



# Policy Compass

## US Economic Growth in Q3: Drivers, Distortions, and the 2026 Outlook

By  
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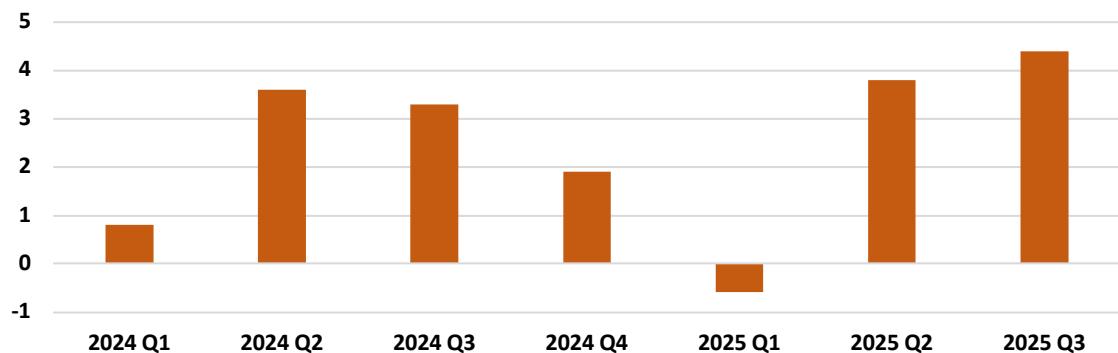
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#### **Executive Summary**

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- Q3 2025 GDP grew 4.3%, surprising analysts given tariffs, geopolitical tensions, and restrictive financial conditions.
- Growth was uneven and demand-driven, supported by consumer spending, government outlays, and net exports, while private investment lagged.
- Trade and policy effects were delayed, with export front-loading and import shifts temporarily boosting output.
- Labour market and inflation trends signal moderation, as payroll growth slowed and inflation remained above target late in 2025.
- 2026 outlook points to slower, still-positive growth (2.2–2.4%), dependent on consumption, fiscal support, and policy, but vulnerable to trade shocks and investment weakness.

#### **Key Picture: Real GDP, Percent Change From Preceding Quarter**



*Source: [Bureau of Economic Analysis](#)*

#### **1. Introduction**

The US economy delivered surprising growth in the third quarter of 2025, despite the expected constraints of surrounding tariffs and tensions. Real GDP expanded at an annualised rate of 4.3%, accelerating from the previous quarter. This occurred despite a contextual backdrop of heightened trade tensions, persistent policy uncertainty, and persisting restrictive financial conditions. The strength of the headline figure therefore, appears difficult to reconcile within an environment influenced by new tariffs, elevated geopolitical risks, and the effects of monetary tightening.

This observed Q3 growth, however, also underscores a recurring feature of the post-pandemic expansion, in which the US economy has the capacity to sustain growth despite intensifying constraints. The pressures that would have been expected to weigh on activity were offset by a combination of strong domestic demand, fiscal support, and shifting trade dynamics. Concurrently however, the composition of this growth raises important questions regarding durability, particularly given signs investment momentum and labour-market moderation were already easing by late 2025.

## 2. Q3 GDP Drivers

According to the Bureau of Economic Analysis, this real GDP growth of 4.3% in Q3 was driven primarily by strong domestic demand and net export dynamics, rather than a rebound in private investment. Consumer spending made up the most significant contribution, reflecting continued resilience in household demand.

Government expenditure also contributed a meaningful boost to growth. Both federal and state/local spending increased over the quarter, which contributed to offsetting sluggishness elsewhere in the economy and demonstrated the role of fiscal support in sustaining activity. In contrast, private investment weakened, suggesting that acceleration in growth was not driven by expansion in productive capacity, but by near-term demand.

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Trade dynamics further amplified headline growth. Exports rose in Q3 alongside declining imports, mechanically lifting the contribution of net exports to GDP. While this improved the headline figure, it does not necessarily signal a significant increase in US competitiveness. The pattern is instead consistent with tariff-related distortions to trade flows, including front-loading of exports and the postponement or substitution of imports in anticipation of impending higher trade costs. These timing effects can temporarily inflate measured output, even if underlying demand remains unchanged.

The composition of growth, therefore, matters as much as its rate. With consumption and government spending doing the heavy lifting, comparative to investment's contribution, the expansion in Q3 appears demand-driven and so potentially fragile. This is a significant consideration given the broader policy backdrop of tariffs and uncertainty. These policy factors often weigh heavily on capital expenditure, meaning the consequences of trade policy may emerge in the longer term.

Q3's strength therefore is likely uneven, and short term. It demonstrates the US economy's capacity to generate growth through consumption and fiscal support, however masks signals from investment and trade that would arise more visibly later in 2025.

## 3. Why Is This Surprising?

Q3's strength is striking relative to the economic and policy environment in which it occurred. Entering the second half of 2025, many forecasters expected growth to slow as the cumulative effects of tighter monetary policy, recurring trade frictions, and elevated geopolitical uncertainty weighed on demand. However, headline GDP accelerated.

A central component of this expected drag were tariffs. Higher trade barriers are anticipated to raise input costs, disrupt supply chains, and deter investment. While these effects may yet materialise, they were not evident in aggregate activity data in Q3. Resulting rising exports and falling imports, however, in fact boosted net exports' contribution to growth. Businesses appear to have, in anticipation of higher costs in future, adjusted the timing of trade decisions, bringing activity forward. This front-loading can support short-term growth even as it increases the risk of subsequent slowdown.

Uncertainty as a factor would normally be expected to weigh on activity. Policy measures and geopolitical risk remained elevated through much of 2025, a backdrop that has historically dampened capital expenditure and hiring. The fact that these effects were not yet fully reflected in Q3 GDP suggests that adjustment may still be occurring with a lag.

The Q3 outcome, therefore, does not invalidate or disprove concerns around tariffs and tighter policy. It, rather, highlights the capacity for timing effects and demand resilience to delay their impact, raising questions about how growth will evolve once these buffers begin to erode.

#### 4. Outlook for 2026

Beyond the Q3 headline, data released in late 2025 suggests that momentum was already slowing as the economy entered the final quarter of the year. Labour market indicators in particular point to a gradual slowing. According to the Bureau of Labour Statistics, payroll growth slowed markedly, with employment rising by just 64,000 in November, while the unemployment rate grew to 4.6% and has shown minimal net improvement since spring. While this doesn't necessarily signal abrupt deterioration, it does indicate that the labour market is no longer tightening in a way that would sustain this growth indefinitely.

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Late 2025 inflation dynamics offer a similarly mixed picture. Headline consumer price inflation eased to 2.7% year-on-year in November, placing it well below its post-pandemic peak and back within the high 2% range. This provides policymakers with some breathing room, however, inflation remains above the Federal Reserve's target, suggesting policy may remain restrictive for some time.

Institutional forecasts broadly converge on a view of slower, though still positive, growth in 2026. The Federal Reserve's December Summary of Economic Projections points to GDP growth moderating toward its longer-run potential, alongside a modest rise in unemployment as inflation continues to cool under an appropriate policy stance. The IMF and World Bank similarly expect US growth to decelerate into a 2.2-2.4% range. These projections suggest that while the US economy is unlikely to contract in 2026, growth will be narrower and more dependent on sustained consumption, fiscal support, and policy, leaving expansion vulnerable to trade shocks and investment slowdowns.

Trade policy remains one of the central sources of uncertainty. While some research suggests tariffs may dampen inflation by weakening demand, most forecasters agree that they impose a drag on investment and consumption that becomes more visible over time. Consequently, the effects that were delayed or masked on Q3 may have an increased impact on activity in 2026.

The strong Q3 growth underscores the US economy's capacity to generate momentum even as prevailing economic constraints intensify. Consumer demand, fiscal support, and net export dynamics combined to deliver an unanticipated headline expansion. This occurred despite tariffs, restrictive financial conditions, and elevated uncertainty. However, the composition of Q3 growth, and succeeding Q4 data, would suggest caution in extrapolating said growth.

With subdued investment, easing labour market momentum, and inflation persisting, the foundations of growth appear to have been narrower than the headline figure would imply. Institutional forecasts for 2026 point to moderation, rather than contraction, in a slowing economy, while supported by disinflation, that is exposed to policy missteps and delayed trade effects.

## NOTES

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