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The K-economy in 2026: Same story, new amplifiers

Overview

- **The K-shaped economy reflects a long-standing divergence where wealthier households benefit from asset appreciation, better schools and technology, while lower-income families face structural disadvantages and financial strain.**

- **Pandemic-era policies temporarily narrowed inequality, but gains quickly reversed as capital income surged, government stimulus was removed, and inflation eroded real wages, pushing income concentration to 60-year highs.**

- **Without broad adoption, rapid technological change, especially AI, may widen gaps. Building digital literacy, infrastructure and workforce upskilling will be critical in preparing current and future workers for the AI revolution – helping integrate tools into workflows, improving productivity and business performance, with changes benefiting all.**

- **Lower inequality is strongly associated with longer, more sustainable periods of economic growth. Policies like asset-building, progressive taxes, and improving learning opportunities can make innovation an equalizer, not a divider. While poorly designed redistribution can weaken incentives, well-designed policies align growth and fairness – two sides of the same coin.**

The term "K-shaped economy" emerged in the wake of the COVID-19 pandemic to describe a split where some segments of society rebounded quickly while others fell behind. Unlike traditional V- or U-shaped recoveries, the K-shape illustrated a bifurcated path: higher income households benefited from remote work capabilities, rapid asset appreciation and digital transformation, while lower-wage workers faced historic layoffs, prolonged disruption and disproportionate financial strain.

But this divergence wasn't new. It underscored a decades-long trend of widening inequality. Pandemic-era stimulus and lockdown-driven conditions briefly narrowed the gap to levels not seen since the early 1990s (Chart 1, Gini Coefficient). Yet the reversal was fleeting. Income concentration

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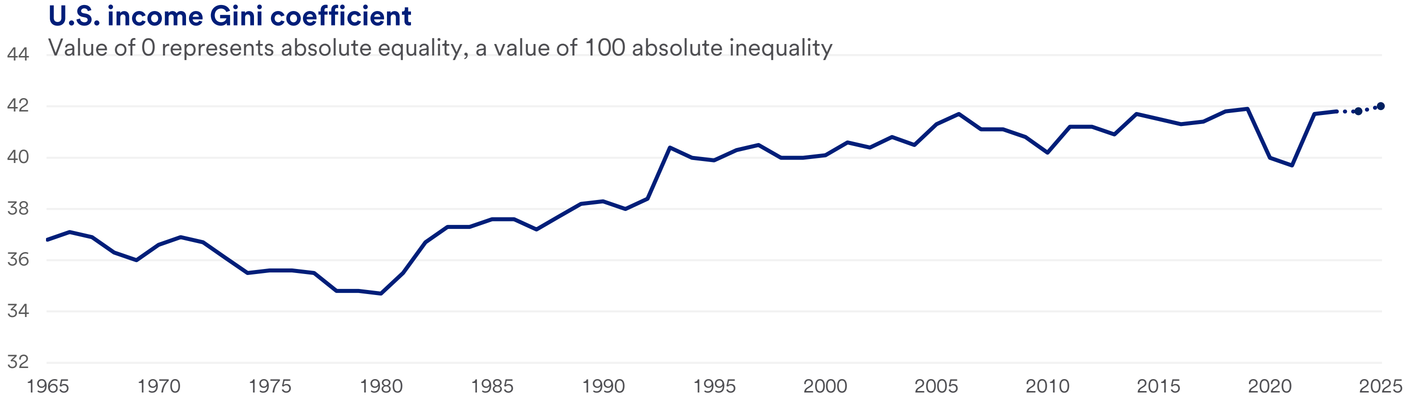
has since returned to pre-COVID peaks. And recent policy shifts are expected to push inequality to new record highs.

In short, the pandemic didn't rewrite the narrative – it merely paused it, and the economy has since resumed its previous trajectory. Today, the K-shape has become the defining lens for understanding resilience and vulnerability between the haves and the have-nots. It continues to steer consumption and borrowing patterns, widen generational divides and influence policy debates. Moreover, new forces – higher interest rates, persistent inflation and the rapid adoption of transformative technologies such as artificial intelligence (AI) – appear to be amplifying these disparities even further.



Source: U.S. Bank Economics; Bloomberg; World Bank; Census ACS (2024 Est.); Statistica (2025 Est.)
Note: A Gini coefficient of 0 reflects perfect equality, where all income or wealth values are the same. A Gini coefficient of 1 (or 100%) reflects maximal inequality, where a single individual has all the income while all others have none

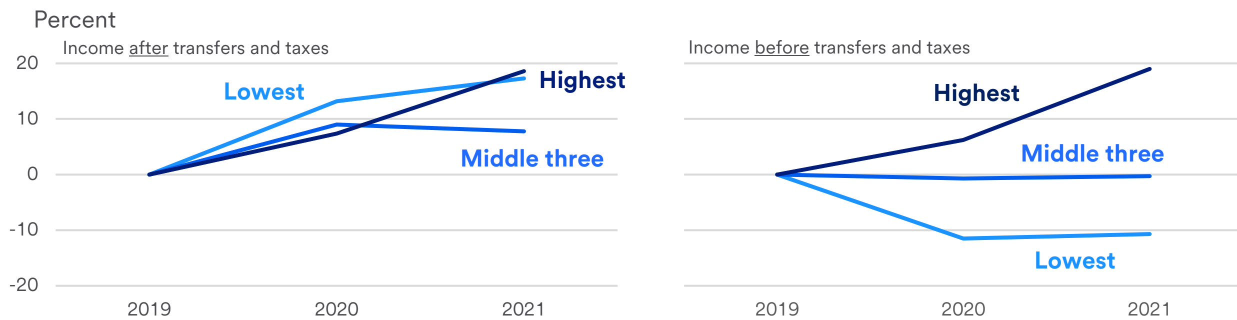
After decades of debate on the subject, it's no surprise that the effects of rising income inequality are complex. To some extent, it's necessary for a market economy to function, as it incentivizes investment and expansion. However, excessive income concentration can also undermine growth by fueling political polarization, while reducing overall demand in the economy. As Keynes demonstrated, inequality often leads affluent households to save more and consume less, while those with less means rely on borrowing and debt until those options are exhausted. When these imbalances become unsustainable, the economy tends to swing from boom to bust – exemplified by the Great Recession.[1,2]

Today, a new force – rapid technological change – threatens to reshape these dynamics even further. Since this shift is inevitable, how the U.S. adapts workforce skills will ultimately determine whether AI-driven innovation – and the new industries it spawns – flattens the K or keeps the economy on its familiar path. Therefore, building digital literacy will be a critical step in preparing current and future workers to integrate these tools into their workflows.

Historical context: Pandemic disruption and the inequality snapback

The pandemic's K-shaped recovery highlighted a decades-long pattern.[3] Income concentration, as measured by the Gini coefficient, has trended higher since the early 1980s, interrupted only briefly during COVID. Wage gains for essential or frontline workers improved incomes for those low-paid workers in that line of work. But the unprecedented fiscal support – stimulus checks, expanded unemployment benefits and enhanced tax credits – during the pandemic boosted incomes for many low-paid households. According to the CBO, after taxes and transfers, income growth for the lowest quintile (adjusted for inflation) nearly matched that of the highest quintile and exceeded the middle three quintiles (Chart 2) between 2019 and 2021.[4] This drove income concentration to its lowest level since the early 1990s, marking the sharpest improvement in decades.

Cumulative growth in average household income, by quintile



Source: U.S. Bank Economics; Congressional Budget Office (CBO)

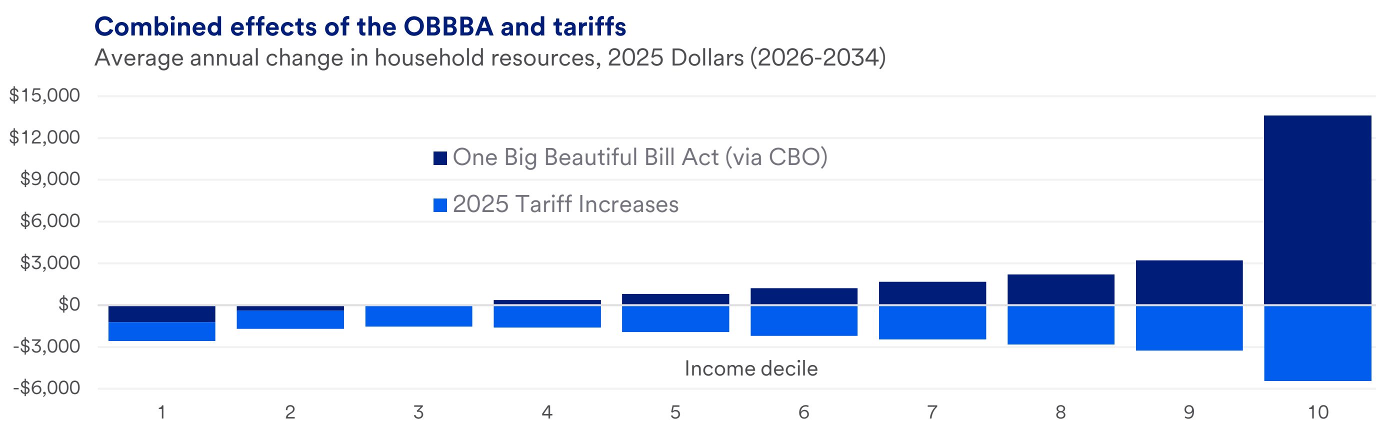
Yet these gains were temporary. As the economy reopened, surging equity markets delivered extraordinary non-wage income to the wealthiest households, while lower-wage families – who own fewer assets – saw little benefit. The CBO reports that between 2019 and 2021, average household income <u>before</u> transfers and taxes rose 19% for the top quintile, driven largely by realized capital gains – the highest levels since at least 1979. In contrast, income for the lowest quintile fell by -11% before transfers, and the middle three quintiles saw little change. These dynamics underscore the structural role of asset ownership in driving inequality.

The number of Americans considered middle class shrunk from 61% in 1971 to 51% in 2023, barely a majority, according to a 2024 Pew Research report.[5] With the share of Americans in both lower-income and higher-income groups even larger, as financial conditions for American households drift even further apart. For those that remained middle class, their share in overall household income dropped to 43% in 2022 from 62% in 1971, with the total share of household income for higher income households up to 48% from 29%.

As initial support faded, structural forces reasserted themselves. Pandemic-era programs – meant as a bridge during the crisis – were withdrawn. Inflation surged to 40-year highs, with price spikes in essentials such as food, energy and rents eroding real wages, hitting lower-income household purchasing power the hardest. Stock and housing markets surged, disproportionately benefiting wealthier households. And, while demand for service jobs initially boosted lower-paying roles, professional and technical positions rebounded faster and maintained their lead. Within two years, income concentration had reached its pre-pandemic peak and today is approaching levels not seen in 60 years.

Compounding these trends, recent policy choices are amplifying the divide. Monetary tightening meant to curb inflation – through higher interest rates – disproportionately affects credit-sensitive households and smaller firms. And regressive fiscal measures are deepening the gap. Higher tariffs raise costs for essentials, amplifying inflation where it hurts most. Immigration restrictions have tightened labor supply in service sectors, providing more reason to accelerate automation. And the 2025 tax bill extended lower tax rates, especially for high earners, while cutting programs like SNAP and Medicaid. Combined with tariff-driven price increases, these fiscal policies are expected to reduce incomes for the bottom 10% of households by an average of 7%, while those at the top will see gains of about 1.5% (Chart 3).[6,7] As a result, income concentration is estimated to have reached its highest level in over 60 years – with the Gini coefficient climbing to a 42 in 2025.

All told, the pandemic highlighted both the potential and the limits of policy intervention. While fiscal support temporarily narrowed gaps, long-term trends favor roles that complement technology and reward specialized skills. In this environment, access to digital infrastructure and opportunities for upskilling have become as critical as traditional education. Without broad access to these tools, inequality risks becoming self-reinforcing.



Source: U.S. Bank Economics; Congressional Budget Office (CBO), Yale Budget Lab

Wealth inequality: Object permanence

Wealth inequality runs even deeper than income concentration. Unlike earnings, wealth disparities are reinforced by compounding returns and inheritance, extending gaps across generations. To put it in perspective: in 2022, the top 10% of U.S. families held about 60% of all wealth; with the top 1% alone controlling 27%, while the bottom half owned just 6%.[8] Intergenerational transfers play a major role in this divide – baby boomers are expected to transfer $68-84 trillion over the next two decades, further entrenching inequality.[9]

Homeownership – often viewed as the cornerstone of the "American Dream" – illustrates this dynamic. For most middle-class families, home equity is their largest source of wealth. Yet the challenges of homeownership seem increasingly insurmountable – with more than half of adults saying they'll need more than 3 years to save enough for a downpayment, and 1 in 5 saying they'll never be able to afford it, according to Bankrate's 2025 Down Payment Survey.[10,11] By contrast, children born into wealth often receive parental assistance – whether for the downpayment or ongoing housing costs – accelerating the path to home ownership and providing a financial safety net afterward. These advantages amplify intergenerational disparities.

Macro pressures and business risk in a divided landscape

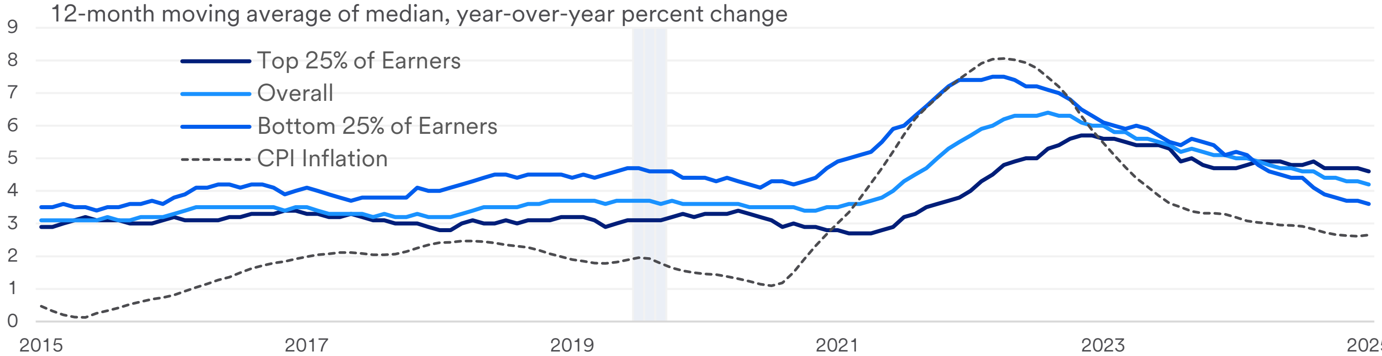
The bifurcation embedded in the K-shaped economy, or inequality in general, adds more vulnerability to the expansion. Research has shown that more equality helps sustain long-term economic growth, where the level of inequality was one factor in determining which countries that can sustain healthy growth for many years, even decades, and those that see growth spurts fade quickly.[12]

Aggregate spending remains resilient, anchored by wealthier households whose balance sheets and asset holdings provide a floor for demand. Yet concentration at the top also raises vulnerability to wealth shocks: if asset markets falter, consumption among these households could fall swiftly, pulling aggregate demand down.[13,14]

Credit stress is building on the lower arm of the K. For the first time in over a decade, wage growth for lower-paid workers now trails higher earners – according to the Atlanta Fed Wage Tracker – reflecting a shift toward roles that complement technology and reward specialized skills (Chart 4).[15] And high delinquency rates among younger and lower-income households point to thinner buffers and stricter lending standards (Chart 5).[16] A decisive turn in the credit cycle – triggered by rising defaults or a further tightening of underwriting – would strain household finances and risk rippling through the economy.

U.S. wage growth by wage level

12-month moving average of median, year-over-year percent change



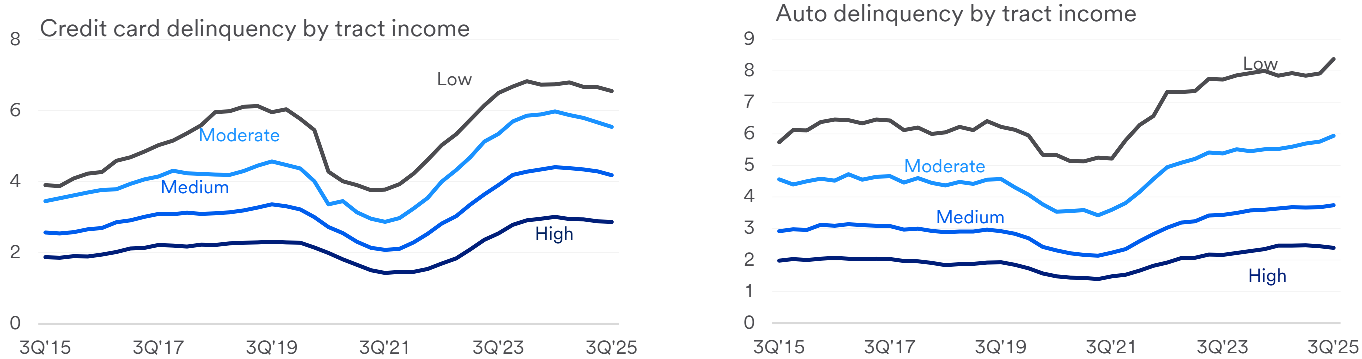
Source: US Bank Economics, Bloomberg, Atlanta Fed

Healthy macro trends also mask the divergence the K-shaped economy has on businesses' bottom lines. Post-COVID retail sales held up rather well, in aggregate. But that hides the impact by their clientele. A recent report showed that those businesses catering to higher-income ZIP codes, businesses serving lower-income ZIP codes faced slower demand growth and more negative consumer sentiment – reinforcing the uneven playing field driven.[17] Elevated interest rates and tighter liquidity conditions add pressure on smaller firms and credit-sensitive sectors. Larger firms in capital-intensive or technology-driven sectors continue to attract investment and expand capacity

Labor market signals point to stress: layoff announcements are rising, with a growing share of employers referencing automation within discussions of job cuts.[18] Tariff-related pressures remain another headwind, as firms exposed to global trade fragmentation pass through price increases and scale back hiring, keeping margin risk elevated. And policy uncertainty – around fiscal sustainability, monetary stance and industrial strategy – risk amplifying these pressures, shaping investment flows and sectoral performance in ways that reinforce the K-shape.

Delinquency rates across the income distribution

Percent



Source: U.S. Bank Economics; Federal Reserve Bank of New York Consumer Credit Panel/Equifax

Note: Delinquency rate measures the fraction of balances that are at least 30 days past due, excluding severely derogatory loans

Narrowing the gap: Can innovation flatten the K?

Technology introduces a critical variable. AI and automation are accelerating productivity in capital-intensive sectors, reinforcing advantages for firms and workers with specialized skills. If these benefits remain concentrated among larger corporations and high-income households, the K-shape will harden.

Yet technology could narrow the divide – if adoption becomes broad-based. Tools that enable small businesses to integrate AI, combined with workforce upskilling and accessible digital infrastructure, could spread productivity gains beyond the top tier. This would boost efficiency and create pathways for income growth in lagging sectors. Public policy will play a decisive role: investment in digital literacy, broadband access and targeted incentives for small firms could determine whether innovation becomes an equalizer or a divider.

The question ahead is clear: will technology flatten the K – or will entrenched forces keep the economy on its familiar path? In an economy shaped by old divides and new amplifiers, the answer will define the next chapter of growth and equity.

Policy challenges: How to solve the K

The K-economy complicates the use of otherwise blunt policy tools. Inflation erodes purchasing power faster for lower income households than those farther up the scale. Restrictive monetary policy aimed at curbing inflation disproportionately affects credit-sensitive groups – often lower-income households and smaller firms – though benefits accrue some price pressures are contained. Contractionary fiscal policy, such as cuts to food assistance or health programs, would only deepen the divide. Similarly, tariffs intended to reduce trade deficits or promote domestic industry tend to raise costs for lower-income households, relative to other segments of the income spectrum, adding yet another layer of strain.

Solutions to address income inequality have also been around for centuries, like the progressively funded universal social security, health and welfare system instituted by Elizabeth I in 1601.[19] One way to build a more inclusive economy, with more people participating in the market economy, is this: investing in digital education and financial literacy for both the current and future workforce. This will not only help improve upward mobility but also add to economic productivity, yielding a bigger pie for all. An earlier study found that if the U.S. was able to increase the education of the American workforce by just one year, something that was done during the period 1960 to 1965, not only would the worker benefit, but potential economic activity would be 2.4% higher in five years than if education did not change.

Other policy options could address structural drivers of inequality, such as offering affordable housing and first-time buyer programs. Other ways include promoting asset-building initiatives, implementing tax credits for younger cohorts and finding solutions to reduce wealth and income concentration, including tax code, in order to build a more inclusive economy.

A rising tide may lift all boats. But if the smaller ones are capsized in the wake of the few large yachts, the economy loses in the end.

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