Economic Conditions and Outlook Part 1: the U.S. and California

by

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The Inland Empire Economic Partnership (IEEP) released its economic forecast for 2026 at its State of the Region event in mid-February. We present the national and state outlook here. Subsequent articles will focus on the Inland Empire economy and the housing market.

To summarize upfront, the "jobless boom" that marked much of last year will continue in 2026. That is, gross domestic product (GDP) will grow at elevated levels, but job creation will be weak. This will result in relatively large productivity gains. Meanwhile, inflation will miss the two percent target set by the Federal Reserve. However, weakness in the labor market may prompt two or three small interest rate cuts in the Federal Funds Rate.

At the national level, headline indicators tell a somewhat encouraging story. GDP, which grew at an annual rate of 2.2 percent last year, will expand at an above average rate of 3.3 percent this year, in part due to tax policies coming into effect early this year. The "One Beautiful Bill Act" will result in over $190 billion dollars in refunds, increasing consumer expenditures which account for two-thirds of the economy. Nonresidential construction, such as manufacturing plants and AI data centers, will see an uptick. Despite continued uncertainty about the housing market, residential construction will increase in response to lower interest rates, with at least two cuts expected in the second half of the year.

Despite impressive GDP growth, the unemployment rate will edge up from 4.3 percent last year to 4.5 percent in 2026. These rates fall within the range of what economists call the "full-employment unemployment rate," meaning that the overall labor market is in good shape. However, job gains will likely fall below average, hence the reason for describing this year's overall economic outlook as one of "jobless growth." In fact, this will be a repeat of last year, with job growth of half a percent, falling short of the long run average of closer to one percent (0.8 percent). Last year, for example, the U.S. economy only gained 584,000 jobs compared to the over 2 million jobs gained in 2024. This is an unusual development since above average GDP growth typically generates above average job gains.

Several developments may be contributing to the weak job growth. First, the growth rate of the labor force has been declining for some time, and recent immigration policies accelerated the trend. It has also resulted in population growth stagnation, and hence less of a need for

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employment to grow at recently observed rates. Second, firms in the tech and logistics industries ramped up hiring during the pandemic to retain their workforce at a time of great uncertainty, but have since cut jobs. Third, industries such as manufacturing and financial activities have followed a long run decline in jobs while other industries, such as motion picture and sound recording, have faced structural changes in recent years, resulting in job cuts. Fourth, AI is reimaging workflows, the first signs of which may have contributed to the negative net flows of employment in some industries, especially younger white-collar workers being unable to find jobs. Taken together, job gains this year are expected to be about half the long run average of 92,000 per month experienced over the last 25 years.

Inflation continues to be a concern, as it has in recent years. Inflationary pressures tied to the pandemic caused the Consumer Price Index (CPI) to hit nearly 10 percent in mid-2022, prompting the Federal Reserve Bank (Fed) to initiate a series of interest rate hikes as part of its effort to tame inflation. The Fed's actions were intended to cut inflation to its target of two percent. However, the CPI, excluding food and energy, stood at 2.5 percent at the last release, while the Fed's preferred measure, the personal consumption expenditures price index (PCE) excluding food and energy, rose to 3.0 percent. While the CPI is moving in the right direction, the PCE is moving away from the target.

The Fed's actions this year will be shaped by its dual mandate to maintain both price stability and full employment. With the inflation rate currently above its target of two percent and weak job gains, the Fed has adopted a "wait and see" attitude. We do not expect the inflation rate to come down from current levels due to the effects of the fiscal stimulus in the "Big Beautiful" tax bill, but the Fed may have to act if job creation stalls out or turns negative in 2026. Moreover, recent developments in the Middle East will cause at least a temporary increase in the price of oil in the coming weeks. Should this push inflation up, the Fed may be less inclined to cut interest rates.

While the outlook for the national economy may be summarized by looking at GDP, the labor market, and inflation, the nation's trade situation is also relevant to the Inland Empire, given the importance of logistics in the region. Despite increases in tariffs to rates not seen since the 1930s, the Ports of Los Angeles and Long Beach had a record-breaking year for container activity in 2025. Lower imports from China coincided with higher imports from other Asian countries. Forty percent of all U.S. imports come through these two ports and a large share of inbound and outbound goods pass through the Inland Empire en route to their final destination. While elevated levels of activity will continue, it is unlikely that the ports will surpass the record levels seen last year. As a result, logistics activity and employment in the region may be under pressure. A depreciating U.S. dollar makes imports more expensive, also contributing to a weaker outlook for logistics in the year ahead.

The term “jobless boom” also applies to California, in that job growth was very weak despite impressive growth in state GDP for much of the last year. In the third quarter of 2025, the latest data available, real GDP grew at a strong 4.5 percent, outpacing the corresponding national rate (4.4 percent). California’s unemployment rate showed little change throughout 2025,starting the year at 5.4 percent and finishing the year at 5.5 percent in December. The state unemployment rate was higher than the nation and all other states, despite being well below the long-run average of 7.1.

However, the state barely eked out any job gains last year. Health care accounted for the vast majority of jobs created, adding 150,000 positions, but just 5 of 17 industries added 203,000 jobs, the remaining 12 industries lost 152,000 jobs, for a net gain of 51,000, or a 0.3 percent increase. Like the nation, the state’s economic performance may be described by the term “jobless boom.”

Looking ahead to 2026, we forecast significantly lower output growth, since the state economy is heavily relying on the expansion of just three sectors: health, public education, and logistics, each of which will be negatively affected by national policies. Health care will cace competing forces in the year ahead. The aging population will place increasing demands on the sector this year and into the next decade, but changes to and cuts in Medicare and MediCal will have an adverse impact on the demand for services as patient costs increase. Similarly, public education will lose COVID-era federal funding and will face a long-term decline in enrollments due to demographics, both of which will cause difficult budgetary choices. Finally, although logistics fared well despite increases in tariffs, it will be difficult to repeat last year’s record-setting performance again in 2026.