggest beneficiary — at least in the short run.

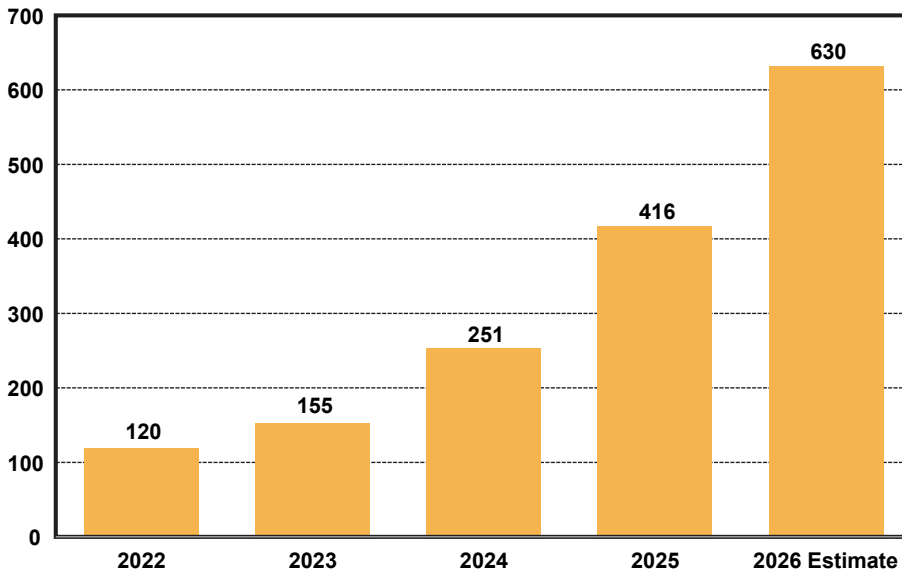
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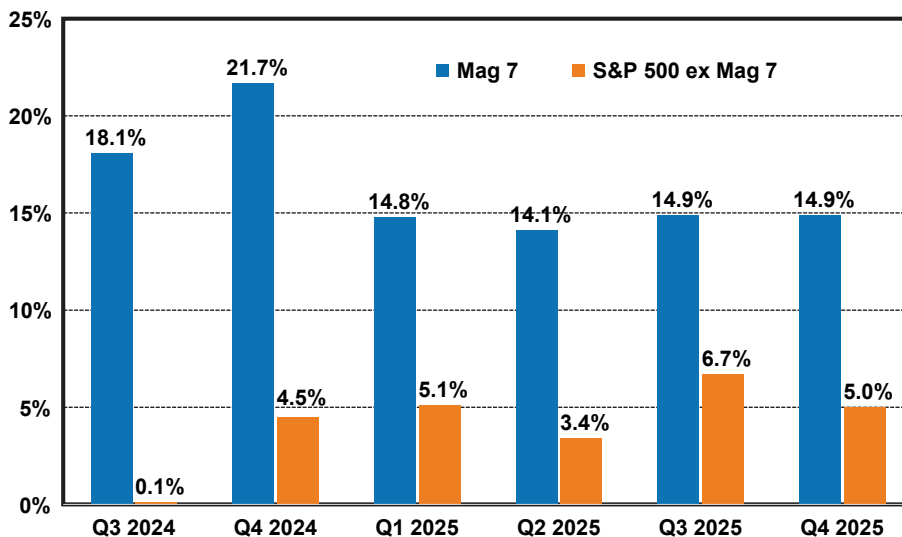
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**FIGURE 25**  
**The AI Investment Boom Continues Unabated**  
**(AI-related investments, billions of dollars)**



Corporate earnings have been nothing short of spectacular (Figure 26). The S&P 500 has delivered five consecutive quarters of double-digit year-over-year earnings growth — a streak not seen since 2017–2018 — with profit margins expanding rather than contracting. Another round of double-digit growth is also penciled in for the first quarter of this year, even as the war rages on. Much of the strength has been driven by the Magnificent Seven (or is it the *Light of the Seven?*), whose collective earnings grew at a dizzying 22% in 2025, while the remaining 493 companies posted a more modest — though still respectable — 9% gain. Encouragingly, the breadth now appears to be widening: estimates suggest earnings growth for the remaining firms could reach double digits in the first quarter of 2026, nearly matching the pace of the Mag Seven — a sign that corporate America, much like the words of House Tyrell, is not merely surviving, but 'Growing Strong.'

**FIGURE 26**  
**Corporate Earnings Have Impressed...Especially for Mag 7**  
**(earnings, y-o-y percent)**



The U.S. economy is also stronger in another respect — one that has commanded much attention but surprisingly little scrutiny over the past couple of years. The narrative of a K-shaped economy — the idea that growth is hoisted on the shoulders of affluent consumers (on the spending side) and on the back of AI (on the investment side) — became outlandishly fashionable over the past few years. By this line of thinking, growth was driven almost entirely by the top 20% of the income distribution, which by some estimates accounted for more than two-thirds of consumption. Economists, ever enamored with their letters, even began speaking of an E-shaped economy — three tiers instead of two — with wealthy consumers thriving, middle-class households spending anxiously, and lower-income households genuinely struggling. On the investment side, some estimates pegged AI’s contribution to growth at as high as 80%. “What unites people? Armies? Gold? Flags? Stories. There’s nothing in the world more powerful than a good story,” Tyrion Lannister reminds us — and the K-shaped economy is as catchy as they come.

Our view of the K-shaped narrative is more nuanced and less sweeping, in that while the general direction is broadly correct, the specifics are almost certainly overstated. To begin with, the U.S. economy has always relied more heavily on higher-income consumers than the rest — a pattern that stretches back decades. More importantly, the estimates underpinning the K-shaped narrative — most prominently those computed by Moody’s Analytics — are based on a methodology that is almost certainly flawed. Moody’s calculations derive household savings by quintile from financial and wealth data and then treat the residual as personal outlays — consumption, in other words. Moody’s then concludes that the K-shaped economy has been brewing since COVID: spending by the top 10% grew by 62% between the third quarter of 2020 and the third quarter of 2025 — nearly double the 37% increase recorded for the bottom 20% of the income distribution.

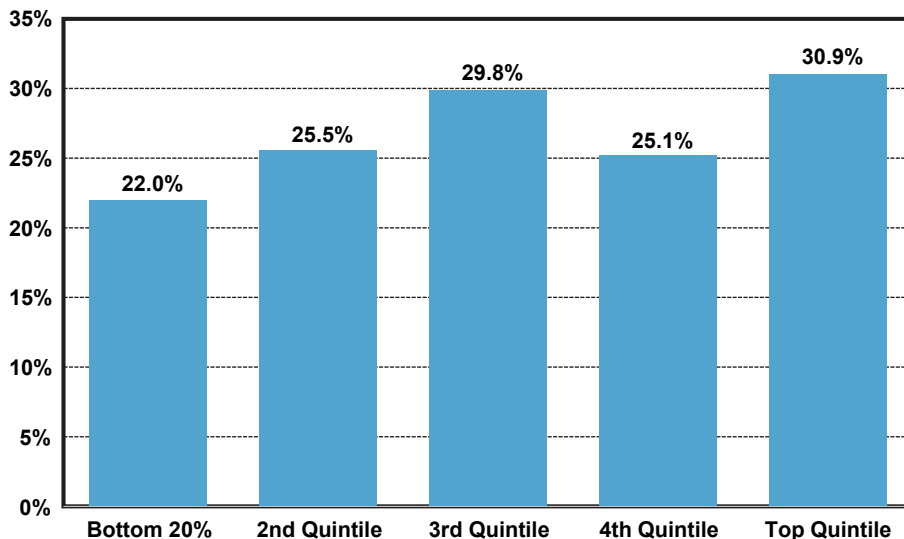
Except a number of surveys and hard data appear to contradict these claims. The BLS Consumer Expenditure Survey — which is released with significant lags (for example, the 2024 data were issued only at the end of 2025) — shows that the top 20% of income earners account for roughly 35% of total consumer spending, not the nearly two-thirds reported by Moody’s. Moreover, there is little evidence of a meaningful divergence in spending growth across income groups. If anything, spending by higher- and lower-income households has tended to move largely in tandem — accelerating together in the post-pandemic period and slowing together through 2023 and 2024 (Figure 27).

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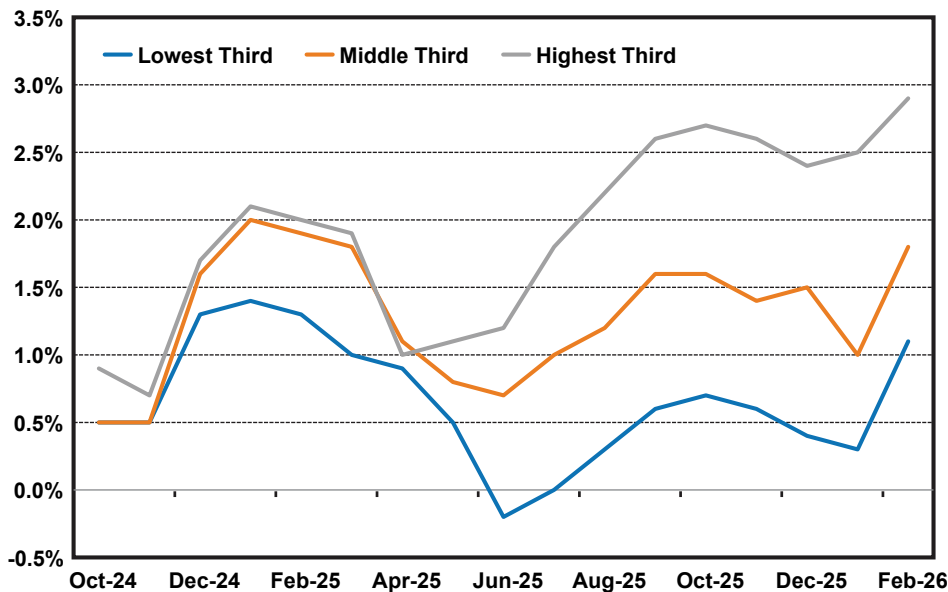
**Spending by higher- and lower-income households has tended to move largely in tandem — accelerating together in the post-pandemic period and slowing together through 2023 and 2024.**

**FIGURE 27**  
**Spending by Income Cohort Does Not Appear Lopsided**  
**(cumulative growth since COVID)**



Figures from other sources do not appear particularly K-ish, either. Consumer Edge, a data provider that estimates spending based on credit- and debit-card transactions, finds that the gap in spending growth between higher-income households and the rest has moved back and forth over the past several years, averaging roughly zero overall. Bank of America also estimates spending by income based on credit cards and debit card data. Because the series only began about a year ago, the evidence is still limited, but it points to a temporary widening between low-, middle-, and high-income consumers around mid-2025 — arguably resembling more of an E-shaped pattern than a K-shaped one (Figure 28). But even here some caution is warranted: card-based measures abstract from major components of household spending — most notably rents, housing-related costs, and other large purchases — which limits their ability to capture the full picture of consumer behavior.

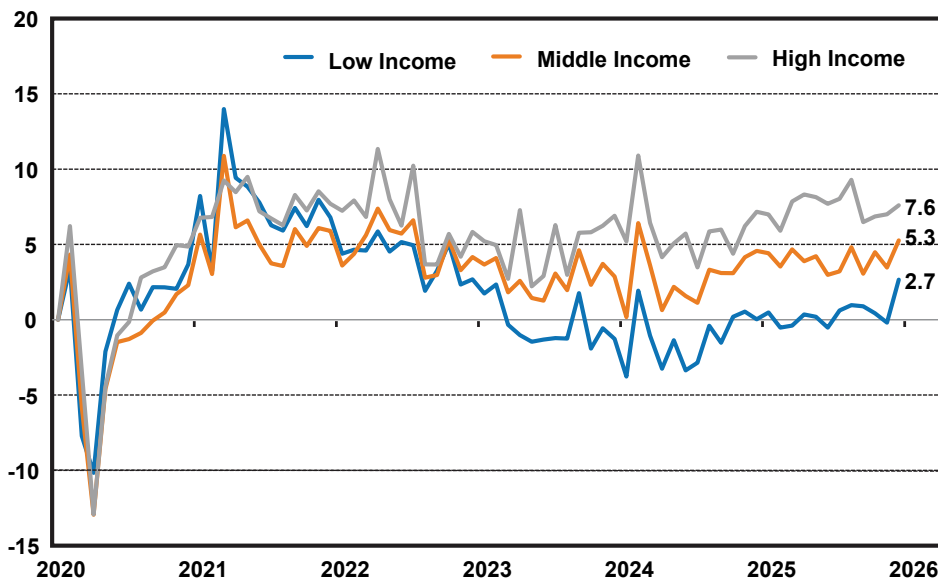
**FIGURE 28**  
**Perhaps an E-shape instead of a K-shape?**  
**Some Spending Differences between Income Groups**  
**(Bank of America, credit/debit card usage, y-o-y percent change)**



The New York Fed's Economic Heterogeneity Indicators, which track spending by income group, also show little evidence of a pronounced K-shaped pattern. On a year-over-year basis, there are no clear or consistent divergences across income groups. If anything, any K-shaped dynamic appears subtle, with slightly faster spending growth for higher-income households emerging only in cumulative terms since the pandemic. Even then, the gap is far less dramatic than Moody's estimates suggest. Cumulative spending growth since the pandemic ranges from roughly 29% for lower-income households to about 36% for higher-income households — a modest difference, and a far cry from the nearly two-to-one gap reported by Moody's (Figure 29). Moreover, the cumulative gap between higher- and lower-income spending appears to have widened primarily in 2023 and then stabilized, rather than progressively worsening as the K-shaped narrative implies.

**The cumulative gap between higher- and lower-income spending appears to have widened primarily in 2023 and then stabilized, rather than progressively worsening as the K-shaped narrative implies.**

**FIGURE 29**  
**A Faint K-Shaped Spending...But Not as Large as Most Contend**  
**(NY Fed consumer spending survey, cumulative growth since January 2020)**



The second preferred claim of the K-crowd is that growth is being driven almost exclusively by AI and AI-related investment. Some estimates place this contribution as high as 80%, with one widely cited figure reaching 92%. These claims, too, appear wildly exaggerated. Because much of the hardware underpinning the AI buildout — servers, semiconductors, and networking equipment — is manufactured abroad, a significant portion of this investment leaks out of the domestic economy through imports and therefore ought not to count toward GDP figures. Adjusting for imports, our calculations suggest that AI-related investment accounted for roughly a quarter of GDP growth last year — hefty, to be sure, but not outlandishly so.

None of this is to say that the U.S. economy is not worryingly lopsided. The K-shape is alive and well when it comes to wealth and sentiment. Wealth inequality, in particular, has risen appreciably since the pandemic. But a widening wealth gap is not the same as a K-shaped economy in terms of its macroeconomic impact — and for that, we should rejoice. If consumer spending and investment are more broad-based and less dependent on the fortunes of a few, the economy is less fragile and ultimately more robust.

A couple of other positive developments — related to fiscal and monetary policy — are also likely to support growth in the near term. In fact, they were initially expected to serve as tailwinds for faster expansion this year. Instead, given the current supply shocks, they will likely cushion the blows rather than propel growth forward. The first is the One Big Beautiful Bill Act (OBBBA), the gargantuan law passed last summer, which will deliver sizable tax cuts to American households and businesses this year. And unlike its predecessor, the Tax Cuts and Jobs Act — where benefits arrived in dribs and drabs — the OBBBA aims to deliver its goodies in one giant slug.

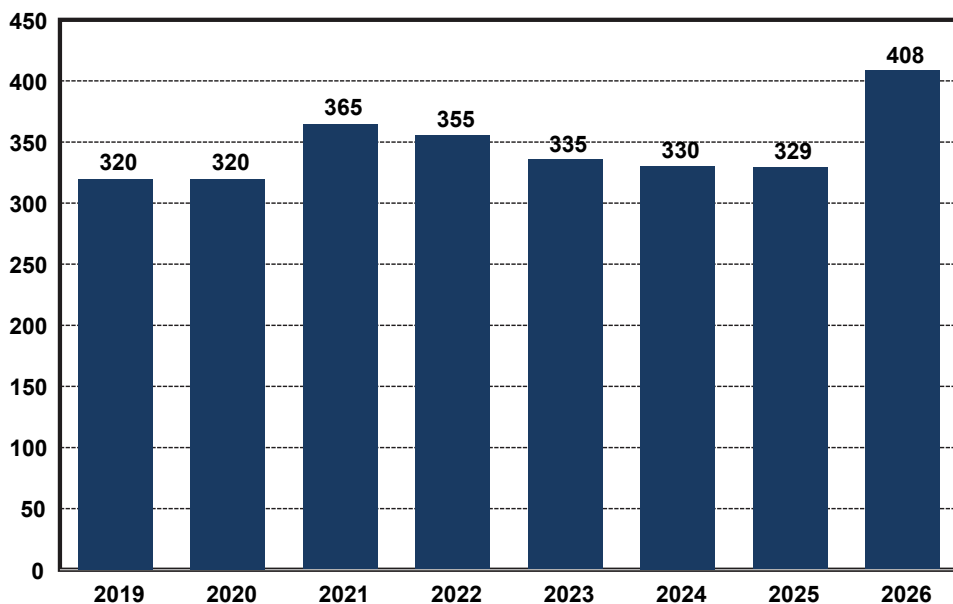
Indeed, the retroactive individual tax changes in the OBBBA for 2025 amount to roughly \$120 billion. Not all of this will arrive in the form of refunds: for some households, the changes will instead reduce the taxes they owe. Roughly two-thirds of households typically receive refunds, implying that about \$80 billion will be distributed as direct checks, boosting the average tax refund to roughly \$3,500 — an 12% increase from the previous year. The remaining \$40 billion will be realized through

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lower income tax liabilities for households that normally owe taxes. In addition, the IRS has updated its withholding tables for 2026 — something it did not do in 2025 — meaning that households will also benefit from larger take-home pay throughout the year. While harder to estimate precisely, this change will likely amount to an additional \$100 billion in disposable income (Figure 30).

**FIGURE 30**  
**One Big Beautiful Refund: Tax Refunds Are Higher This Year**  
**(total tax refunds, billions of dollars)**



Totting it up, the overall reduction in household income taxes from the OBBBA amounts to a titanic \$220 billion, or roughly 0.7% of GDP. Based on distributional tables from the Joint Committee on Taxation, the new tax cuts are generally tilted toward middle- and upper-middle-income households, particularly once changes to business income taxation are taken into account (such as 100% bonus depreciation, immediate expensing of domestic research and development (R&D), etc.) though lower-income households are also set to benefit from a raft of provisions geared toward this segment — including no taxes on auto loan interest, tips, and overtime. The Treasury Department recently announced that as many as 30 million taxpayers had already taken advantage of the no-tax-on-tips provision alone. Overall, we pencil in that the OBBBA will boost consumer spending by roughly \$90 billion this year. A good chunk of that may end up in gas tanks, but the support is arriving at a critical moment, to ease — at least somewhat — the pain at the pump.

The stagflationary shock delivered by the war in Iran — and to a lesser extent by tariffs — has greatly complicated the Fed’s task, as its dual mandate comes under increasing strain from rising inflation and weakening growth. It is also difficult to pin down the views of the incoming Fed Chair Kevin Warsh (pending confirmation) — a perennial hawk who has turned somewhat more dovish in recent times. Warsh has attributed this shift to his optimism about AI-driven productivity gains, the deregulatory stance of the current administration, and the need to lower interest rates to support “Main Street,” as he puts it. His views on balance sheet policy, however, are more clear-cut: he has never wavered in his dislike of bloated Fed balance sheets accumulated through successive rounds of asset purchases. He also appears less keen on heavy reliance on forward guidance — placing less emphasis on frequent “Fed talk” and favoring a more “trend-dependent,” rather than strictly “data-dependent,” approach.

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Mr. Warsh’s views aside, the Fed operates as a committee, and policy decisions ultimately depend on a majority of votes. Prior to the war, we had expected the Fed to deliver three additional rate cuts this year, bringing the policy rate closer to neutral. Those hopes are now dashed. While we expect the Fed to largely “look through” the current oil shock — holding rates steady rather than hiking — we now anticipate only one rate cut this year, likely toward the end of the year, when some of the uncertainty surrounding the conflict may have eased. Even that single cut appears precarious: market pricing currently implies no cuts this year, with the first reduction not expected until the fall of 2027. Our call therefore rests on the uneasy assumption that inflation pressures from the energy shock will be temporary, while labor market strains and persistent housing affordability challenges prove more durable, ultimately forcing the Fed to ease.

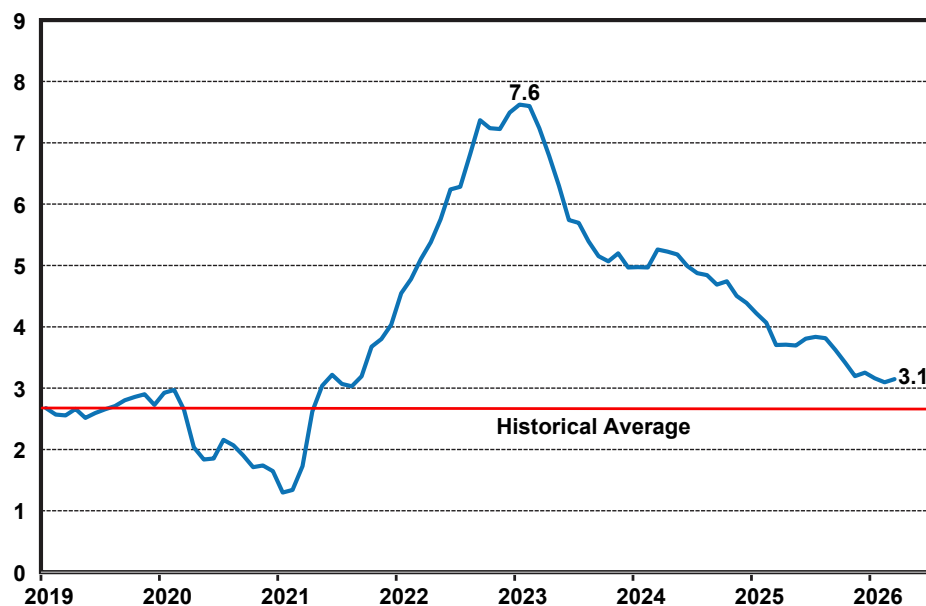
Against this fairly anodyne backdrop, two concerns remain: persistent worries that sticky inflation could turn into resurgent, second-wave inflation, and fears that the deterioration in the labor market may deepen further. Our view on both is more nuanced. We expect headline inflation to rise over the next two months, peaking around 3.9% in mid-summer as energy costs mount. The March report already showed a sizable increase in CPI inflation — a jumbo-sized jump of 0.9 percentage points month-over-month, lifting the year-over-year rate from 2.4% to 3.3%. Core inflation, however, remained subdued, rising only 0.2 percentage points to a 2.6% annualized rate from 2.5% in the previous two months, suggesting that broader spillovers from higher energy costs into underlying inflation pressures have so far remained limited.

Nonetheless, some seepage is likely, though the effect should remain muted — especially if the energy shock proves relatively short-lived, as we assume in our baseline scenario. Service inflation — which accounts for roughly two-thirds of the consumption basket — has moderated meaningfully and is advancing at an annualized pace of 3.1%, the lowest since the pandemic (Figure 31). Much of this improvement reflects easing pressures in the housing market: shelter inflation stands at a 3.0% annualized pace, the lowest in more than four years and broadly in line with pre-pandemic trends. These developments should help temper any near-term inflationary pressures stemming from higher energy costs and, while not fully offsetting them, should at least prevent a broader resurgence in underlying core inflation.

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**FIGURE 31**  
**Service Inflation Has Moderated**  
**(service CPI, y-o-y percent change)**



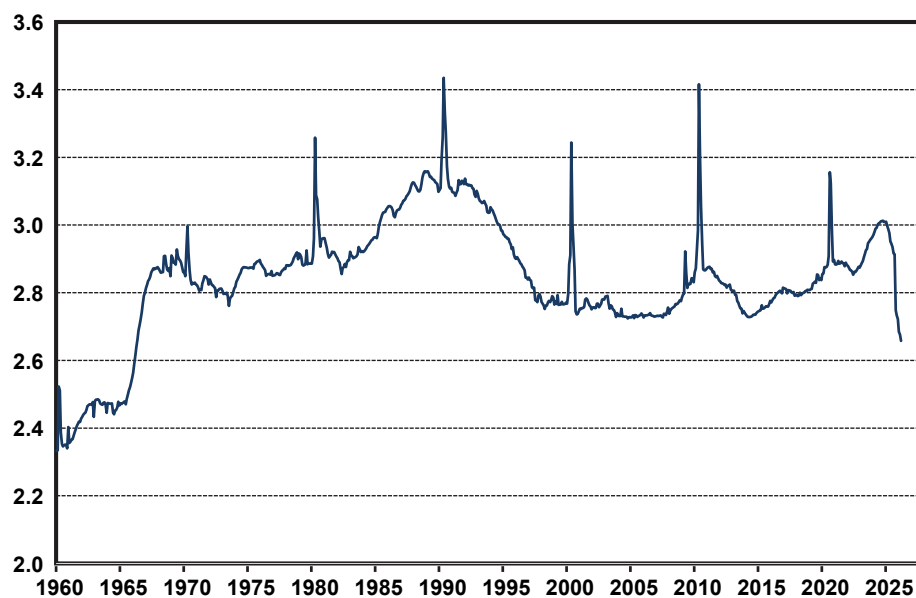
The second concern is the labor market, which appears suspended in time and space — frozen in a “low-hire, low-fire” equilibrium where job growth can land on either side of zero in any given month. But this characterization masks a more complex reality: by some measures, the labor market remains remarkably strong, while by others it appears downright dismal. For example, the prime-age employment-to-population ratio (workers aged 25–54) stands at 80.7%, near a record and in the 91st percentile of the past 25 years — meaning it is higher today than roughly 90% of all months since 2001. A broader age-adjusted employment-to-population ratio also sits around the 90th percentile, while real weekly earnings currently rank in the 97th percentile of the historical distribution.

**The second concern is the labor market, which appears suspended in time and space — frozen in a “low-hire, low-fire” equilibrium where job growth can land on either side of zero in any given month. But this characterization masks a more complex reality: by some measures, the labor market remains remarkably strong, while by others it appears downright dismal.**

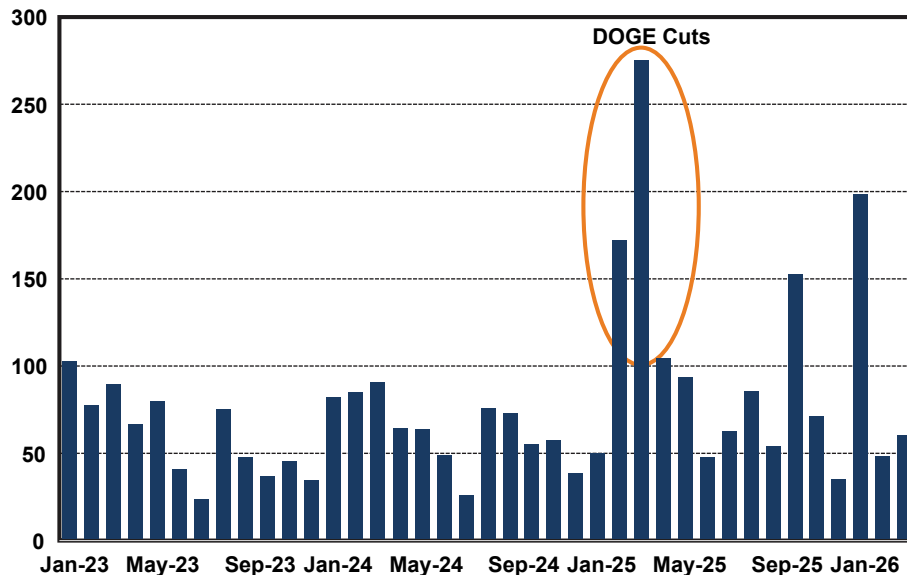
Measures of unemployment also remain relatively subdued. The headline unemployment rate and the broader U-6 measure — which includes marginally attached workers — sit at the 72nd and 70th percentiles of their historical distributions, respectively, meaning unemployment is lower than roughly 70% of months in the sample. The core unemployment rate, which excludes temporary layoffs, stands at the 66th percentile, while long-term unemployment (those unemployed for 27 weeks or more) sits near the 52nd percentile. While all of these measures have edged higher over the past year — pointing to some softening in labor market conditions — they remain far from levels typically associated with a meaningful downturn.

Moreover, firms are not laying off workers *en masse*. Indeed, the only sector that has shrunk meaningfully is the federal government: Since January 2025, a striking 352,000 jobs have been eliminated — but this reflects an explicit policy choice by the current administration rather than broader economic weakness (Figure 32). On the private sector side, conditions appear less dire. Initial unemployment claims are running at around 210,000 — among the lowest levels of this cycle and comfortably below the 300,000 threshold that typically signals rising recession risks. Challenger job-cut announcements did surge in October last year and again in January, when several large firms — including Amazon, UPS, and Oracle — announced layoffs, but have since returned to a more typical historical pace over the past two months (Figure 33). The WARN database — which tracks the 60-day advance notices required for large-scale layoffs — shows that layoffs last year totaled roughly 304,000, broadly in line with 2024 (301,000) and 2023 (297,000). WARN notices so far this year stand at around 139,000 — somewhat elevated but not unusual given that layoffs tend to be front-loaded earlier in the year.

**FIGURE 32**  
**Federal Workforce Has Shrunk to Lowest Level in Five Decades**  
**(millions of workers)**



**FIGURE 33**  
**Layoff Notices Have Remained Relatively Subdued**  
**(Challenger Survey, thousands of jobs)**



Much of the recent layoff activity reflects two forces that long predate the current landscape: companies correcting hiring excesses of the pandemic boom, and the early — but accelerating — displacement effects of AI. Whether the latter will continue to intensify remains an open question, but odds are that AI-related displacements are just starting. Nonetheless, our take on AI is orders of magnitude more optimistic than the dystopian view of Citrini: every transformative technology has been predicted to eat the world — and none yet has. AI will claim a slice, perhaps a large one, concentrated among knowledge workers whose tasks are most easily automated. But it will also create new jobs, new industries, and new demand — much as the ATM, far from eliminating bank tellers, led to cheaper branches, more branches, and roughly unchanged teller employment.

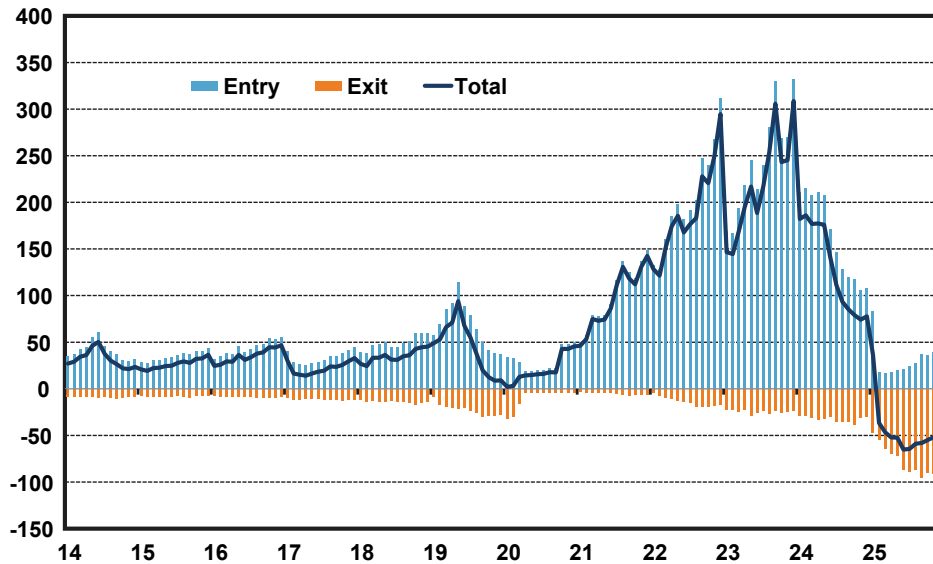
While layoffs and unemployment rates remain low, what fares poorly in the current labor market are measure of job formation. Monthly payroll growth is languishing in the 22nd percentile — meaning job creation has been stronger than it is now roughly 78% of the time over the past quarter century. Much of this weakness reflects the unusual uncertainty clouding the current macroeconomic landscape: two sizable shocks — tariffs and a hot war — are enough to chill hiring and capex plans even among the most optimistic firms. Normally, a slowdown in labor demand would push the unemployment rate higher, as new entrants to the labor force struggle to find work. That hasn't happened — largely because labor demand is slowing alongside a generational slump in labor supply, driven in part by tighter immigration policies under the current administration.

The Congressional Budget Office has sharply revised down its estimates of net migration into the United States — from roughly 3.5 million in 2023 to just 400,000 in 2025 and 570,000 in 2026, well below the roughly 1 million annual average of the past quarter century. But even these figures may be too rosy. The Dallas Fed and Brookings Institution estimate that net migration likely ranged between -295,000 and -10,000 in 2025, and could fall between -925,000 and +185,000 in 2026 — an unusually wide band reflecting substantial uncertainty surrounding deportations and, especially, self-deportation. Focusing solely on unauthorized immigration, the contraction appears even more pronounced: the net effect in 2025 is estimated at roughly -45,000 per month — or about -550,000

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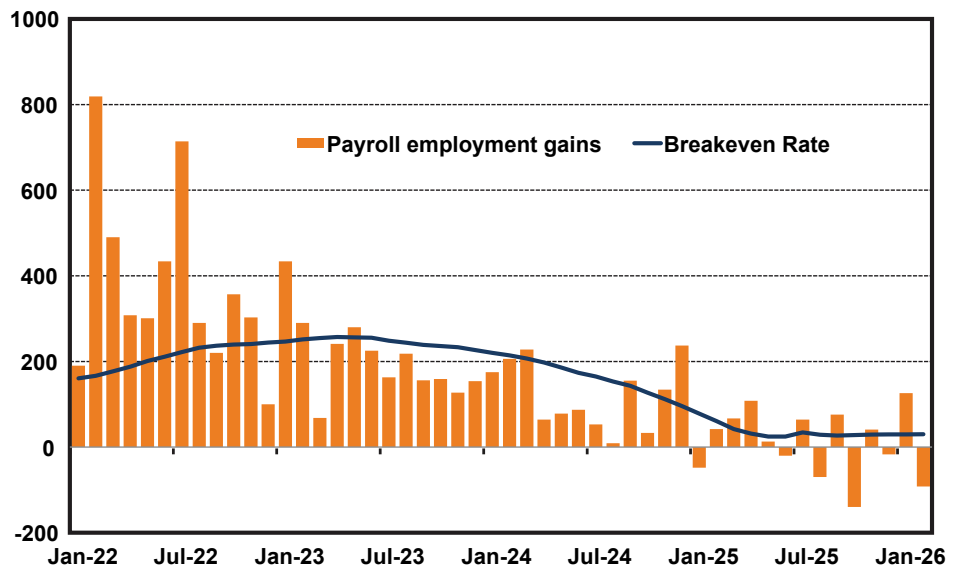
for the year as a whole (Figure 34). And while deportations have grabbed media headlines, a slowdown in new arrivals — particularly at the Southern border and through humanitarian parole and refugee programs — appears to have played a much larger role in reducing overall migration flows in 2025. Nationwide border encounters, for example, have fallen dramatically — from roughly 255,000 per month in 2023, to about 57,000 in 2025, and 30,000 currently.

**FIGURE 34**  
**Net Outflows of Illegal Immigration Have Turned Negative**  
**(thousands, monthly)**



This matters not least because the collapse in immigration flows is coinciding with a slowdown in labor force participation as the U.S. population ages. Slower labor force growth means that even if the economy creates fewer jobs than in the past, the unemployment rate does not necessarily have to rise. In other words, the “breakeven” pace of job creation — the rate needed to keep unemployment steady — has downshifted significantly. Depending on the immigration assumptions, even zero job formation — as strange as it may sound — could be consistent with an unemployment rate that remains near current levels. By our estimates, the breakeven rate has fallen sharply, from roughly 160,000 jobs per month in 2023 to around 30,000 today (Figure 35).

**FIGURE 35**  
**The Breakeven Rate Has Declined to Around 30,000 per Month**  
**(thousands of jobs, level)**



By this measure, the latest labor market report — at 178,000 jobs — is absolutely spectacular, if not for the fact that the following month may well bring a negative payroll print. That has been the story of the year thus far, with a stellar month followed by a dismal one: January payrolls came in at 160,000, only to be undone by the February decline of 133,000. But data volatility aside, there are some genuine reasons to muster a bit of excitement about labor market trends this year. Unlike last year — when almost the entire engine of job growth was the Health Care sector — gains this year appear far more dispersed. Health Care still tops the charts with roughly 170,000 jobs added, but other sectors are also expanding: Construction is up by 50,000 jobs; Professional and Business Services has expanded by 45,000 jobs; Leisure and Hospitality by 38,000; Trade and Transportation by 22,000; and even the three-year slump in Manufacturing appears to be over, with the sector adding 11,000 jobs. It is still too early to declare the labor market's woes over, but these developments are certainly encouraging.

Rarely has there been a time when risks to the baseline forecast have been so sky-high, and we say this with the benefit of a great many years of experience and an even greater dose of humility. As *Game of Thrones* wisely advises, “Never forget what you are. The rest of the world will not. Wear it like armor, and it can never be used to hurt you.” In that spirit, we wear humility as our armor. Forecasting in times of war is as dangerous as it gets, not least because wars — and especially asymmetric ones — rarely unfold in predictable ways. Our baseline scenario assumes a resolution of the conflict and some semblance of normality in the Strait of Hormuz by mid-summer, with many flare-ups — “escalate to de-escalate” — and heart-stopping volatility between now and then. But it is perhaps even easier to envision darker scenarios, where the war stretches into a quagmire-like stalemate — neither winding down nor escalating decisively, neither war nor peace — and where the Strait is neither fully reopened nor fully closed, operating instead in fits and starts. In this purgatory-like scenario, oil prices settle in the danger zone well north of \$100 for the remainder of the year, consumption posts back-to-back quarterly declines, and U.S. growth becomes mired in a world of higher inflation and stalled activity — *stallflation*, so to speak. A mild U.S. recession — and a more pronounced global downturn — would then cease to be tail risks and approach near certainty.

The second risk comes from the troubles brewing in private credit. Our view is that this represents a painful credit cycle in a largely untested asset class — one that is likely to unfold as a slow burn rather than an immediate systemic shock. Importantly, we do not expect this to become a system-wide crisis, as was the case with subprime loans during the 2007–2008 financial crisis. For starters, the scope of the problem is smaller: private credit totals roughly \$1.5–\$1.6 trillion — about the same size as the subprime market during the GFC, but in an economy that is now roughly twice as large. More importantly, subprime exposure mushroomed through synthetic structures — derivatives and CDOs — into a far larger web of risk, ultimately reaching roughly \$5 trillion. The CDS market alone peaked at a staggering \$62.2 trillion in notional value by year-end 2007. And no, we did not misplace a zero. It really was that large.

Perhaps the most structurally significant difference between 2008 and today is the presence of a circuit breaker — the gating of exits in private credit funds. While gating often makes for alarming headlines, it helps prevent the forced liquidations that accelerated losses during the subprime crisis. Back then, mortgage-backed securities and CDOs traded continuously in highly liquid markets, with panic-driven selling pushing prices sharply lower, each transaction triggering mark-to-market losses that forced additional selling — a death spiral that was both instantaneous and brutal. Gating redemptions, by contrast, interrupts this feedback loop, slowing the pace of withdrawals and preventing fire sales. In that sense, gating does not signal failure; it is the mechanism working as designed.

**Rarely has there been a time when risks to the baseline forecast have been so sky-high, and we say this with the benefit of a great many years of experience and an even greater dose of humility.**

**Forecasting in times of war is as dangerous as it gets, not least because wars — and especially asymmetric ones — rarely unfold in predictable ways.**

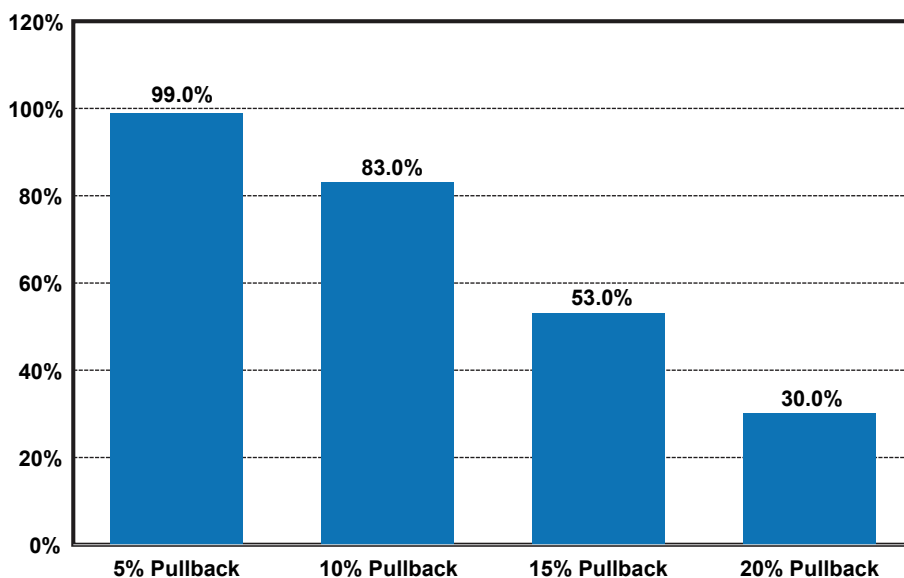
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**While gating often makes for alarming headlines, it helps prevent the forced liquidations that accelerated losses during the subprime crisis.**

Having said that, gating merely prevents acute stress from spiraling into a full-blown crisis; it does not eliminate the underlying risks, instead spreading the pain over a multi-quarter — or even multi-year — period. The more worrisome scenario is not private credit stress in isolation, but private credit layered on top of broader macroeconomic strains that could tighten financial conditions: a sustained oil price shock, a sharp deterioration in the macroeconomic outlook, or a deeper-than-expected slowdown in software company cash flows. This is not our baseline case, but the odds of a more adverse outcome have risen appreciably, as we would be the first to acknowledge.

Another source of concern is elevated market valuations, which have reached fresh highs as the fog of war with Iran has lifted and oil prices have eased. But this also leaves the outlook more fragile. When valuations are in the 9th or 10th decile—as they are today—even the flutter of a butterfly’s wings can set off a hurricane. History bears this out. When valuations are this stretched, there is roughly a 99% probability of at least a 5% market pullback, and an 83% chance of a 10% correction. Even a 15% decline is far from unlikely, occurring about 53% of the time, while a full 20% correction carries a still-meaningful 30% probability (Figure 36).

**FIGURE 36**  
**Risk of a Market Pullback is High When Valuations Are Stretched**  
**(probability of a market pullback, percent)**



Geopolitical risks are flaring up rather than tamping down, with a notable twist: America is more often than not fanning the flames rather than cooling the fire as it seeks to assert global dominance, strengthen national security, and secure energy independence. The Trump Administration has kicked off 2026 with a far more forceful foreign policy, aimed at expanding U.S. influence across the Western Hemisphere and key global energy chokepoints. The so-called Trump Corollary—or “Donroe Doctrine”—rests on a simple premise: the U.S. cannot remain the preeminent global power if it is not first the preeminent regional one. Actions in Venezuela earlier this year, which resulted in the removal of Nicolás Maduro, are one example. The doctrine has also born fruit in Panama, where a January ruling by the Supreme Court voided the contract of a Hong Kong–linked operator at both ends of the canal. Cuba may be next in the administration’s crosshairs. The Greenland matter remains unresolved and tensions over it are likely to flare up again. And the ongoing foray into Iran makes clear that this is not just about regional dominance, but global reach. One thing is clear: geopolitical shocks are no longer tail risks—they are part of the baseline. And that means more volatility in markets, and more uncertainty in the macro outlook.

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**One thing is clear: geopolitical shocks are no longer tail risks—they are part of the baseline. And that means more volatility in markets, and more uncertainty in the macro outlook.**

*Everything, Everywhere, All at Once* is an apt title for an economy being battered by seismic supply-side shocks, persistent geopolitical flare-ups, shifting trade regimes, and rapid technological disruption—all colliding at once against a macro backdrop that is growing progressively more fragile. Yet despite these crosscurrents, our baseline remains one of continued expansion—though it will be anything but smooth. This expansion will meet its maker one day (*Valar Morghulis*—all men must die), but not before it runs its natural course—serves its purpose, so to speak (*Valar Dohaeris*—all men must serve). As of now, signs are that its life won't be snuffed out soon, at least not over the next couple of years (our forecast horizon).

In the immortal words of *Game of Thrones*: “What do we say to the God of Death?”  
“Not today.”

## A Game of Thrones: Tariffs and Trade Deals

**Tywin Lanister: “A lion does not concern itself with the opinion of the sheep.”**  
—*Game of Thrones*

“The man who passes the sentence should swing the sword,” Ned Stark solemnly declared in the halls of Winterfell—a code of honor as stark and unforgiving as the North itself. Mercifully, for the U.S. (and the global economy), the sword was rarely swung with the full force the sentence demanded. When Mr. Trump unveiled his “Liberation Day” tariffs—the most sweeping unilateral trade action in a generation—the world held its breath and markets swooned. Tariffs ranging from 10% to a staggering 50% were imposed on 57 countries, while a universal 10% levy blanketed the rest of the globe. The sentence, as pronounced, sounded nothing short of catastrophic. And yet, barely a week later, the blade was stayed: most tariffs were paused for 90 days, ushering in a breathless round of negotiations. The chaotic months that followed saw a rolling cascade of exemptions, carve-outs, delays, and dealmaking. The sentence was thunderous, but the sword never swung in full. That gap—between the sentence and the swing, between threat and execution—defined the tariff story of 2025 as much as the tariffs themselves. Thus was born the “Trump Put”—or, as markets have come to dub it with a mix of relief and irreverence, the TACO trade (an acronym for Trump Always Chickens Out).

This more measured recounting of last year's tariff story, however, glosses over the high drama that unfolded throughout much of the year. As with everything Mr. Trump does, nothing is ever low-key—tensions flare before they cool, threats escalate, stakes are cast as existential, and uncertainty itself is wielded as a weapon. It makes for high-stakes drama—if a somewhat exhausted audience. For a brief but dizzying period between April and May, tariffs on China escalated from 34% to 104% to 145%, only to be ratcheted back down to roughly 30% by mid-May. In late July, Brazil was hit with a punitive 50% tariff, framed as a national emergency but widely seen as retaliation for legal actions against former President Jair Bolsonaro (and perhaps its growing role within BRICS), before agricultural exemptions—covering coffee, beef, and fruit—were quietly granted in November. India's initial 25% tariff rate was likewise doubled to 50% in response to its continued purchases of Russian oil, then scaled back to 18% in early February 2026 after Indian Prime Minister Narendra Modi agreed to pivot away from Russian crude and toward American energy—though India has since been granted renewed flexibility amid skyrocketing oil prices due to the war in Iran.

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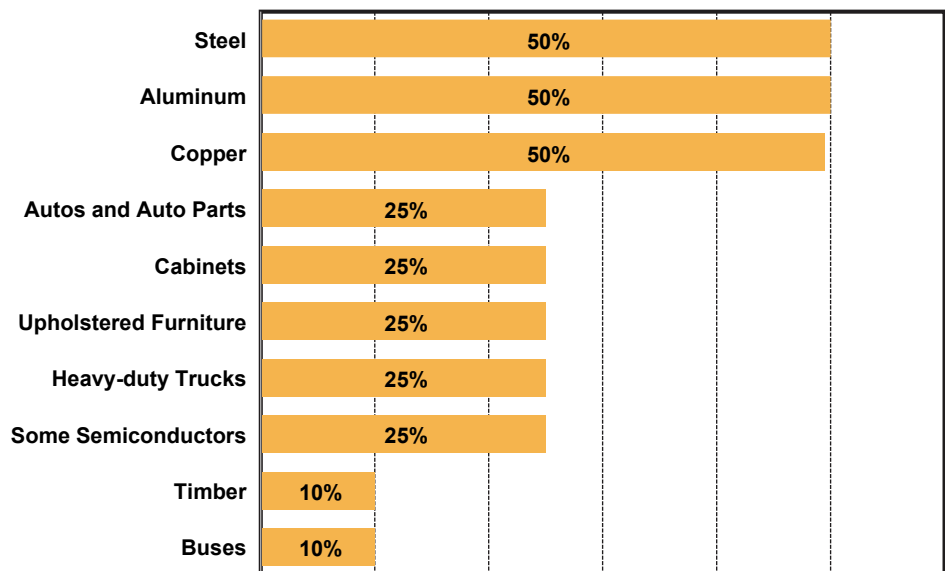
Some of the most outlandish threats never materialized. In October, Mr. Trump threatened—then walked back—a 100% tariff increase on China in response to its export controls on rare earths. Canada was targeted multiple times with tariffs ranging from 10% to 100%—the former over Ottawa’s anti-tariff ads aired on U.S. networks during the World Series (featuring president Reagan, no less), and the latter tied to its recent rapprochement with China. South Korea was threatened in January with an increase in its tariff rate from 15% to 25% over delays in ratifying a U.S. trade deal. Eight European countries were also put on notice, facing tariffs of 10% (to be raised to 15% by June)—unless Denmark ceded Greenland to the United States. Tariffs of 25% were also threatened on countries importing Iranian oil.

Amid this geopolitical realignment of global trade, it is easy to forget that Mr. Trump’s steepest tariffs are not directed at metaphysical constructs like nation-states, but at the physical world itself—entire industries, from steel and copper to lumber and even kitchen cabinets, have borne the brunt of his most punitive levies. The list of targeted goods is both large and growing: a 50% tariff on steel, aluminum, and copper imports; 25% on autos, auto parts, and heavy-duty trucks; 10% on timber, 25% on kitchen cabinets and bathroom vanities; and 25% on upholstered furniture (Figure 37). These measures rest on Section 232 of the Trade Expansion Act of 1962, which allows the United States to restrict imports deemed a threat to national security—however expansively defined. Apparently, that definition now begins and ends in the American bathroom.

More are on the way. “If you think this has a happy ending, you have not been paying attention,” Ramsay Bolton’s chilling words ring all too true here. That is in part because Section 232 carries far more enduring authority than the country-specific IEEPA framework, which was unceremoniously struck down by the Supreme Court in February. A raft of investigations is already underway, spanning pharmaceuticals, critical minerals, semiconductors, shipbuilding, aircraft, and medical devices. Mr. Trump has also threatened tariffs of 100% on foreign films, 200% on French wine and spirits, and 92% anti-dumping duties on Italian pasta—though, for the sake of this forecast, we can only hope the latter two never come to pass, as one of your favorite (and humble) economists happens to subsist on French wine and Italian pasta, especially while writing this report.

Tariffs—whether threatened or imposed—have had real effects. While the administration fell short of its pledge to secure “90 trade deals in 90 days” last April, the United States has nevertheless signed a flurry of agreements with key trading partners. By November 2025, the White House counted nine framework deals, two final reciprocal trade agreements, and two investment agreements. By early 2026, that roster had expanded to include virtually every major U.S. trading partner.

**FIGURE 37**  
**Tariffs on Some Sectors are High and Likely to Persist**  
**(tariff rate)**

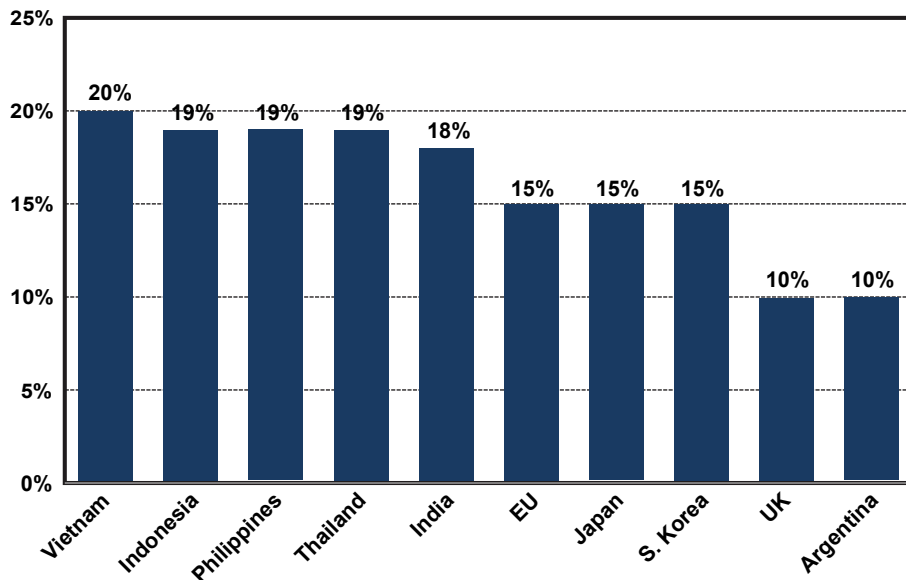


**While the administration fell short of its pledge to secure “90 trade deals in 90 days” last April, the United States has nevertheless signed a flurry of agreements with key trading partners.**

In total, the administration has concluded five final reciprocal trade deals, alongside roughly a dozen looser “framework” agreements with partners such as the EU and India. These latter deals are deliberately thin on detail: often fewer than a dozen pages and heavy on broadly worded commitments. Almost all included concessions by trading partners to purchase more American goods, open their markets to U.S. firms, increase investment in the United States, or commit to buying American oil and gas—all while facing higher U.S. tariffs and lowering their own on U.S. exports. All had one unifying feature in common: overwhelmingly—almost embarrassingly—onesided in favor of the U.S. As French Prime Minister François Bayrou, put it: "It is a dark day when an alliance of free peoples, brought together to affirm their common values and to defend their common interests, resigns itself to submission."

Countries with less heft and large exposure to U.S. trade — Vietnam, Cambodia, Malaysia, Thailand, and Indonesia — paid the highest price. Each received a reduction from eye-watering Liberation Day rate — Vietnam from 46%, Cambodia from 49%, Thailand from 36%, Indonesia and Malaysia from 32% and 25% respectively — down to a uniform 19%-20% (Figure 38). In return, each gave away considerably more: zero or near-zero tariffs on all American goods, elimination of non-tariff barriers, rules of origin commitments targeting transshipment, and critical minerals cooperation. Vietnam faced an additional 40% tariff on any goods deemed transshipped — a barely veiled anti-China measure targeting its entire re-export model. Cambodia and Malaysia went further still, agreeing to adopt U.S. tariffs on third countries, align with U.S. export controls, and — in Malaysia’s case — accepting a termination clause if it enters a trade agreement with any country that “jeopardizes essential U.S. interests.” Cambodia and Thailand received their deals only after agreeing to a U.S.-brokered ceasefire in their bilateral border conflict — making trade concessions the price of both market access and peace. None of the agreements addressed semiconductors — a critical export for Malaysia in particular — or provided relief from Section 232 sectoral tariffs.

**FIGURE 38**  
**Tariff Rates For Partner Countries Were Reduced Under Trade Deals**  
**(statutory tariff rates)**



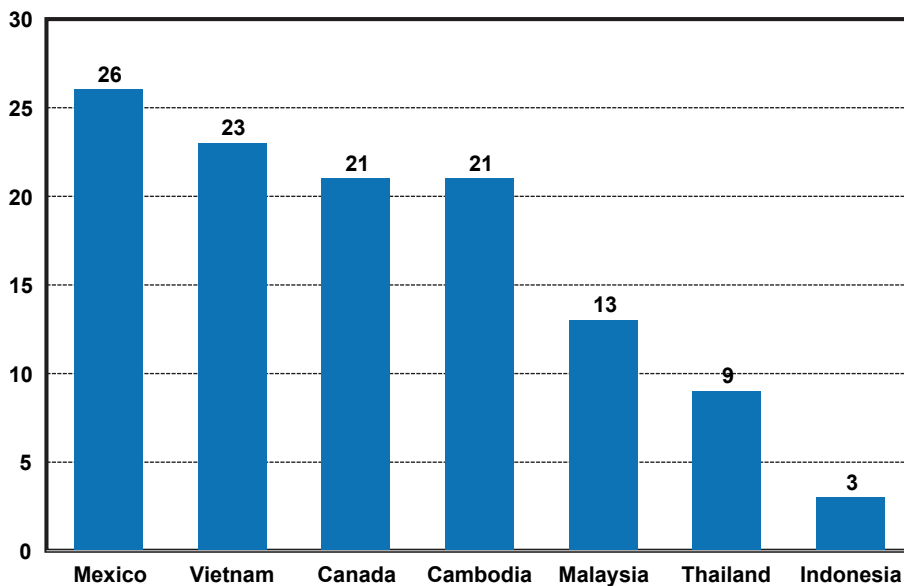
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It's hard to see how these agreements sit comfortably with these trading partners, many of whom would much rather occupy the uneasy neutrality that straddles the gulf between the United States and China than the treacherous terrain of either camp. Yet they may have little choice, at least in the short run: Exports to the U.S. account for a hefty 30% of Vietnam's total exports — equivalent to 23% of its GDP — and a staggering 37% of Cambodia's, or 21% of its GDP. Malaysia sends 14.5% of its exports to the U.S., nearly 13% of its GDP. Thailand and Indonesia are somewhat less exposed — 17% and 9% of total exports, 9% and 3% of GDP respectively — but hardly insulated (Figure 39). It is by now painfully clear that the U.S. sees these agreements less as trade deals and more as instruments of strategic alignment, quietly constructing a China-containment architecture, one bilateral agreement at a time—a dynamic that eerily echoes Cersei Lannister's stark maxim: "Everyone who isn't us is an enemy."

**FIGURE 39**  
**Exposure to U.S. Is Very Large for Some Countries**  
**(exports, percent of GDP)**



Countries with greater leverage—the EU, Japan, South Korea, and Taiwan—conceded less, though still far more than what a genuinely reciprocal negotiation would produce. All face a 15% reciprocal tariff rate, down from threatened levels of 25–32%, and secured relief on autos, pharmaceuticals, and semiconductors. In exchange, they committed to purchasing U.S. products—chiefly oil and gas—and investing more heavily in the United States. The EU pledged \$750 billion in U.S. energy purchases through 2028 and \$600 billion in new investment—despite importing only \$72 billion in U.S. energy in 2025, implying that annual purchases would need to roughly triple to meet the target, a gargantuan feat. Japan committed to \$8 billion in annual agricultural purchases, \$7 billion in annual energy imports, and \$550 billion in investment in strategic U.S. sectors, along with a profit-sharing arrangement allocating 90% of returns to the United States once principal is repaid. South Korea pledged \$350 billion in investment—\$150 billion earmarked for U.S. shipbuilding—alongside \$150 billion in LNG purchases. Taiwan committed \$500 billion in semiconductor and AI investments over an undefined horizon, an extraordinary sum relative to the size of its economy. As one economist quipped, the arrangement resembles a version of “Chinese capitalism with American characteristics.” Whether these commitments will fully materialize remains uncertain, particularly given that many of the agreement frameworks are thin on detail and rather difficult to enforce.

**Countries with greater leverage—the EU, Japan, South Korea, and Taiwan—conceded less, though still far more than what a genuinely reciprocal negotiation would produce.**

India also wrangled a middling deal, offering targeted and limited concessions rather than sweeping ones. It secured a reciprocal tariff rate of 18%—down from a peak of 50%—along with exemptions for generic drugs, aircraft parts, and auto components. In return, India agreed to eliminate or reduce tariffs on U.S. industrial goods and on a narrow range of agricultural products—tree nuts, red sorghum, fruits, soybean oil, wine, and spirits—while carefully shielding its most politically sensitive sectors: dairy, rice, and wheat. India also pledged to purchase \$500 billion in U.S. energy, technology, aircraft, and precious metals over five years, and to halt purchases of Russian oil—though the target appears quite outlandish given that total U.S. exports to India currently run at roughly \$50 billion annually. The agreement itself is among the flimsiest. Following the initial announcement, India remained silent for several days, and after subsequent pushback, the word “commitment” was quietly downgraded to “intent,” while references to removing India’s digital services tax—originally part of the framework—disappeared entirely.

Countries in America’s backyard—the Western Hemisphere—were treated with a much lighter touch and considerably more goodwill, perhaps reflecting what has come to be known as the “Donroe Doctrine”—a 21st-century makeover of the Monroe Doctrine aimed at reasserting U.S. dominance in the Western Hemisphere, this time directed squarely at China rather than the European powers of yore. El Salvador and Guatemala found themselves in the enviable position of facing only modest tariffs—just 10%—while Ecuador was assessed a slightly higher 15% rate. Ecuador secured exemptions for bananas, coffee, cocoa, and other key agricultural exports to the United States, while El Salvador and Guatemala saw Liberation Day tariffs on textiles and apparel restored to zero under CAFTA-DR. In exchange, all three agreed to open their markets to U.S. agricultural goods and committed to intellectual property reforms, digital trade alignment, and anti-forced-labor provisions. Crucially, none were asked to mirror U.S. tariffs on China, or reconfigure their trade relationships with China.

The countries that ultimately secured the most favorable deals were the United Kingdom and Argentina—the former benefiting from the vestiges of a nostalgic “special relationship” (though, as Mr. Trump wistfully put it recently, it is no longer not quite “what it used to be”), and the latter from a genuine ideological alignment between Mr. Milei and Mr. Trump. Both received capped tariff rates of 10% and significant carve-outs. Argentina secured exemptions for 1,675 products, including politically sensitive beef exports. The United Kingdom obtained preferential treatment for its first 100,000 vehicles, which enter the U.S. at 10% rather than 27.5%; aerospace components and pharmaceuticals were made entirely tariff-free; and British steel remained at 25%, while tariffs for most other countries were raised to 50%. In return, the UK agreed to open its market to U.S. beef and ethanol, while Argentina reduced tariffs on 221 categories of U.S. goods and committed to intellectual property reforms and supply-chain coordination.

The fate of these trade deals is now in limbo following the Supreme Court’s resounding smackdown of the administration’s use of IEEPA powers, on which much of the tariff architecture—and the deals built upon it—rested. As we had expected, the court ruled that the statute itself does not authorize the use of tariffs, that stretching IEEPA to cover broad-based tariff authority violated the “major questions” doctrine (which requires clear and unambiguous statutory authority for executive actions with significant economic consequences), and that the power to tax lies exclusively with Congress, not the president. In one fell swoop, the High Sparrow had dethroned the Queen—a decisive institutional check on sweeping executive power.

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The problem, however, is that while the court’s decision may have permanently removed the chaotic nature of tariffs—levies imposed on anyone, for any reason, and for any length of time—it may also have unleashed a period of turmoil potentially even more disruptive than the Liberation Day tariffs themselves. First, the court remained silent on what to do with the roughly \$166 billion in tariff revenue already collected. U.S. Customs and Border Protection—the agency responsible for collecting the duties—has acknowledged that it lacks the technical capacity to process refunds for more than 330,000 importers across roughly 53 million customs entries. Second, and perhaps more subtly, the fate of the agreements themselves is unclear. Many of these deals rest on shaky legal ground now that the IEEPA foundation underpinning the tariff architecture has been removed.

Most importantly, Mr. Trump appears just as determined to rebuild his tariff wall—this time brick by brick—creating new layers of uncertainty and likely a fresh crop of legal challenges. Immediately following the Supreme Court’s decision, he imposed a universal 10% tariff—levied on top of Most Favored Nation (MFN) rates—under Section 122 of the Trade Act of 1974, which allows the president to impose temporary tariffs to address balance-of-payments deficits. He has already threatened to raise the rate to 15%, the maximum permitted under the statute. Yet this authority comes with its own legal vulnerabilities. When Section 122 was enacted, the dollar was tied to gold and U.S. gold reserves were dwindling, raising genuine concerns about balance-of-payments pressures. None of those conditions apply today: the dollar has been off the gold standard for more than five decades, which means Section 122 will almost certainly face legal challenges on these grounds.

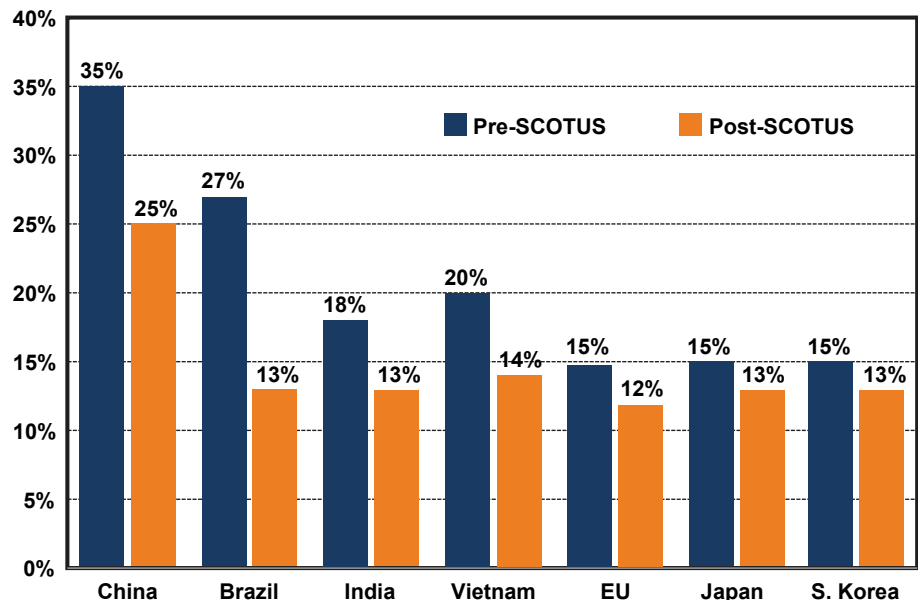
Perhaps the biggest issue lies at the very core of Section 122. First, the authority can only be applied for 150 days, after which it requires congressional reauthorization—something Mr. Trump is unlikely to secure. Second, and more fundamentally, Section 122 tariffs are applied indiscriminately, striking at the heart of the “reciprocal tariffs,” which were designed to reward countries the United States sought to draw more closely into its orbit and penalize recalcitrant ones. Indeed, countries such as China and Brazil, which were severely punished under IEEPA, would come out ahead under Section 122—even if the rate were raised to 15%.

Brazil’s effective tariff rate would fall from roughly 27% to about 13% (accounting for exemptions), while China’s would decline from around 35% to roughly 25% (Figure 40). By contrast, countries that negotiated more favorable deals—such as the EU, Japan, and the UK—would face effective rates closer to 17–18%, as the 15% levy is layered on top of existing MFN tariffs. Unsurprisingly, the response from these partners has been swift and pointed. “A deal is a deal,” the European Commission declared after Mr. Trump threatened to raise levies to 15%. For now, the EU is set to ratify the trade deal after pausing it for clarification including adding a suspension clause should the US impose further tariffs.

**The problem, however, is that while the court’s decision may have permanently removed the chaotic nature of tariffs—levies imposed on anyone, for any reason, and for any length of time—it may also have unleashed a period of turmoil potentially even more disruptive than the Liberation Day tariffs themselves.**

**Most importantly, Mr. Trump appears just as determined to rebuild his tariff wall—this time brick by brick—creating new layers of uncertainty and likely a fresh crop of legal challenges.**

**FIGURE 40**  
**Greatest Beneficiaries of SCOTUS Decision: China and Brazil**  
**(tariff rate before and after SCOTUS decision, percent)**



But Section 122 tariffs will likely run their course through late July, after which they are expected to be replaced with more battle-tested and well-established trade statutes. Section 301 — which empowers the U.S. Trade Representative to investigate unfair foreign trade practices and impose retaliatory tariffs — was widely deployed during the first Trump Administration against China, while Section 232, which targets specific sectors on national security grounds, is another key tool. Unlike IEEPA, Section 301 is more procedurally demanding, requiring detailed fact-finding and public comment, and although it carries no sunset provision, it includes a mandatory four-year review under which tariffs terminate unless domestic industries request continuation, triggering a USTR review. Section 232 is significantly more flexible — requiring a less onerous process, imposing no time limits, and carrying no mandatory review requirements. Importantly, neither places caps on how high tariffs may go. Both have survived seven years of legal challenges since the first Trump Administration and are now deeply entrenched — what U.S. Trade Representative Jamieson Greer has described as a "durable replacement architecture." As House Greyjoy's words remind us: "What is dead may never die — but rises again harder and stronger." IEEPA is dead but Sections 232 and 301 are rising again — harder and stronger — in its place.

Indeed, work to rebuild the tariff wall is already underway. An ever-expanding list of industries is expected to be ensnared under Section 232 — a favorite of Mr. Trump given its relatively light procedural requirements. Section 301 is moving even faster. Less than three weeks after the Supreme Court decision, the U.S. Trade Representative launched Section 301 investigations targeting 16 economies for structural excess capacity in manufacturing: China, the EU, Singapore, Switzerland, Norway, Indonesia, Malaysia, Cambodia, Thailand, Korea, Vietnam, Taiwan, Bangladesh, Mexico, Japan, and India. The following day, the list expanded dramatically to 60 economies for alleged failures to enforce bans on goods produced with forced labor. The logic is fairly simple: many of the economies included in the overcapacity probe overlap with countries with which America entered framework agreements over the past year. The investigations are designed to lock in Section 301 tariffs at the rates established in those agreements before Section 122 authority expires on July 24. Public comments are due April 15, with hearings scheduled to begin May 5.

There is one last arrow the administration could reach for in its quest to reconstruct its tariff architecture: Section 338 of the Tariff Act of 1930 — nearly a century old, born in the infamous era of Smoot-Hawley, and never used. On its face, it appears as broad and unconstrained as IEEPA, directing the president to impose tariffs "whenever he shall find as a fact" that a foreign country places a burden or disadvantage on U.S. commerce through unequal impositions or discrimination. The only constraint is a 50% ceiling, but even that may not be a meaningful deterrent, given that no country (save for China briefly) exceeded this threshold last year after the dust settled from the Liberation Day tariffs. The deeper limitation lies in the statute's underlying logic: It was designed for cases where a country treats U.S. goods discriminatorily relative to other trading partners — a condition that is difficult to establish under WTO rules, where the cardinal principle is non-discrimination through Most Favored Nation (MFN) tariffs applied uniformly across members. To be sure, the USTR could parse country by country and product by product to identify instances where a Section 338 duty might apply, but that is precisely the point: Section 338 is a scalpel, not a sledgehammer — ill-suited for the sweeping tariff architecture the administration appears to be rebuilding through Sections 301 and 232.

**Work to rebuild the tariff wall is already underway. An ever-expanding list of industries is expected to be ensnared under Section 232 — a favorite of Mr. Trump given its relatively light procedural requirements. Section 301 is moving even faster.**

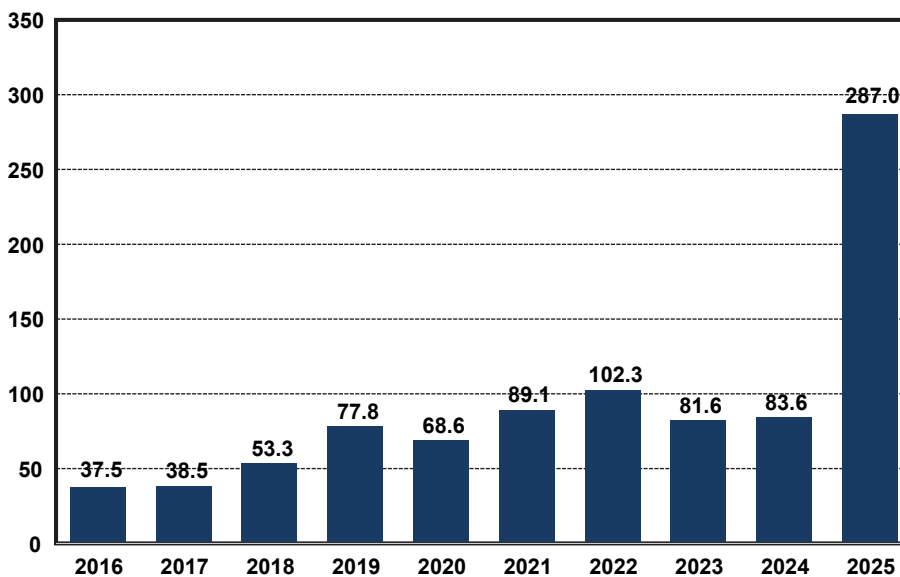
All this suggests that tariffs will be with us for some time — at least for the duration of the current administration, but likely even beyond. The more important question, then, is whether, one year in, they have achieved any of the administration’s goals. That is harder to determine than it may seem, not least because the Trump Administration appears to view tariffs as a multipurpose tool designed to address a wide range of objectives: countering unfair trade practices, strengthening supply chains, reindustrializing America, narrowing lopsided trade imbalances, reducing strategic vulnerabilities, raising revenue, addressing both economic and non-economic foreign policy concerns — from fentanyl and immigration to the Panama Canal and Greenland — and gaining negotiating leverage. In this sense, tariffs have become part of a broader economic statecraft toolkit, where economic power is wielded alongside political and military power.

Take tariff revenues first. Prior to the Supreme Court decision, the outcome would have to be viewed as a resounding success, delivering a striking fiscal windfall. In 2025, U.S. customs duties totaled roughly \$287 billion — more than three times the \$79 billion collected in 2024 and remarkably close to the \$280 billion we had projected a year earlier (Figure 41). Now, however, roughly \$166 billion collected under IEEPA may need to be refunded — equivalent to about 5% of corporate profits generated in the United States last year, or roughly 0.6% of GDP — with interest compounded daily at an annual rate of 6%–7%.

**All this suggests that tariffs will be with us for some time — at least for the duration of the current administration, but likely even beyond.**

**In 2025, U.S. customs duties totaled roughly \$287 billion — more than three times the \$79 billion collected in 2024 and remarkably close to the \$280 billion we had projected a year earlier.**

**FIGURE 41**  
**Tariff Revenues Have Skyrocketed**  
**(billions of dollars)**



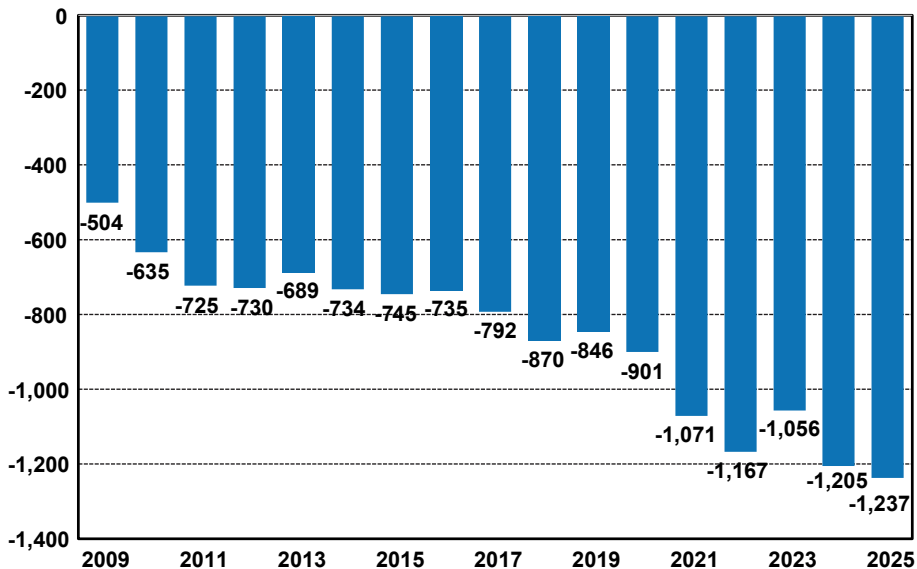
The administration will not make the process easy, slow-walking the refunds and reckoning that protracted litigation will outlast the patience — and legal budgets — of the small businesses that bore much of the burden. The administration is also reportedly counting on some firms forgoing claims altogether, particularly those that have already passed tariffs on to consumers. Some large companies may also decide to tread lightly to avoid drawing the ire of Mr. Trump, who has shown little hesitation in targeting firms publicly on Truth Social. Treasury Secretary Scott Bessent has been characteristically blunt about the odds: "I got a feeling the American people won't see it" — a remark that reads as both a prediction and, perhaps, a strategy.

Our view is that some refunds will ultimately materialize, but the process will likely take years. In the meantime, the new tariff edifice being constructed on the foundations of Sections 301 and 232 is likely to generate comparable revenue in 2026 — in our estimation, roughly \$250 billion. This is higher than some models suggest, because we never discount the Trump Administration's determination to rebuild more or less the same-height tariff wall, only now with reinforced steel and concrete instead of mere bricks.

**Tariffs have had a decidedly more mixed effect when it comes to addressing the yawning trade deficit between America and the world.**

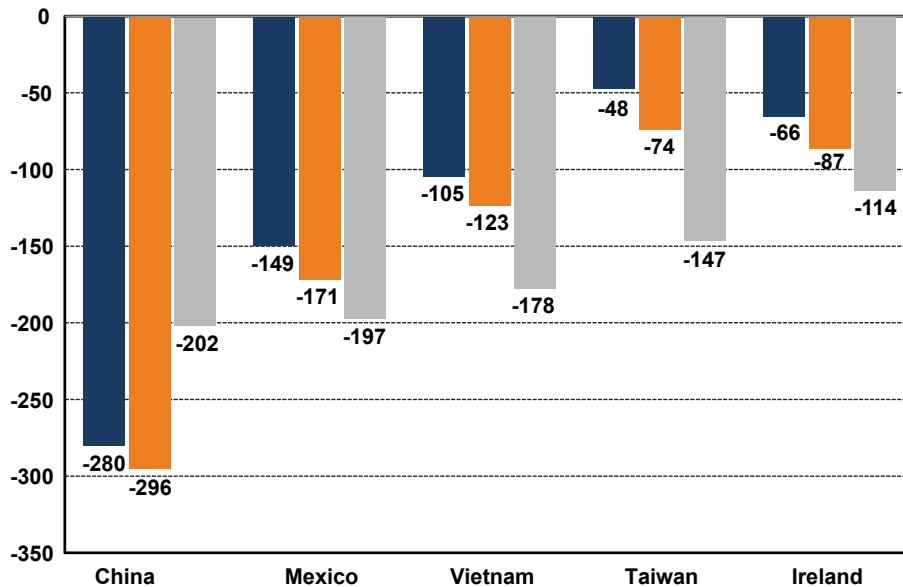
Tariffs have had a decidedly more mixed effect when it comes to addressing the yawning trade deficit between America and the world. The U.S. goods trade deficit remained virtually unchanged last year at roughly \$1.2 trillion. Perhaps the only solace is that it did not deteriorate further: in 2024 alone, the deficit widened by \$148 billion (Figure 42). Beneath the surface, however, seismic shifts are underway. Trade deficit with China shrank dramatically, from nearly \$300 billion in 2024 to \$202 billion in 2025. The longer-term trend is even more striking: the deficit with China peaked at \$387 billion in 2022 and is now almost half that size.

**FIGURE 42**  
**Transformed But Not Eliminated: Trade Deficit At Record Levels**  
**(trade deficit in goods, billions of dollars)**



But deficits with other countries have grown in tandem. Trade deficit with Mexico now stands at \$196 billion — the second largest after China — roughly double its pre-COVID level (Figure 43). The deficit with Vietnam, now the third largest, has climbed to \$178 billion from just \$66 billion before the pandemic. Both reflect supply chain shifts away from China following Mr. Trump's first trade war and their further acceleration during the second. AI has also played a role as well: the trade deficit with Taiwan has surged to \$147 billion — triple its level just two years ago — driven largely by booming semiconductor imports.

**FIGURE 43**  
**Reshuffled: Trade Deficit With China Has Declined, but Increased with Others**  
**(billions of dollars)**



In short, trade deficits have morphed rather than disappeared, shifting away from China and toward other trading partners. If the goal was decoupling from China, tariffs have had their intended effect. But a mere reshuffling of imbalances is unlikely to satisfy Mr. Trump, who appears to be seeking a meaningful narrowing — if not outright elimination — of the deficit. As we have warned in this space, that will not be easy. In the words of Tyrion Lannister, “It’s not easy being drunk all the time. Everyone would do it if it were easy.”

Reindustrializing the U.S. manufacturing base is another pillar of the Trump Administration’s agenda. It is right to focus on this issue: China’s rise to manufacturing preeminence presents an existential challenge to the United States — not only in terms of economic growth, but also geopolitical power. There is little doubt that the US has become heavily dependent on China for critical goods, ranging from drones and smartphones to pharmaceuticals and personal computers. Moreover, as China has become deeply embedded in global supply chains — not just with America, but across the world — its leverage has grown considerably, giving it the ability to exert meaningful economic pressure in pursuit of strategic and geopolitical objectives.

The figures tell a jarring tale: China’s manufacturing value-added in nominal dollar terms stands at \$4.7 trillion, whilst America’s is \$2.9 trillion — meaning China’s manufacturing output is 62% larger than America’s even though its economy is 36% smaller. But even these numbers obscure reality, given the significant undervaluation of the renminbi, which trades at roughly half its purchasing power parity value. Adjusted for this, China’s manufacturing dominance likely dwarfs that of the US by an even more formidable margin. In automobiles, China produced nearly three times as many cars as the US in 2023 — 30 million versus 10.6 million. In shipbuilding, it commands more than 50% of the global market and is the leading manufacturer in 14 out of 18 vessel categories. In steel, it produces more than the rest of the world combined, with a global market share of 53% — or roughly 12 times US production. The United States, for its part, produces just 4% of the world’s steel.

America has attempted to reverse this imbalance in recent years through different policy approaches. The Biden Administration revived industrial policy through subsidies and targeted investment, while Trump, in both his first and second terms, relied primarily on tariffs. Yet neither

**In short, trade deficits have morphed rather than disappeared, shifting away from China and toward other trading partners.**

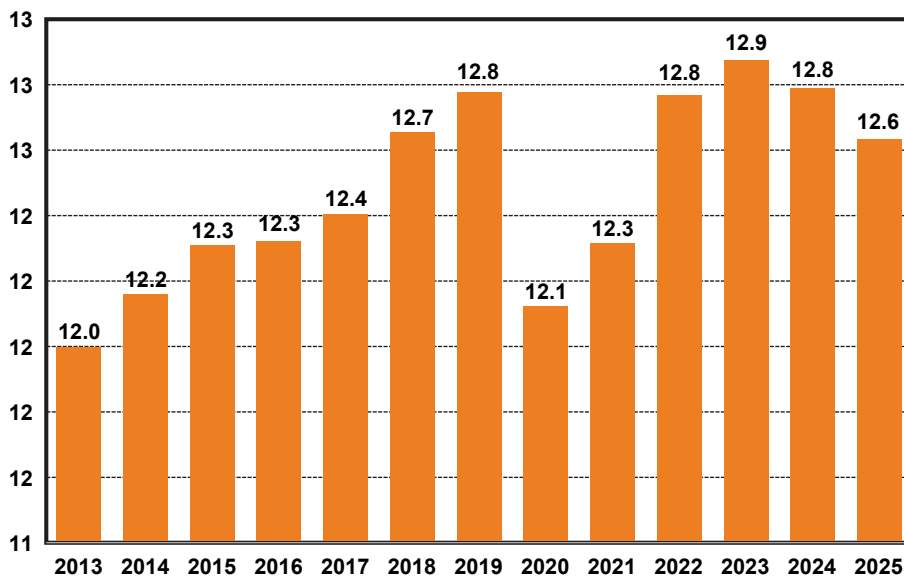
**The Biden Administration revived industrial policy through subsidies and targeted investment, while Trump, in both his first and second terms, relied primarily on tariffs.**

strategy has addressed — in a coherent and systematic way — the formidable challenges of meaningfully rebuilding the U.S. manufacturing base. Matching domestic manufacturing output to domestic demand would require a roughly 40% increase in U.S. manufacturing value-added — about \$1.2 trillion. At current productivity levels, achieving this would require approximately 5 million additional manufacturing workers, or about 3% of the entire U.S. employed workforce. In absolute terms, that would imply rebuilding manufacturing employment to levels comparable to those seen before China’s entry into the World Trade Organization in the early 2000s.

Numerous obstacles stand in the way. Compliance with federal regulations — spanning health and safety, environmental rules, taxes, and homeland security — now costs manufacturers roughly \$349 billion annually, a 26% increase in real terms since 2012. On a per-worker basis, these compliance costs are roughly equivalent to total value-added per worker in China. Labor constraints are equally daunting: U.S. manufacturing employs about 12.7 million workers but already faces roughly 500,000 unfilled vacancies. Expanding the workforce by another 5 million would require that roughly 25% of all new labor force entrants over the next decade choose manufacturing — a dramatic reorientation that current policy tools, including tariffs, have not meaningfully addressed. As Tim Cook, Apple’s boss puts it: “companies go to China because of the skill, and the quantity of the skill in one location. In the US, you could have a meeting of tooling engineers and I’m not sure we could fill the room.”

All this suggests that revitalizing the manufacturing sector was always going to be a tall order, and the administration’s efforts have yet to bear fruit. Manufacturing employment fell for a second consecutive year last year, shedding an estimated 157,000 jobs on top of the 84,000 lost in 2024 (Figure 44). In fact, manufacturing employment has been on a modest secular decline since peaking at a post-pandemic high of nearly 13 million in 2022, falling by roughly 300,000 jobs since then. To be sure, tariffs have supported some domestic employment (and prices) in heavily protected industries — particularly primary metals, benefiting from steel and aluminum tariffs — but these gains were more than offset by losses in downstream sectors that rely on these inputs, including machinery, computers, and transportation equipment, which experienced some of the steepest employment declines.

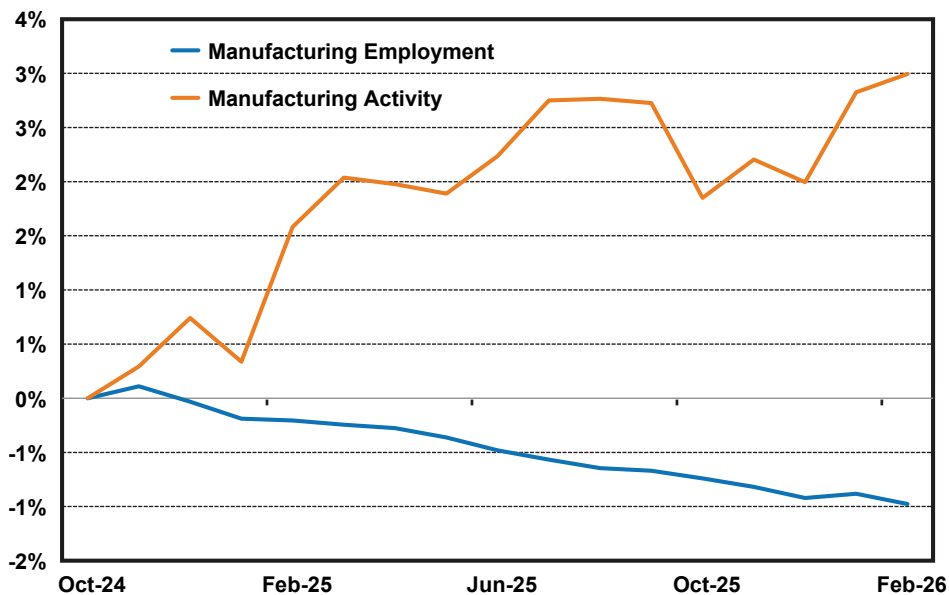
**FIGURE 44**  
**A Tough Couple of Years for Manufacturing**  
**(employment, millions of workers)**



Manufacturing construction, though still elevated, has also dampened. It peaked at \$235.6 billion in 2024 and has since declined roughly 7%-16% from that high — not because reindustrialization is failing, but because the CHIPS Act and IRA megaprojects that drove the boom are winding down from construction into operations, while tariff-induced policy uncertainty is freezing new starts.

It is possible that a revival in manufacturing will take time, as the administration argues. In fact, it is likely that before we see a pickup in manufacturing employment, activity will strengthen first. Indeed, industrial production rebounded robustly last year even as manufacturing employment continued to shrink (Figure 45). The outlook appears to have improved further this year: the ISM index — a key sentiment gauge for the manufacturing outlook — moved into expansion territory for the first time in three years during the first quarter. Manufacturing employment has also edged higher, expanding by 11,000 jobs in the first three months of the year. Perhaps even more encouragingly, Construction — often the first sector to pick up when large infrastructure and manufacturing projects are in the pipeline — has strengthened meaningfully, adding 57,000 jobs in the first quarter.

**FIGURE 45**  
**Manufacturing Activity Has Held Up Well Even as Employment Languishes**  
**(percent change since October 2024)**



"When you play the game of thrones, you win or you die. There is no middle ground." Cersei Lannister's dramatic flourish may be a touch over the top for today's geopolitical landscape, but it captures the high-stakes nature of the contest the United States is now engaged in as it seeks to rebalance what it sees as a lopsided trade position, rebuild its manufacturing base, and reassert control over critical supply chains. We hope in this quest to reshuffle the world order it does so with a steely resolve but also a soft diplomatic touch — dispelling what Thucydides warned, and Mark Carney recently invoked, that "the strong do what they can, and the weak must suffer what they must." After all, in the words of Sansa Stark: "When the snow falls and the white winds blow, the lone wolf dies, but the pack survives."

## ORANGE COUNTY, SOUTHERN CALIFORNIA AND CALIFORNIA

The U.S. economy has held up remarkably well this past year, despite the drag from ongoing tariffs and a relatively tight monetary stance maintained by the Federal Reserve over the past three years. Solid wage growth has continued to support consumer spending, while a surge in AI-related investment has provided a powerful tailwind to business outlays. But the economic landscape has shifted materially over the past month, overshadowed by the escalating conflict involving Iran. The result is a sharp rise in uncertainty—making the near-term outlook harder to read and the longer-term trajectory even more difficult to forecast. Nowhere is this more evident than in inflation, which has become increasingly volatile as oil prices surge in response to the conflict.

While employment growth has remained subdued—as reflected in the recently revised payroll data—shifts in immigration policy, including stepped-up deportations, have reduced the effective supply of labor. This tightening on the supply side has helped keep the unemployment rate lower than one might expect given the overall softness in job creation.

### California’s “Jobless Boom”: AI-Led Growth and Labor Market Weakness?

California’s economy is increasingly resembling what can only be described as a “jobless boom”—a period in which output and incomes rise, but employment struggles to keep pace. The driver is unmistakable: rapid growth in high-value sectors such as artificial intelligence, clean energy, and aerospace, where the state remains the global leader in innovation. These industries are generating strong income gains—particularly at the top of the distribution—and attracting significant capital, with 35 of the world’s top 50 AI firms headquartered in California. The AI surge, in particular, is poised to continue fueling investment.

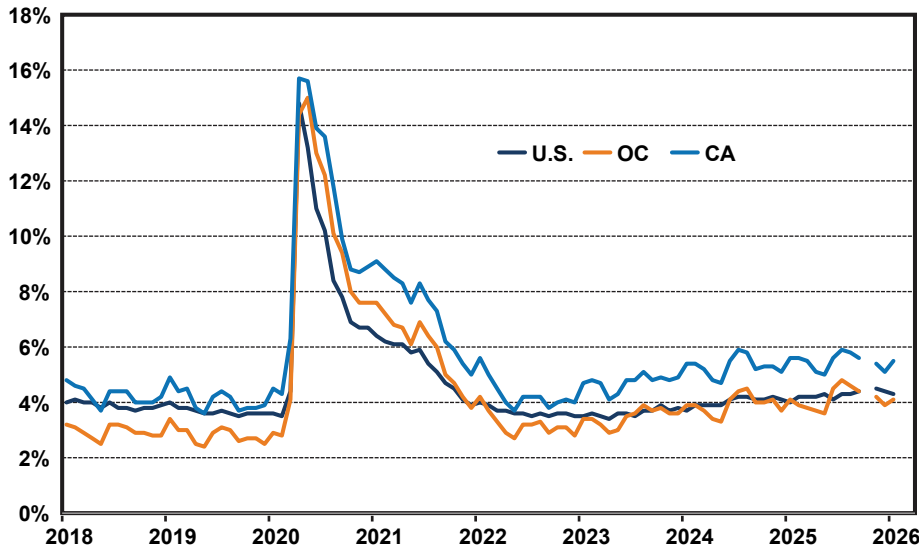
But beneath the surface, the fiscal picture is far less reassuring. The Governor’s 2026–27 budget projects a relatively modest \$2.9 billion deficit, yet the Legislative Analyst’s Office paints a more sobering picture, warning of a “chronic” imbalance. Structural deficits in the range of \$20 billion to \$35 billion annually loom over the coming years, driven largely by a highly volatile revenue base tied to capital gains—and, by extension, to stock market where valuations are extremely stretched.

In contrast to the national economy—and to many other states—job growth in California has remained notably weak, not just over the past year but for the last three years. And unlike the national picture where the unemployment rate has remained relatively subdued, the state’s unemployment rate stood at 5.5% in January, well above the national rate of 4.3%. This gap has persisted for some time and is evident also across Southern California. Historically, Orange County has outperformed the nation on this metric, but since the pandemic its unemployment rate has frequently matched or even exceeded the U.S. average (Figure 46). The picture is even more concerning in Los Angeles County and the Inland Empire, where unemployment rates remain consistently elevated.

**California’s economy is increasingly resembling what can only be described as a “jobless boom”—a period in which output and incomes rise, but employment struggles to keep pace.**

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**FIGURE 46**  
**California Unemployment Rate is More Elevated**  
**(unemployment rate, percent)**

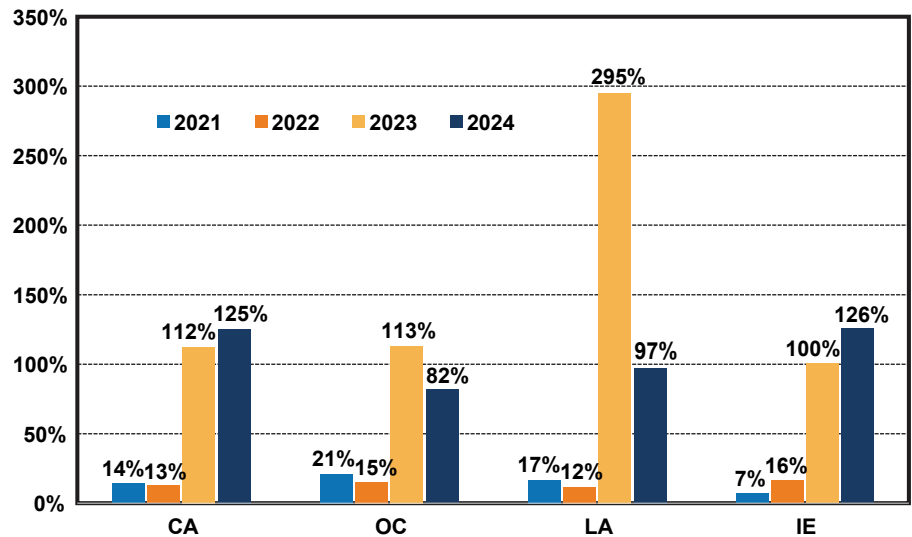


Payroll job growth—a broad barometer of labor market health—has been stuck at stall speed. In 2025, California’s payrolls inched up by a paltry 0.31%, trailing even the modest 0.47% gain nationally. Across Southern California, the picture is even more concerning: Orange County shed jobs at a rate of 0.09%, Los Angeles County declined by 0.11%, and only the Inland Empire managed to post any meaningful growth, at a still modest 1.04%.

Not only has the pace of job growth slowed, but the composition of those gains has become increasingly concerning. Much of the recent hiring has been concentrated in Education and Health Services—sectors heavily influenced by government spending—rather than broadly distributed across the private economy. In California, total job growth in 2025 amounted to just 55,750 positions, yet the Education and Health Services sector alone added 176,000 jobs—implying that the rest of the economy collectively shed more than 120,000 jobs.

This pattern is evident across Southern California. Orange County recorded a net loss of 1,560 jobs in 2025 (Figure 47), despite adding 11,500 positions in Education and Health Services. Los Angeles County saw a net decline of 5,100 jobs, even as the same sector added 40,100. The Inland Empire fared somewhat better, posting a net gain of 17,700 jobs, but even there, 28,500 of those were concentrated in Education and Health Services, while its traditionally strong Trade, Utilities, and Warehousing sector lost 1,900 jobs. Perhaps most concerning is the fact that this is not a one-off development. The same pattern emerged in 2023 and 2024, marking a clear shift away from the more broad-based job growth that characterized earlier years.

**FIGURE 47**  
**Health Care Has Accounted for the Vast Majority of Jobs In Recent Years**  
**(health care as share of total jobs)**



While job growth has slowed to a trickle also at the national level, California faces a distinct set of challenges. Tariffs and federal immigration policies have hit the state disproportionately hard. California remains an agricultural powerhouse, with more than \$400 billion in annual output, but the sector is grappling with labor shortages and shifting trade policy (as discussed in the U.S. outlook). Tariffs are also weighing on the logistics sector—a key engine of job growth in both the Inland Empire and Los Angeles County, anchored by the region’s ports. While the full extent of the impact is still unfolding, the direction is clear: as trade policy continues to evolve, so too will the pressures on some of California’s most critical industries.

Stricter immigration enforcement and deportation policies are beginning to materially tighten labor supply, particularly in lower-skilled segments of the workforce. U.S. immigration policy has been in flux since the return of the Trump Administration in January 2025, with changes that are likely to have significant—though not yet fully realized—effects on future labor force growth. The administration has moved aggressively to expand enforcement, including a broad push to detain unauthorized immigrants, the removal of temporary protections for more than 1.5 million humanitarian migrants, and increased scrutiny of temporary visa holders, including international students and H-1B workers. Additional proposals under consideration include expanded reviews of green card holders and naturalized citizens, as well as tighter restrictions on both temporary and permanent immigration flows.

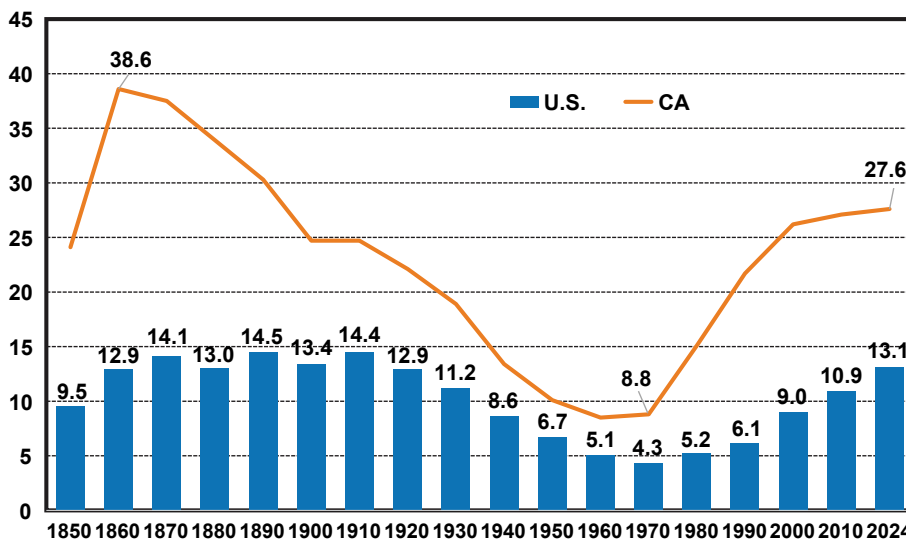
Immigration has been a central driver of U.S. population growth. Since 2000, immigrants and their U.S.-born children have accounted for essentially all of the growth in the prime working-age population. California sits at the center of this dynamic. The state is home to 10.9 million immigrants—roughly 22% of the nation’s foreign-born population—nearly double that of the next largest state, Texas, with 5.8 million (Figure 48). As of 2024, the most recent data, 28% of California’s population was foreign-born—the highest share in the country and more than twice the national average. The demographic imprint runs even deeper: 44% of children in California have at least one immigrant parent. Yet this key source of population and labor force growth is slowing sharply. Net international migration into California fell from 260,000 in fiscal year 2024 to just 126,500 in fiscal year 2025—nearly a 50% decline.

**While job growth has slowed to a trickle also at the national level, California faces a distinct set of challenges. Tariffs and federal immigration policies have hit the state disproportionately hard.**

**Tariffs are also weighing on the logistics sector—a key engine of job growth in both the Inland Empire and Los Angeles County, anchored by the region’s ports.**

**Stricter immigration enforcement and deportation policies are beginning to materially tighten labor supply, particularly in lower-skilled segments of the workforce.**

**FIGURE 48**  
**Immigrants Have Always Accounted for a Large Share of CA Population**  
**(immigrant population as share of total)**



## A Persistent Affordability Crisis: California Dream Put on Hold

The “California Dream” continues to run up against a persistent affordability crisis. Rents and food prices have climbed by roughly 25% since 2020, while the state’s minimum wage—now at \$16.90—has added to cost pressures for businesses. The result is a paradoxical “jobless boom,” in which the population shrinks due to out-migration even as the remaining economy becomes more productive on a per capita basis.

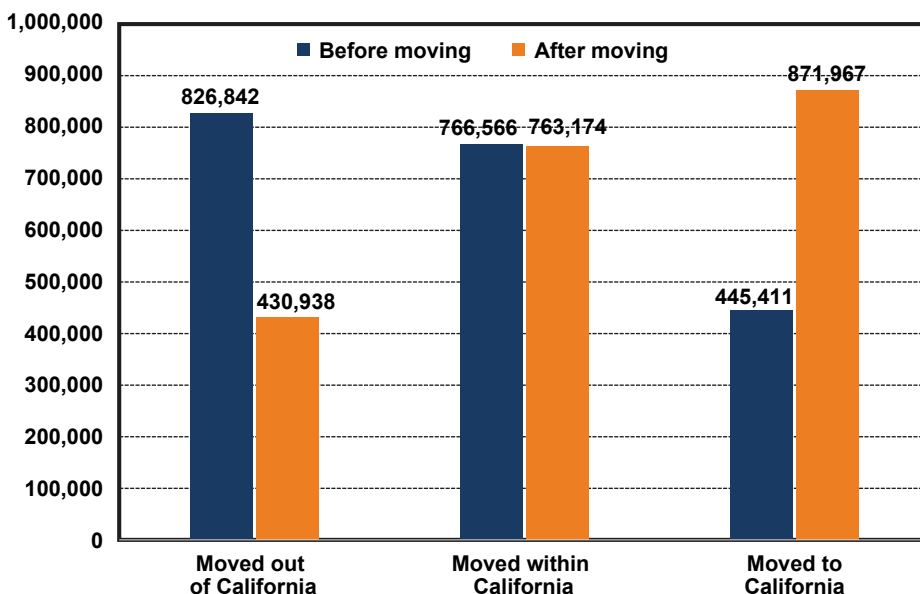
Population dynamics underscore the strain. California experienced its first net population decline during the pandemic, and growth has remained subdued since. Out-migration has exceeded inflows for more than two decades, and that imbalance remains pronounced in the post-pandemic period. In 2025 alone, nearly 150,000 more people left the state than moved in. In recent years, it has been international immigration—not domestic migration—that has kept overall population growth in positive territory.

Rising living costs—particularly for housing, groceries, gas, and utilities—are increasingly pushing Californians to consider relocating. Housing costs in the state far exceed those in most of the country, and median household incomes are no longer sufficient to support even basic homeownership. Evidence from the UC Berkeley Policy Lab underscores the incentive to move: Californians who relocate to more affordable areas reduce their housing costs by an average of \$672 per month, and within seven years, their likelihood of owning a home increases by 48%. Home prices fall by nearly half once someone relocates outside CA, a staggering difference (Figure 49).

**California experienced its first net population decline during the pandemic, and growth has remained subdued since.**

**In 2025 alone, nearly 150,000 more people left the state than moved in. In recent years, it has been international immigration—not domestic migration—that has kept overall population growth in positive territory.**

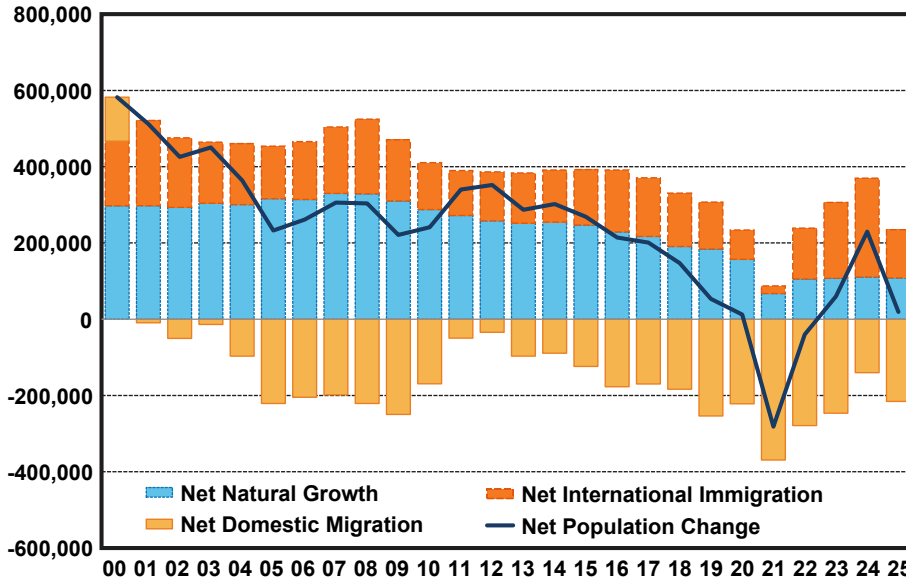
**FIGURE 49**  
**Housing Prices Paid Drop By Nearly Half If Relocating Outside CA**  
**(average home price, dollars)**



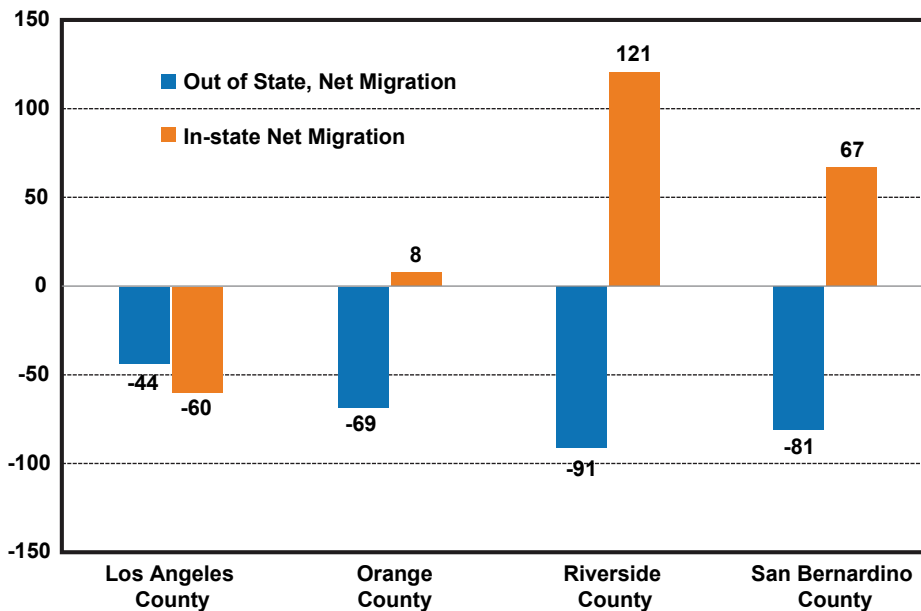
The gap between exits and entries has persisted for more than two decades, with outflows consistently exceeding inflows (Figure 50). But it isn’t just flows: the composition of those leaving has also shifted. Fewer movers now come from lower-income neighborhoods, while higher-income areas are contributing a growing share of out-migrants. Notably, however, those departing from these higher-income neighborhoods tend to have more constrained financial profiles than their peers—characterized by lower credit scores, higher student debt, and lower homeownership

rates. Geography also plays a key role in migration patterns. Nearby states capture the bulk of outflows, with Nevada receiving the largest net inflow of Californians, followed by Idaho, Oregon, and Arizona. More distant destinations such as Texas and Florida rank lower in net migration. Domestic outmigration is also a Southern California story: Every county in the SoCal region has experienced outmigration over the past 10 years, though for the Inland Empire a portion of this trend has been offset by in-state migration (Figure 51).

**FIGURE 50**  
**International Migration Has Been the Most Enduring Source of Population Growth for CA**  
**(thousands of people)**



**FIGURE 51**  
**Domestic Outmigration is a Problem Also for SoCal**  
**(per 10 thousand of population, 2016-2025 average)**



As if persistent domestic outmigration were not enough, California is also weighing higher taxes on the uber-wealth—raising the risk of further outflows among some of its most mobile residents.

## Taxing the Wealthy – The California Way

California is currently considering a landmark wealth tax targeting its wealthiest residents. The most recent proposal, the 2026 Billionaire Tax Act, is designed as a ballot initiative that would impose a one-time 5% tax on the worldwide net worth of California billionaires as of December 31, 2026. Payments would be distributed over five years. If approved by voters in November 2026, this measure would be the first significant tax on general wealth in U.S. history. This proposal comes at a critical juncture, as California faces a projected \$19 billion annual budget deficit due to federal spending reductions under the One Big Beautiful Bill Act (OBBBA), or H.R. 1, signed in July 2025. The initiative is explicitly framed as a response to this fiscal emergency. It builds upon prior annual wealth tax proposals, notably AB 310 (2021) and AB 259 (2023), which did not advance in the legislature but contributed significant academic insight to the current debate.

## National Wealth and Income Concentration

Since the late 1970s, the concentration of wealth and income at the top of the national distribution has intensified, reaching levels reminiscent of the late 1920s. According to extensive reports available at the [Woods Center website](#), U.S. wealth inequality from 1913 to 2012 displays a unique U-shaped pattern: high concentration during the Gilded Age, a prolonged decline through the mid-20th century, and a sharp rebound since the late 1970s. While the direction of this trend is clear, estimates vary by methodology.

Wealth concentration is only part of the story; income is also highly concentrated and has become even more so since 1980, although to a lesser degree than wealth. The top 1% holds roughly twice the share of national income as it does of national wealth, while the bottom 50% owns less than 5% of wealth and receives about 12% of income. Notably, the top one percent's share of national income nearly doubled between 1980 and 2014, as the bottom half's share declined by a similar margin. Among the wealthiest, the share of the top 400 wealthiest individuals as a proportion of GDP has doubled each decade since 1982.

Wealth is far more concentrated than income—by a factor of two to three, depending on country and measurement. This distinction is important for tax policy: Income taxes reach only cash flows, while much of the growth in top wealth results from asset appreciation, which generates no taxable income until realized.

The structural argument for a wealth tax arises from this gap: Wealthy individuals often accumulate assets at rates far exceeding their reported taxable income, through retained corporate earnings, unrealized equity appreciation, and borrowing against appreciated assets. As a result, income taxes alone are insufficient for progressive taxation at the top. The annual reported income of top wealth holders is less than 4% of their wealth; with preferential capital gains treatment, their effective tax rate amounts to ordinary income rates on less than 3% of wealth, while their total economic return, including unrealized gains, is likely 8% or higher.

**The 2026 Billionaire Tax Act, is designed as a ballot initiative that would impose a one-time 5% tax on the worldwide net worth of California billionaires as of December 31, 2026.**

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**The top 1% holds roughly twice the share of national income as it does of national wealth, while the bottom 50% owns less than 5% of wealth and receives about 12% of income.**

**The structural argument for a wealth tax arises from this gap: Wealthy individuals often accumulate assets at rates far exceeding their reported taxable income, through retained corporate earnings, unrealized equity appreciation, and borrowing against appreciated assets.**

The increasing concentration of wealth and income in the U.S. is not unique; post-1980, nearly all advanced economies have experienced a reversal of the postwar trend toward greater equality. The U.S., however, stands out in both the magnitude of this increase and the limited effectiveness of its tax system in offsetting it.

In 2018, total U.S. household net wealth stood at roughly \$90 trillion—about five times national income. By 2025, it had risen to approximately \$145 trillion, a 60% increase over seven years, driven largely by asset price appreciation. A hypothetical 1% uniform tax on this base, assuming no evasion, would generate about \$1.45 trillion. However, this figure assumes the tax is applied broadly across all households, not just to high-wealth individuals.

## California's Wealth Inequality?

California's share of U.S. billionaires—roughly 25%—has grown far faster than its share of the population (12%), even in the wake of the 2012 income tax hike (Table 1). A key reason is structural: The state's income tax system does not capture unrealized capital gains. As a result, founders of companies such as Meta and Google can hold appreciated stock indefinitely without incurring California income tax on that accumulated wealth. The proposed wealth tax is aimed squarely at closing this gap.

**TABLE 1**  
**Billionaire Wealth and Taxes**

METRIC	CALIFORNIA	UNITED STATES
Share of U.S. population	12%	—
Share of U.S. millionaires	17% (2021)	—
Share of U.S. billionaires	25% (2021)	—
Top 1% income share	25.5% (2015)	22% (2015)
Billionaire collective wealth	\$960B (Jan 2021)	\$4.1T (Forbes)
Billionaire wealth growth (2011-2021)	\$300B to \$960B (+220%)	Broadly similar
CA billionaires' Effective Tax Rate (all taxes)	~23% of economic income	28% economy-wide

The scale of the divergence is striking. The combined wealth of California billionaires has surged from about \$300 billion in 2011 to \$700 billion in 2019, and to roughly \$2.19 trillion by October 2025—a more than sevenfold increase in just over a decade. By contrast, average California incomes have grown at only about 1.5% annually in real terms. As a result, billionaires often pay a smaller share of their true economic income in taxes than the average Californian—a disparity that lies at the core of the equity argument for a wealth tax.

**The increasing concentration of wealth and income in the U.S. is not unique; post-1980, nearly all advanced economies have experienced a reversal of the postwar trend toward greater equality. The U.S., however, stands out in both the magnitude of this increase and the limited effectiveness of its tax system in offsetting it.**

**California's share of U.S. billionaires—roughly 25%—has grown far faster than its share of the population (12%), even in the wake of the 2012 income tax hike.**

## Fiscal Motivation for the Tax Proposal

A pressing fiscal motivation underpins the 2026 proposal. The OBBBA federal spending cuts enacted in July 2025 have created a specific budget emergency that shapes the ballot initiative:

- **OBBBA (H.R. 1, signed July 2025):** Projected \$19B/year budget deficit for California health spending; up to 1.6 million Californians could lose Medi-Cal coverage.
- **SNAP restrictions:** Reduced federal nutrition assistance funding, impacting school funding formulas that depend on SNAP enrollment data.

## The Tax Proposals

An earlier proposal would have imposed an annual wealth tax of 1% to 1.5% on residents with net worth above \$50 million, estimated to generate roughly \$22.3 billion per year from approximately 15,000 taxpayers—about 0.07% of California households. Revenues under this framework would be expected to grow alongside asset values and overall economic expansion. For context, Senator Elizabeth Warren’s 2019 federal wealth tax proposal—featuring a 2% rate above \$50 million and 3% above \$1 billion—was projected to raise roughly twice the revenue of the California plan.

The 2026 Billionaire Tax Act ballot initiative takes a different approach: a one-time 5% levy on the worldwide net worth of California billionaires, projected to raise approximately \$100 billion over five years, or about \$20 billion annually (Table 2).

**TABLE 2**  
**Wealth Tax Revenue Projections**

REVENUE COMPONENT	AMOUNT
CA billionaire wealth base (Forbes, Oct 2025)	\$2.19 trillion (204 billionaires; 27.8% of all U.S. billionaire wealth)
Gross 5% tax on base	\$109.5 billion
Less: 10% avoidance/evasion reduction	- \$10.5 billion
Net revenue estimate (5 years, 2027-2031)	~\$100 billion (~\$20B/year)

The optimistic assumption of only 10% avoidance is based on four factors: (i) the one-time structure prevents multi-year asset restructuring to avoid the threshold; (ii) migration is negligible since residency is determined as of January 1, 2026; (iii) 72% of California billionaire wealth is in publicly traded stock with SEC-reported ownership; and (iv) with about 200 affected taxpayers, thorough individual-level auditing is feasible.

## Base Erosion and Migration Effects

Empirical analysis of Proposition 30—a 2012 income tax increase—provides a behavioral baseline for California’s revenue projections. Significant tax revenue erosion occurred from high earners reducing their reported taxable income through restructuring, avoidance, and income shifting, rather than by physically leaving the state.

Another study found that about 30% of the wealth tax base had already left California before the initiative qualified for the ballot. Six billionaires publicly confirmed their departure between the initiative's filing and the January 1, 2026 residency date, removing approximately \$536 billion from the taxable pool.

Accounting for this erosion—as well as additional, unobserved departures using elasticity estimates from the academic literature—projected collections fall to roughly \$40 billion over five years. Once the permanent loss of future income tax revenues from departing billionaires is incorporated, the net present value of the 2026 Billionaire Tax Act turns negative, at approximately -\$24.7 billion—implying that California would ultimately be worse off financially than if the tax had never been enacted.

Migration—the physical relocation of wealthy Californians to lower-tax states—is one of the most visible concerns associated with a proposed wealth tax. This is distinct from avoidance and restructuring, which involve legal changes to assets or income by individuals who remain in the state. Proponents of the bill point out that California's share of U.S. millionaires and billionaires increased between 2011 and 2021, even after the 2012 Proposition 30 income tax hike—suggesting that higher taxes have not prevented wealth accumulation.

Skeptics, however, argue that stock wealth measures can be misleading. Total wealth can continue to grow even as out-migration at the margin increases, since new wealth creation can offset departures. The more relevant metric, therefore, is not the level of wealth, but the departure rate. Empirical evidence from Proposition 30 supports this view: The exit rate for top earners rose by 0.8 percentage points—a 53% increase relative to the baseline.

Avoidance—the legal reduction of taxable wealth or income by residents who stay in California—is another concern. This issue is less visible publicly, as it involves private restructuring of assets and often only becomes apparent when revenue shortfalls occur. Additional concerns include deferral of taxable assets and pre-passage avoidance.

Lastly, asset valuation presents challenges. The proposed legislation outlines specific methodologies for each asset category, but critics argue that some approaches systematically overstate values and that the penalty structure can create perverse incentives, worsening the issue.

## Public Opinion on Wealth Tax Increases

In February 2026, the Public Policy Institute of California conducted a poll to gauge public sentiment regarding proposals to raise taxes on wealthy individuals. The results indicate that a significant portion of California adults and likely voters support increasing taxes on the rich, with six in ten expressing general approval for such measures. Conversely, nearly four in ten respondents are opposed to the idea.

Support for the proposed tax varies markedly by political affiliation. Among Democrats, 81% are in favor, compared with 54% of independents and 31% of Republicans. Despite these partisan differences, the proposal still commands majority support across California's regions and demographic groups.

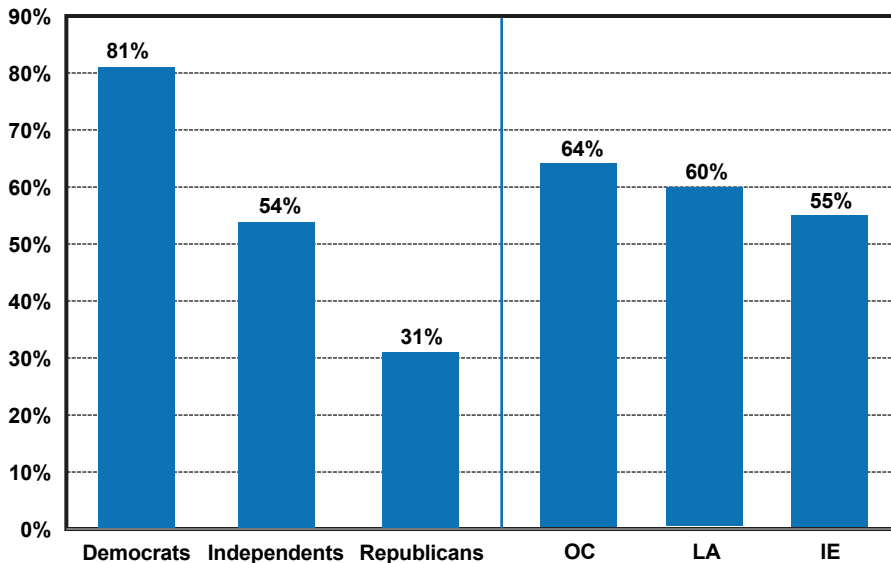
Regional analysis reveals strong support for higher taxes on the rich in several areas. In Orange County, 64% of voters support the increase; in Los Angeles County, support stands at 60%; and in the Inland Empire, 55% of voters are in favor (Figure 52). These figures suggest that the idea of raising taxes on wealthy individuals resonates with a broad base across the state.

**Another study found that about 30% of the wealth tax base had already left California before the initiative qualified for the ballot.**

**Once the permanent loss of future income tax revenues from departing billionaires is incorporated, the net present value of the 2026 Billionaire Tax Act turns negative, at approximately -\$24.7 billion—implying that California would ultimately be worse off financially than if the tax had never been enacted.**

**A significant portion of California adults and likely voters support increasing taxes on the rich, with six in ten expressing general approval for such measures.**

**FIGURE 52**  
**Significant Support for the Wealth Tax**  
**(PPIC survey, percent of respondents)**



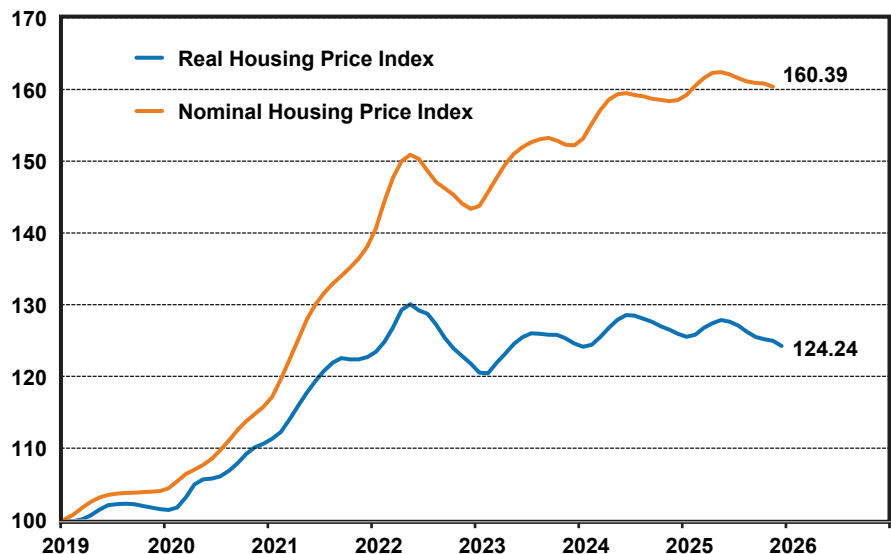
Between January 2019 and December 2025, nominal home prices in the United States surged by 60.4%. However, after adjusting for inflation using the Consumer Price Index (CPI), the real increase in home values was much more modest, at approximately 24.2%.

## Housing and Real Estate

Housing in California has long been expensive, and construction remains a significant part of the state’s economy. But elevated home prices have pushed homeownership to historically low levels. The surge in home prices across the United States following the COVID-19 pandemic was driven largely by the Federal Reserve’s decision to cut interest rates to historic lows in an effort to stabilize the economy. These rates were held low for an extended period, fueling both inflation and asset price appreciation, including in housing. Although the Fed began its hiking cycle four years ago (which has since been partially reversed), momentum in home price growth persisted until recently. By 2025, prices had reached unprecedented levels, though a modest pullback has since emerged—marking the first meaningful sign of softening in years.

Between January 2019 and December 2025, nominal home prices in the United States surged by 60.4%. However, after adjusting for inflation using the Consumer Price Index (CPI), the real increase in home values was much more modest, at approximately 24.2% (Figure 53). This gap underscores an important point: while headline home prices surged, the true purchasing power gained from homeownership was significantly tempered by broader inflationary trends during this period.

**FIGURE 53**  
**Home Prices Have Skyrocketed in Nominal Terms...But Less so in Real Terms**  
**(U.S. nominal and real price indices, level)**



For context, equities saw a far larger nominal increase over the same period, with the S&P 500 rising by 153% between January 2019 and December 2025. To be fair, this comparison is not strictly equivalent, however, as it does not account for the implicit rental value associated with homeownership, which would add to housing’s total return.

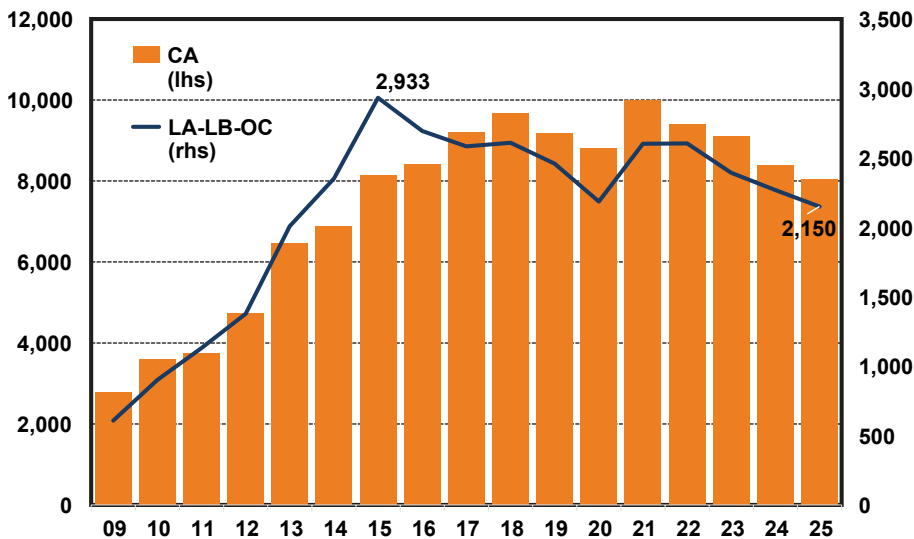
The housing market in 2025 fell short of expectations, weighed down by weak consumer confidence and elevated economic uncertainty. In December, President Trump outlined plans for an aggressive housing reform package aimed at boosting affordability and housing supply. Proposed measures included efforts to lower mortgage rates, reduce regulatory burdens on homebuilders, and expand Federal Housing Administration (FHA) loan limits. Additional ideas under consideration include portable mortgages and allowing homebuyers to tap 401(k) funds for down payments.

Those hopes, however, have largely faded. As 2026 began, expectations shifted toward a flat housing market—even before the conflict in Iran added further uncertainty and upward pressure on mortgage rates and inflation. Builders have increasingly relied on incentives and mortgage rate buydowns to move inventory, and these strategies are likely to persist throughout 2026. At the same time, major public homebuilders have grown more cautious about ramping up new construction. The strength of the spring selling season, along with shifts in consumer confidence, will be critical in determining the market’s trajectory. In California—and Southern California in particular—construction activity has been trending downward for several years. Building permits in 2025 fell below even the pandemic lows of 2020 (Figure 54).

**The housing market in 2025 fell short of expectations, weighed down by weak consumer confidence and elevated economic uncertainty.**

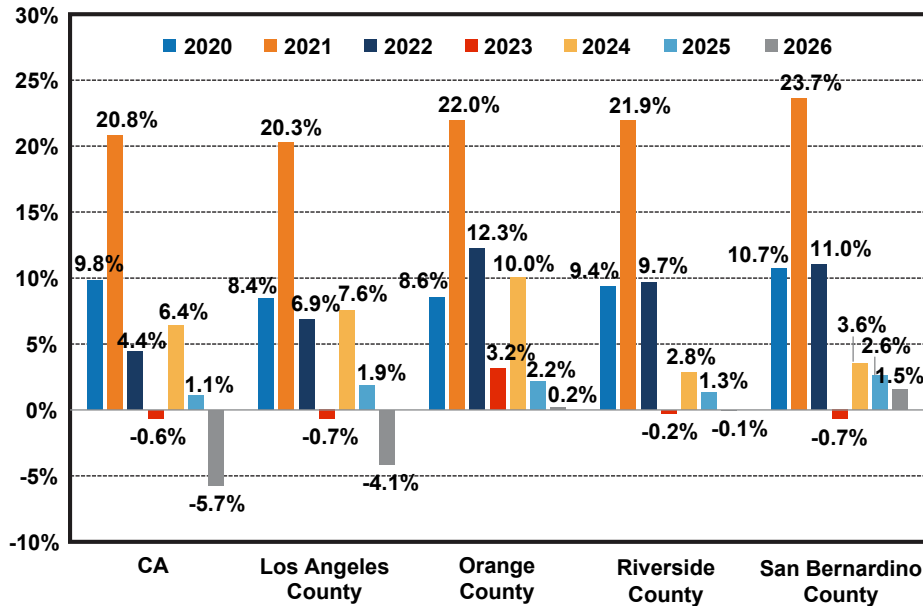
**In California—and Southern California in particular—construction activity has been trending downward for several years. Building permits in 2025 fell below even the pandemic lows of 2020.**

**FIGURE 54**  
**Building Permits Remain Weak Both for CA and SoCal (units)**



California’s housing market broadly mirrored national trends, with rapid price gains during the pandemic—most notably in 2021, when all regions of Southern California saw increases of 20% or more, fueled by pent-up demand (Figure 55). Momentum then reversed, with most regions posting price declines in 2023, with the exception of Orange County. In 2024, Orange County again stood out, recording a 10% increase. By 2025, appreciation had slowed to below 2%, a trend that has carried into early 2026. Yet despite this deceleration, price levels remain elevated. As of February 2026, median home prices stood at \$1.43 million in Orange County, \$842,000 in Los Angeles County, \$631,000 in Riverside County and \$570,000 in San Bernardino County.

**FIGURE 55**  
**Home Price Appreciation Has Cooled Off Last Few Years**  
 (home prices, y-o-y percent change)



Measure ULA (United to House LA), commonly referred to as the “Mansion Tax,” has become one of the most controversial policies in the Los Angeles area real estate market. It imposes a 4% tax on property sales between \$5.3 million and \$10.6 million, and a 5.5% tax on transactions above \$10.6 million. Since its implementation, high-value sales have dropped by more than 50%, with developers and investors pausing activity amid ongoing uncertainty. Sellers, meanwhile, have adjusted by pricing properties just below the tax thresholds to avoid the levy. The broader effect has been a noticeable slowdown in market activity. Some estimates suggest the decline in high-end transactions has cost the city up to \$25 million annually in foregone property tax reassessments—partially offsetting the revenue generated by the tax itself.

The measure applies to commercial, industrial, and multi-family properties, not just single-family homes. Since its introduction, total construction permits in Los Angeles County have fallen by 40%, and multi-family permits by 27%. Development has shifted to suburbs outside the city, where these taxes do not apply. Initial tax collections in 2023 were only about 25% of projections, as many owners rushed to close deals before the April 1, 2023, deadline. By January 2026, the city had collected more than \$1 billion, funding eight city programs focused on eviction defense and affordable housing development.

The future of Measure ULA remains uncertain. In January 2026, the Los Angeles City Council declined to place a major exemption for new construction before voters. By March, however, it had formed an ad hoc committee to explore potential reforms, including a possible ballot measure in November 2026. At the same time, a statewide initiative could emerge to repeal or limit the measure—potentially even retroactively.

Home prices at the national level appear to have peaked, with several warning signs emerging. The number of U.S. homeowners with negative equity rose by roughly 60% in 2025, surpassing one million and accounting for 2.1% of all mortgage borrowers—the highest share since Q3 2023. Negative equity both raises the risk of default in a downturn and constrains housing supply, as many owners are reluctant to sell at a loss. This increase in underwater borrowers comes

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alongside sluggish home sales and persistently weak affordability. Foreclosures are also trending higher, up 20% year-over-year as of February, despite a still-resilient economy. Any deterioration in the labor market could amplify these pressures—particularly if elevated energy costs continue to weigh on household finances.

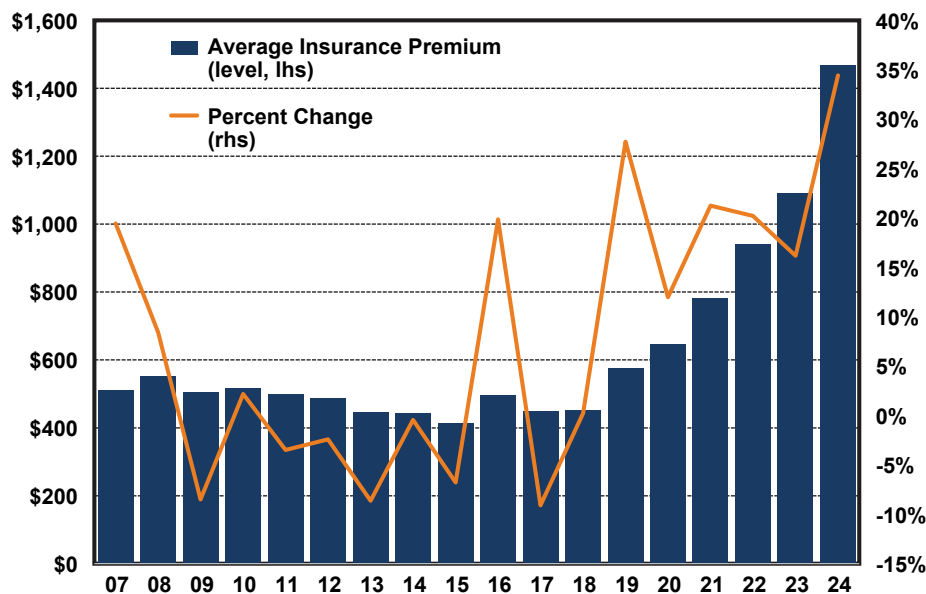
That said, these indicators are more consistent with a market that is cooling and normalizing than one that is deteriorating. Roughly 44.6% of mortgaged homes remain equity-rich—well above the pre-pandemic norm of about 27%. Overall equity levels remain historically strong, and the share of borrowers in negative equity, at around 1.6%, is still a fraction of the roughly 23% seen during the Global Financial Crisis.

Beyond the challenge of high home prices, insurance costs have emerged as a growing concern for homeowners in California and across the country. Premiums vary widely by state, with Hawaii at the low end and Oklahoma at the high end. While factors such as home size, materials, and age influence pricing, the dominant driver is exposure to catastrophic risk. Events such as wildfires, hurricanes, and tornadoes increasingly shape insurance costs. As a result, coastal states like Florida and inland regions such as Oklahoma and Arkansas—where tornado risk is elevated—face some of the highest premiums in the nation.

California’s home insurance rates have surged in recent years, particularly since 2018. After remaining steady at around \$450 from 2005 to 2017, the average home insurance rate increased dramatically, rising 34% in 2024 alone (Figure 56). From 2018 to 2024, average annual premiums soared by 225%. Several major insurers have stopped issuing new policies, complicating matters for homeowners. The devastating January 2025 Los Angeles fires killed at least 31 people, destroyed over 18,000 structures and forced more than 200,000 evacuations. The full impact on insurance premiums is still being assessed, but additional increases of over 10% are expected for the current year.

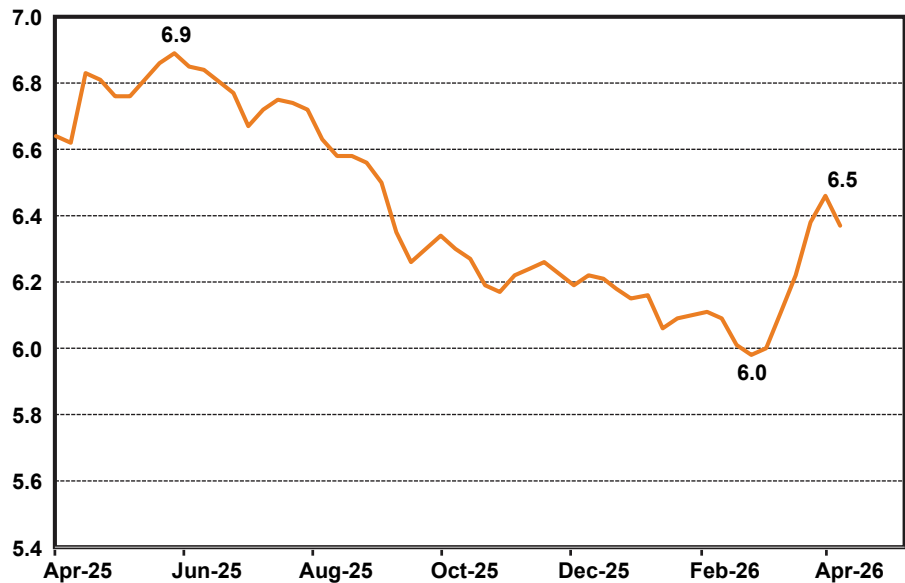
**California’s home insurance rates have surged in recent years, particularly since 2018. After remaining steady at around \$450 from 2005 to 2017, the average home insurance rate increased dramatically, rising 34% in 2024 alone.**

**FIGURE 56**  
**Through the Roof: Home Insurance Premiums Have Surged**  
**(average home insurance premium, level and y-o-y percent change)**



Mortgage rates declined briefly at the start of 2026 but have since moved higher, with the 30-year fixed rate currently around 6.4% (Figure 57). The escalation of the Iran conflict, along with broader uncertainty, has pushed rates up by nearly 50 basis points over the past six weeks. Inflation remains a concern—reinforced by rising energy prices and elevated federal debt—which has led bond investors to demand higher yields. As a result, mortgage rates are expected to remain above 6% through 2026, according to the Mortgage Bankers Association. These elevated rates will continue to weigh on any meaningful recovery in the housing market. At the same time, as prices soften, a growing number of recent buyers are finding themselves in negative equity positions.

**FIGURE 57**  
**Mortgage Rates Have Risen...Again...As Fed Pause Weighs on Rates (percent)**



## Home Affordability at Historic Lows

The combination of high home prices and elevated mortgage rates has pushed affordability to extremely low levels. The U.S. Home Affordability Index—which measures whether a median-income household can qualify for a mortgage on a median-priced home—has fallen from 140 in 2020 (highly affordable) to around 80. As a result, the income required to purchase a typical home has risen sharply, placing homeownership increasingly out of reach. In Orange County, a qualifying income of roughly \$225,000 was needed at the end of 2025 to afford a median-priced single-family home (Table 3)—more than four times the national requirement. Statewide, the income needed is more than double the U.S. average. It is therefore not surprising, as discussed earlier in this report, that many Californians are opting to leave in search of more affordable housing elsewhere.

**The combination of high home prices and elevated mortgage rates has pushed affordability to extremely low levels.**

**TABLE 3**  
**First Time Buyer Housing Affordability Index (Q4:2025)**

REGION	Median Home Price	Monthly Payment Including Taxes and Insurance	Minimum Qualifying Income
California	\$738,910	\$4,680	\$140,400
Los Angeles County	\$798,740	\$5,060	\$151,800
Orange County	\$1,187,030	\$7,520	\$225,600
Riverside County	\$538,540	\$3,410	\$102,300
San Bernardino County	\$422,450	\$2,680	\$80,400
United States	\$352,670	\$2,240	\$67,200

In the multifamily market, oversupply across the Sun Belt and Mountain West—particularly in states such as Texas, Colorado, Alabama, and North Carolina—has led to elevated vacancy rates and declining rents, with landlords increasingly offering concessions to fill units. Metro areas including Austin, Phoenix, Denver, Tampa, and San Antonio are experiencing the greatest downward price pressure due to a surge in new construction.

By contrast, markets with constrained supply—such as New York, Chicago, and San Francisco—continue to post stronger rent growth. Los Angeles, for its part, remains relatively tight, with a vacancy rate of about 5.7% as of early 2026—below the national average—and modest but positive rent growth. In effect, regions that built aggressively are now working through excess supply, while California remains a structurally supply-constrained, landlord-favorable market characterized by low vacancy and strong pricing power.

The commercial real estate sector is showing tentative signs of stabilization after several years of volatility. Risks remain—notably elevated financing costs and a wave of looming debt maturities—but investor sentiment is gradually improving as capital begins to flow back into the market.

## Tell Me Your Hopes and Sorrows: Orange County Business Survey

The Woods Center’s quarterly survey of Orange County business executives—conducted since the early 2000s—showed a modest improvement heading into the second quarter of 2026. Based on responses collected in the second half of March (as the Iran War is ongoing), the Orange County Business Expectations Index (OCBX) rose to 68.5%, up from 66% in the first quarter. This brings the index back to levels last seen in the third quarter of 2024. The OCBX serves as a broad measure of the local economic outlook, constructed from several key indicators captured in the survey. Readings above 50 signal expectations of continued economic expansion in Orange County.

Expectations for the national economy have shifted toward a more neutral stance. In the second quarter, views on national business activity among owners, CEOs and managers moderated relative to the prior quarter. While optimism softened, pessimism also eased, resulting in a broader move toward neutrality.

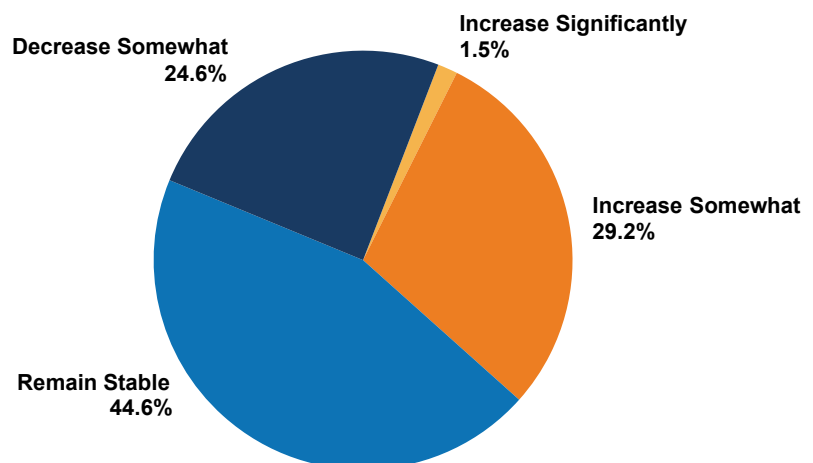
In contrast, Orange County business leaders are expressing increased optimism about conditions within their own industries and the regional economy. According to the survey, 29.2% of executives expect industry activity to improve—more than double the 13% reported in the previous quarter (Figure 58). At the same time, the share anticipating a downturn has declined to 24.6%, down from 31%. Expectations for firm-level growth have also strengthened relative to three months ago. Taken together, these shifts help explain the modest uptick in the Orange County Business Expectations Index (OCBX).

**Los Angeles, for its part, remains relatively tight, with a vacancy rate of about 5.7% as of early 2026—below the national average—and modest but positive rent growth.**

**Based on responses collected in the second half of March (as the Iran War is ongoing), the Orange County Business Expectations Index (OCBX) rose to 68.5%, up from 66% in the first quarter.**

**Orange County business leaders are expressing increased optimism about conditions within their own industries and the regional economy.**

**FIGURE 58**  
**OC Business Sentiment About Own Industry Has Improved**  
**(OCBX survey, percent of respondents)**



## Biggest Concerns

Several key issues emerged as primary concerns for Orange County businesses. The ongoing conflict with Iran, rising fuel costs, persistent inflation, and elevated interest rates rank among the most pressing challenges facing local firms. Together, these factors are contributing to heightened uncertainty and are likely to weigh on business activity.

Other concerns, while still relevant, are viewed as secondary. These include housing supply constraints, government deficits, advances in artificial intelligence, and stock market volatility. Notably, tariffs—which had previously ranked among the top concerns—have become less prominent. Respondents also pointed to additional challenges, including the regulatory environment, taxation, political uncertainty, immigration enforcement (including ICE-related activity), state-level governance issues, and broader geopolitical risks.

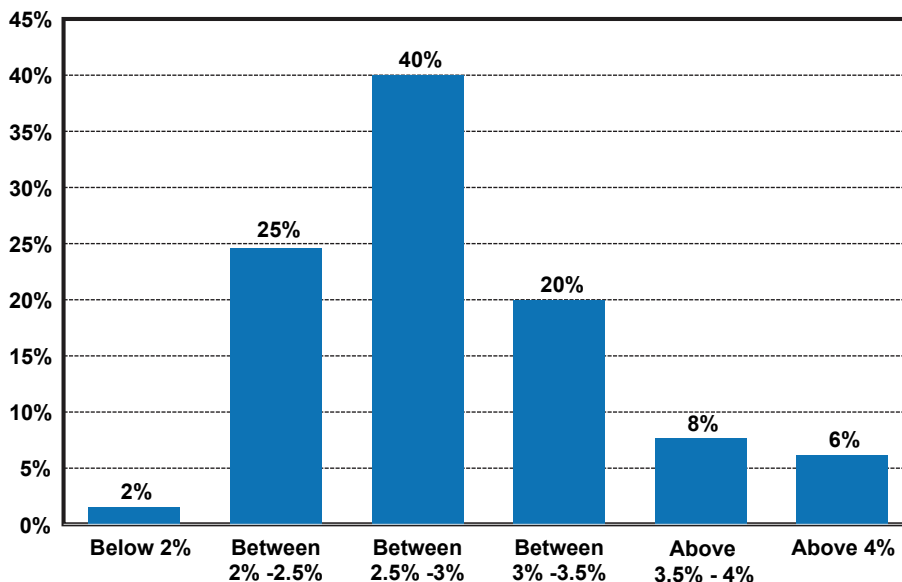
**Several key issues emerged as primary concerns for Orange County businesses. The ongoing conflict with Iran, rising fuel costs, persistent inflation, and elevated interest rates rank among the most pressing challenges facing local firms.**

## Expectations for Inflation and Federal Funds Rate

Survey participants were asked to forecast the rate of inflation for December 2026. Responses span a relatively wide range, though most cluster at the lower end. Specifically, 26.1% of respondents expect inflation to come in below 2.5%, while 40% anticipate a range of 2.5% to 3% (Figure 59). Another 20% place inflation between 3% and 3.5%. Only 7.7% expect a range of 3.5% to 4%, and just 6.2% foresee inflation exceeding 4%. Overall, more than two thirds of respondents expect inflation to remain below 3% by year-end. Even so, this points to a modest uptick from the February 2026 reading of 2.4%, suggesting expectations of slightly firmer inflation as the year progresses.

**Notably, tariffs—which had previously ranked among the top concerns—have become less prominent.**

**FIGURE 59**  
**Inflation Expectations Still Contained Despite Escalation in Oil Prices**  
**(OCBX survey, percent of respondents)**

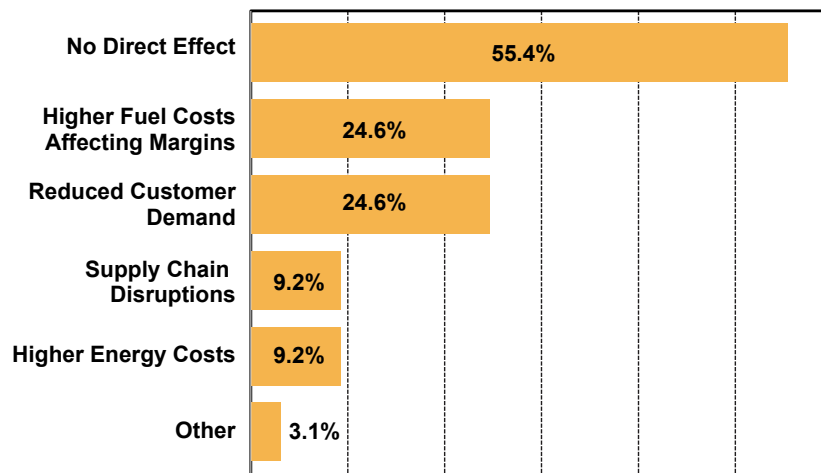


The federal funds rate currently sits in the 3.5%–3.75% range, but expectations for where it goes next are anything but settled. Survey responses for the remainder of 2026 reveal a striking lack of consensus. Roughly one-third of respondents expect the Fed to stay on hold through year-end. Another third anticipates a single 25-basis-point cut, while about 32% see at least two cuts. At the more dovish end, roughly 15% expect two to three cuts before the year is out. Yet a meaningful share—15.4%—are looking in the opposite direction, anticipating that the Fed may resume tightening. Taken together, the message is unmistakable: the once-prevailing narrative of steady rate cuts has fractured. Expectations are now far more dispersed, reflecting an environment where inflation risks, geopolitical shocks, and policy uncertainty are all pulling in different directions.

## Effects of the Iran War

Survey respondents were asked to assess the impact of the ongoing conflict with Iran on their businesses. A majority—55.4%—reported no direct effects. But the early signs of pressure are evident (Figure 60). Roughly one-quarter of respondents cited shifts in demand for their products, while a similar share pointed to rising transportation costs driven by higher fuel prices. In addition, 9.2% reported supply chain disruptions, and an equal share noted that elevated energy costs are beginning to weigh on operations—suggesting that the effects, for now, are indirect but may become increasingly hard to ignore should the conflict last long.

**FIGURE 60**  
**Impact of Iran War on OC Businesses**  
**(OCBX Survey, percent of respondents)**

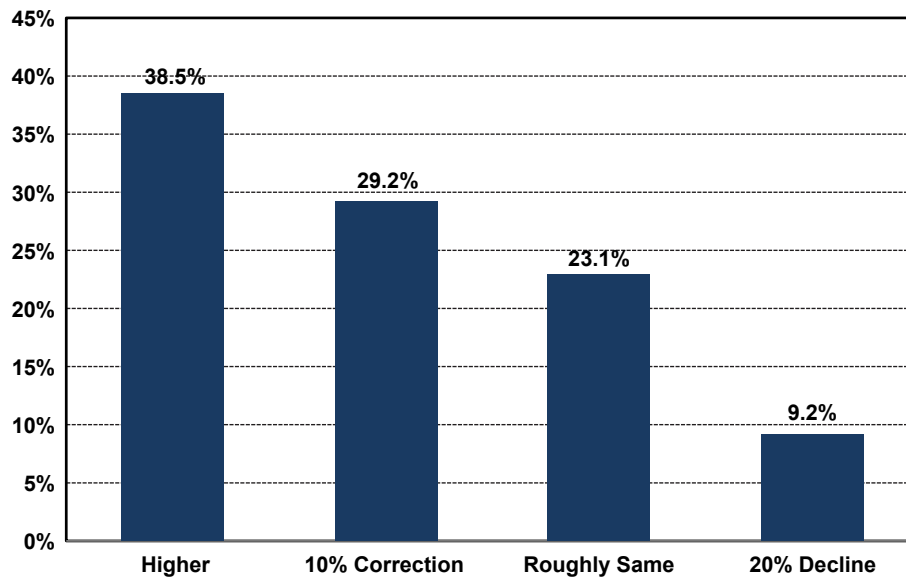


## Expectations for the Stock Market

Since the onset of the conflict with Iran, equity markets have exhibited heightened volatility. In the latest survey, business executives were asked for their outlook on the S&P 500 by the end of 2026, revealing a wide range of expectations.

More than one-third of respondents—38.5%, up from 32% in the previous quarter—expect the index to finish the year higher (Figure 61). Another 23.1% anticipate increased volatility but little net change in overall levels. At the more cautious end, 29.2% foresee a market correction of around 10%, while 9.2% expect a more pronounced decline of 20% or more. Notably, the share anticipating a major downturn has remained broadly stable relative to the prior quarter, when roughly 10% held this view.

**FIGURE 61**  
**Most Expect Stock Market Valuations to Increase or Stay the Same**  
**(OCBX Index, percent of respondents)**

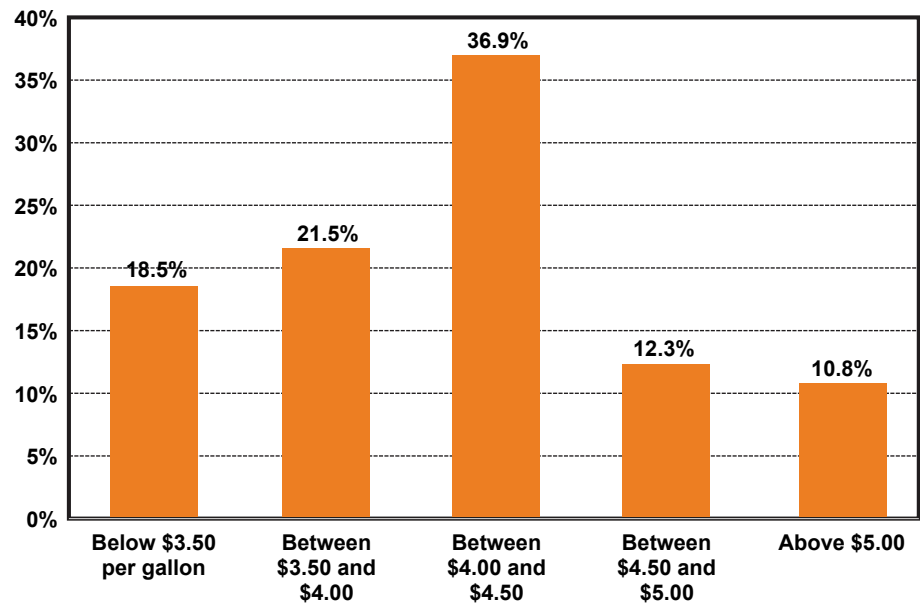


## Expectations for Gas Prices

The ongoing conflict with Iran has contributed to rising gasoline prices nationwide, with the national average at \$3.70 per gallon at the time of the survey. Respondents were asked to forecast prices by the end of the second quarter (June 2026), and the results reveal a wide dispersion of views.

More than a third of respondents (36.9%) expect prices to rise to the \$4.00–\$4.50 range (Figure 62). A further 12.3% anticipate prices between \$4.50 and \$5.00, while 10.8% foresee levels exceeding \$5.00 per gallon. This means that roughly 60% of respondents expect gas prices to remain elevated by the end of the second quarter. About 20% expect prices to remain relatively stable, in the \$3.50–\$4.00 range, while 18.5% anticipate a decline below current levels—contingent on a de-escalation of the conflict. The spread of expectations underscores a market driven less by fundamentals and more by geopolitical uncertainty, with outcomes highly sensitive to developments in the Middle East.

**FIGURE 62**  
**Most Expect Gas Prices to Remain Elevated Through This Quarter**  
**(OCBX Index, percent of respondents)**



## Outlook and Forecasts

Despite the broader economic slowdown, a series of high-profile events is expected to provide a meaningful—if temporary—boost to California and, in particular, Southern California. The year began with Super Bowl LX at Levi's Stadium in Santa Clara, estimated to have generated roughly \$500 million in economic activity. This was followed by the NBA All-Star Game in Los Angeles, projected to contribute another \$250 million to the region.

Looking ahead, California will host 14 matches during the 2026 FIFA World Cup, with total economic impact estimated to exceed \$1.1 billion. Los Angeles County alone is expected to capture about \$594 million, while the San Francisco Bay Area could see up to \$630 million, as both regions welcome hundreds of thousands of visitors. The pipeline continues: SoFi Stadium will host Super Bowl LXI in 2027, and Los Angeles will take center stage globally in 2028 as host of the Olympic and Paralympic Games—events projected to draw 15 million spectators and a global audience of roughly 5 billion.

While these high-profile events provide immediate increases in spending and tourism, their more enduring value stems from the infrastructure improvements and the international recognition they bring to the state.

In the near term, we anticipate moderate economic growth over the next two years. Employment growth, however, is likely to remain subdued, in part reflecting lower levels of immigration. This creates a dual effect: while job creation slows, the unemployment rate is also partially contained as labor supply growth eases. In Orange County, for example, the average annual unemployment rate is projected at 4.2% in both 2026 and 2027, up only slightly from 4.1% in 2025, though monthly readings could climb as high as 4.4% during 2026. A similar pattern holds across the region. In Los Angeles, the unemployment rate is forecast to average 6.1% in 2026 before improving modestly to 5.8% in 2027, while the Inland Empire is expected to post averages of 6.1% in 2026 and 5.7% in 2027.

Artificial intelligence is already reshaping employment across a wide range of industries, with the most immediate effects concentrated in white-collar professions. That impact is expected to accelerate, boosting productivity and lifting overall economic output. However, the resulting jobs growth will likely remain muted. Productivity gains of this kind tend to be labor-saving at the margin, implying more muted job growth even as output expands. Complicating the picture further is the government's recent, sizable downward revision to employment growth over the past several years, as discussed in our macroeconomic section. By lowering the starting point, this revision makes the trajectory of future job gains appear more measured—and, in many respects, more realistic.

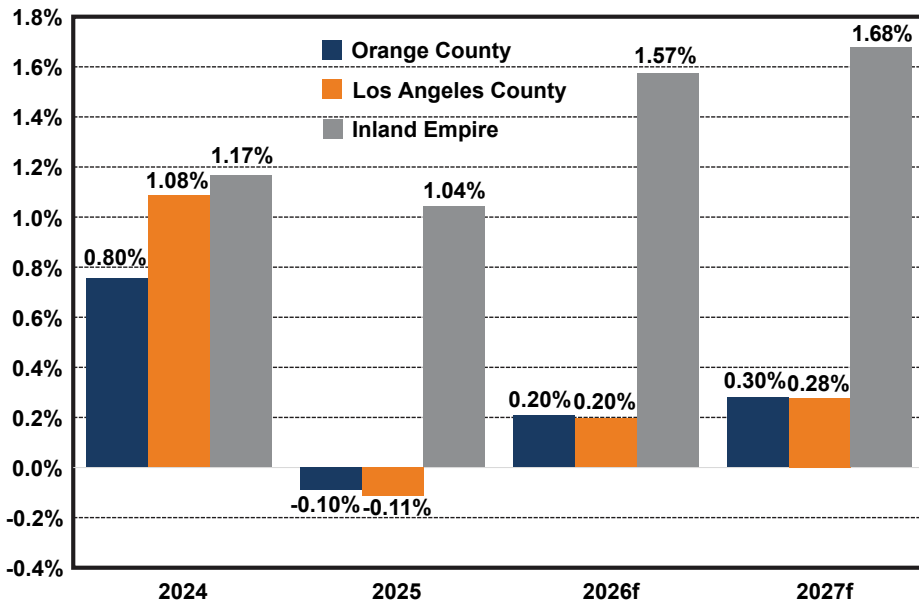
**Despite the broader economic slowdown, a series of high-profile events is expected to provide a meaningful—if temporary—boost to California and, in particular, Southern California.**

**In the near term, we anticipate moderate economic growth over the next two years. Employment growth, however, is likely to remain subdued, in part reflecting lower levels of immigration. This creates a dual effect: while job creation slows, the unemployment rate is also partially contained as labor supply growth eases.**

For Orange County, we expect payroll job growth of 0.21% in 2026 and 0.28% in 2027, following a slight decline of -0.09% in 2025 (Fig 63). In Los Angeles, comparable changes are anticipated: a 0.2% increase in 2026 and 0.28% in 2027, compared to a decrease of -0.11% the previous year. The Inland Empire is projected to see stronger job growth, with rates of 1.57% in 2026 and 1.68% in 2027, up from 1.04% in 2025.

Payroll employment growth is expected to remain subdued across the coastal counties while holding up better in the Inland Empire. In Orange County, payrolls are projected to rise by 0.21% in 2026 and 0.28% in 2027, following a flat reading in 2025 (Figure 63). Los Angeles is expected to follow a nearly identical path, with gains of 0.20% in 2026 and 0.28% in 2027 after contracting by 0.11% the prior year. By contrast, the Inland Empire is projected to experience stronger job growth, at 1.57% in 2026 and 1.68% in 2027, building on a solid 1.04% increase in 2025.

**FIGURE 63**  
**Employment Outlook: Some Growth But Quite Modest**  
**(job growth, annualized rate)**



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