



Economic Compass

Spring thaw, summer heat

Biannual economic outlook

Diane C. Swonk, Chief Economist
KPMG US
June 10, 2026



“I think what our insightful friend is saying is that we welcome the inevitable seasons of nature but we’re upset by the seasons of the economy.”

—Rand to the President, *Being There*, 1979

Peter Sellers’ character, Chance, in *Being There*, has been on my mind. A simple gardener mistaken for a senior government advisor. His distilled, near robotic observations about the four seasons and how the garden grows are subject to the biases of those listening to him.

The political and financial elite mistake his zen like observations for economic wisdom. They are hearing a revelation where there is only the literal truth of what lies above and below the surface.

Markets are doing much the same with the Strait of Hormuz. Each thaw in negotiations is read as a change in season; each break in the clouds, proof that the roots of inflation have stopped spreading and the damage beneath the surface will heal on its own.

That optimism has been buoyed by the global economy’s remarkable capacity to absorb shocks. Calmer futures markets cannot clear mines, reroute shipping lanes or repair damaged wells and refineries.

Financial markets can turn in minutes; physical supply moves to a slower clock. Much of the damage has fallen on emerging markets, largely beyond the spotlight. Rationing and scarcities will worsen even after the strait is reopened.

That will exacerbate supply chain disruptions and the humanitarian crisis that is erupting on the ground. Production is being idled in the hardest hit economies, while cooking oil shortages are adding to food insecurity. Families are soaking rice in cold water to keep food on the table in emerging Asia.

Economy gains steam

Real GDP growth grew at a revised 1.6% annualized rate in the first quarter, 0.4% below the initial estimate. Weaker consumer spending and investment were the main reasons for the downward revisions. The largest blow in spending was to healthcare. State level curbs on Medicaid and a lapse in subsidies for the Affordable Care Act caused a drop in insurance coverage.

The shortfall in business investment was inventories, which were subdued. Manufacturing surveys have improved in response to a restocking of inventories. That will create a tailwind for growth during the second and third quarters.

Real GDP is forecast to rise at 2.9% pace in the second quarter. Consumer spending is picking up, aided by a rebound in job gains. The FIFA World Cup, which starts in June, is another plus; it is spurring travel and tourism both at home and from abroad. Housing activity is frozen. The AI boom is gaining steam and boosting business investment.

Government spending is picking up in response to a rise in defense spending. The trade deficit is expected to widen, as the disruptions due to the conflict in the Middle East hits growth abroad more than at home. The level of exports is expected to remain below the level of imports due to surge in AI inputs. Oil exports the oilier; they soared.

Real GDP is expected to grow at a 2.1% pace in the third quarter, close to the economy’s potential. Consumer spending remains solid if not spectacular over the summer, while housing is stuck in a state of suspended animation. AI infrastructures investments are driving overall gains, with some spillovers to domestic industries. Inventories restocking continues. Government spending could get an extra lift via defense spending, while the trade deficit widens. Inputs to data centers are buoying imports.

The Fed hikes. The forecast for two rate hikes in the back of the year is due to the persistence of inflation. Warsh has only one vote. Hawks will give him a short grace period to see their perspective; the clock on a rate hike is now ticking. That bond market is waking up to that fact and raised the odds of a hike this year.

All of this is unfolding against a fresh wave of trade-policy uncertainty. The United States-Mexico-Canada Agreement (USMCA) heads into a July review. The administration has fast-tracked a new round of tariffs to replace those ruled illegal by the Supreme Court. Those are slated to take effect in August.

This edition of *Economic Compass* is a midyear review of the 2026–2027 outlook by sector. The economy has held up better than many feared with the labor market showing signs of stabilizing along with consumer spending. The AI boom is still gaining momentum, but the costs are adding to inflation before the boost to productivity growth can be scaled.

We are now five years into the post-pandemic bout of inflation. The Federal Reserve did not cause all of it, but it is the institution charged with bringing it down. The forecast for two rate hikes by the Fed in the back half of the year holds, despite political pressure for rate cuts.

2026-2027 Outlook

Summer heat

Chart 1 lays out the forecast by sector for the balance of 2026 and 2027. We now expect real GDP to rise 2.2% on a fourth quarter-to-fourth-quarter basis in 2026 and 2.1% in 2027. That is an upgrade from a month ago and in-line with the 2% pace of 2025.

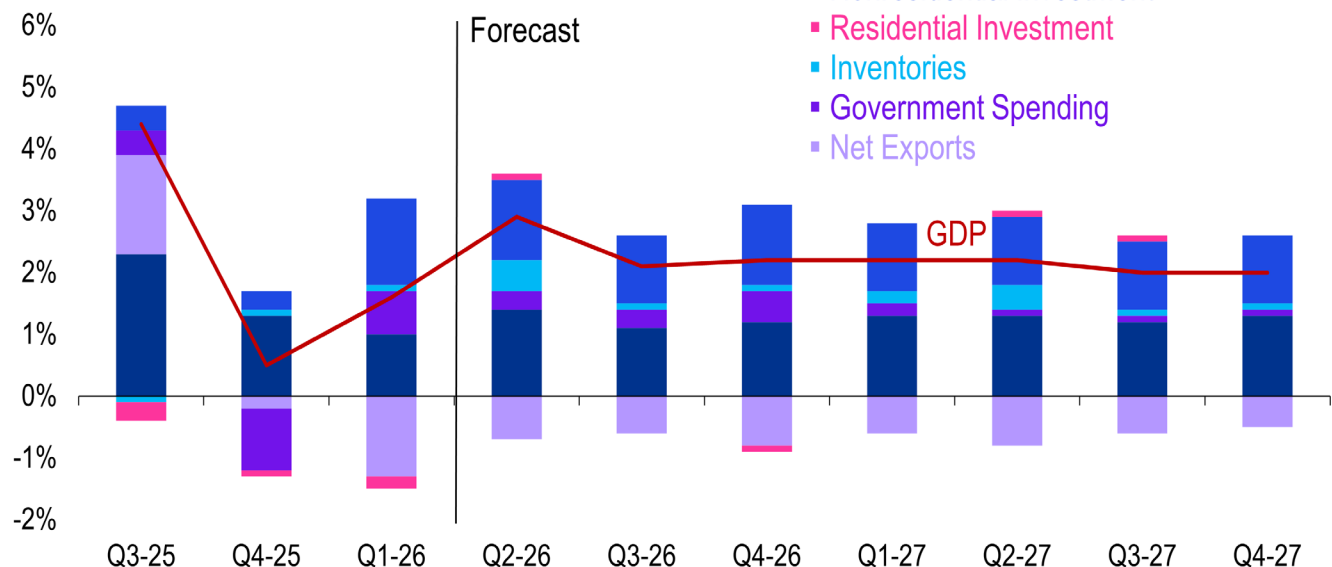
The stronger outlook reflects a rebound in employment, the broadening AI infrastructure boom, fiscal stimulus and the resilience of equity markets. Spending is supported by the highest income households.

The unemployment rate is expected to remain in the low 4% range in 2026 and 2027, close to what the Fed considers full employment. A jump in retirements and curbs on immigration are limiting the pipeline of workers seeking jobs.

Chart 1

GDP growth more resilient

Contributions to real GDP, SAAR %



Source: KPMG Economics, Bureau of Economic Analysis

That is little solace for new college grads, who are left on the sideline due to low labor turnover. Quit rates dropped to the lowest level since August 2020 in late April, which is limiting opportunities for those trying to get their foot in the door.

The forecast assumes the Strait of Hormuz reopens by the end of June. Even if it does, supply chains will not snap back quickly. Idle wells and refineries take weeks to ramp up; some damage could take years to repair.

The forecast carries an extraordinary amount of uncertainty over the end to the conflict and its repercussions. Markets clear either via pivots in demand or changes in supply, Bridging the period between those shifts is happening faster than in the past, did but not without frictions. Those can be physical or policy related and tend to add to inflation. It is hard living in my head these days.

Consumers splinter

Consumer balance sheets look better in aggregate than they do beneath the surface. Net worth hit new highs in the first quarter, while debt-to-income ratios remain near historic lows. The strain is showing up in delinquencies.

Student loan delinquencies edged down at the start of the year, but only because about 2.6 million borrowers went into default; those loans were transferred back to the US Department of Education for resolution.

The top third of earners are still seeing their wages rise faster than the bottom two thirds, but the [gap](#) closed slightly in May. The challenge is inflation, which is outpacing wage gains for the bottom two-thirds.

That wedge is showing up in the disconnect between consumer attitude surveys and overall spending. A minority of consumers is carrying spending gains, while the rest struggle to make ends meet.

Low- and middle-income households are spending more on necessities and less on discretionary items. Curbs to SNAP benefits accentuated those trends at the start of the year. Food banks are slammed.

Even high-income earners traded down. They increased their spending at discounters, off-price retailers and resale shops.

The top tier continued to spend with abandon. Those out on vacation and not at work in May rose to the second highest on record for the month. Bookings for the FIFA World Cup have surged and provide extra support for travel and tourism over the summer.

Lower gas prices later this year and into 2027 should help buoy spending. Big-ticket purchases such as vehicles, furniture and appliances are expected to remain subdued.

Higher interest rates and a lack of housing market churn is the primary reason. Home buying is the single largest trigger to additional goods spending; we tend to fill and remodel homes we buy.

Housing stays frozen

Home buying and building will remain on ice throughout much of 2026 and into 2027. Mortgage lock-in persists, with many owners unable to refinance or trade-up at current rates. The recent jump in rates will only further raise the bar on those transactions.

Escalating construction costs reduced the concessions builders can offer to entice first-time buyers. They represent a hurdle for existing sales due to the costs of renovating an aging stock of homes.

Single-family home values have begun to cool but remain out of reach for too many. Insurance costs have come off their highs, but real estate taxes are still rising; local assessments show up with a lag. The only offset is real estate tax deductions, which were partially reinstated last year.

Multifamily construction is overbuilt, notably in the Sun Belt. That has exerted downward pressure on overall rent measures. The exceptions are the Northeast and Midwest, which saw less overbuilding.

We do not see much life for the housing market until late 2027 and early 2028. A correction in home values and lower rates should open the door to first-time buyers; multifamily excesses should be absorbed.

AI boom fuels business investment

The AI boom is still gathering steam. The four largest hyperscalers have lifted planned capital spending from roughly \$400 billion in 2025 to about \$725 billion in 2026. That is before accounting for developers, who make up over 40% of the market.

The money is there, but capital is no longer a binding constraint. The bottlenecks have shifted to the physical economy: power, water, equipment and skilled labor.

Hyperscalers can partly outrun those bottlenecks by locking in power and outbidding smaller players for scarce inputs. Physical limits may derail some projects, but the larger trend is expected to remain intact.

Backlash at the state and local levels is intensifying; AI regulation will be on the ballot in November. That is despite efforts by the administration to curb regulation.

The AI boom and the Middle East conflict are boosting investment in our energy infrastructure. Gains in the oil sector are more incremental than transformative, with the focus on lifting the efficiencies of existing operations.

Inventories rebuild

Recent manufacturing surveys suggest inventories depleted in late 2025 are now rebuilding. The rebound will add to growth for the remainder of the year.

The same surveys point to more troubling trends. Production is rising without a comparable pickup in hiring, while capital spending plans are muted; escalating costs and trade uncertainty were cited.

Some of the restocking reflects fears of future price hikes, which can trigger its own reinforcing cycle of inflation. That should concern the Fed.

Government spending buoyed by defense

Defense spending was boosted significantly in fiscal 2026, which is adding to growth. The administration is seeking more funding to restock munitions and weapons.

The challenge is deficits and debt, which continue to balloon. Federal debt eclipsed the size of the economy for the first time since WWII earlier this year.

That is not a one-off; it reflects structural pressures that are still building. Baby boomers are in their peak retirement years, pushing up Social Security and Medicare spending.

A slowdown in immigration has made the math for seniors worse. Foreign-born workers pay into Social Security and Medicare, but few can collect those those benefits.

The Congressional Budget Office estimates that Social Security could fall short of the workers needed to support existing claims as soon as 2032. That would cause an abrupt cut to existing benefits if not addressed.

New tariffs and cuts to Medicaid and other support programs cannot begin to fix our fiscal woes. Something's got to give, but timing a tipping point is a fool's errand.

Trade is a drag on growth

The trade deficit is poised to widen through the balance of 2026 and 2027. Disruptions to energy markets and supply chains due to the closure of the Strait of Hormuz is hitting the rest of the world harder than it is hitting us.

That means imports will continue to outpace exports. The boom in AI infrastructure is adding to the demand for imports. Many of the inputs into data centers are imported, and given tariff waivers to outpace China's AI innovations.

The administration has fast-tracked investigations into tariffs for national security and unfair trade policies. Carve outs and waivers do not fully offset the bump in duties on companies that import.

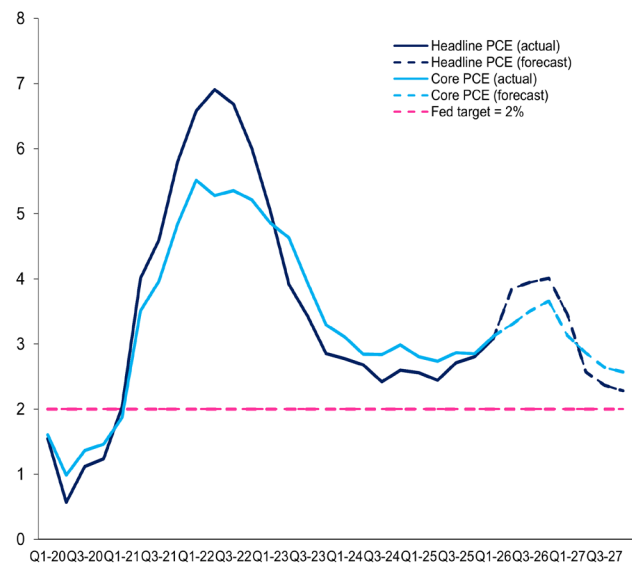
The new tariffs cover 60 countries and will restore much of what was lost to the Supreme Court ruling. The effective tariff rate is expected to hit the 11% peak of 2025 and will further stoke trade tensions.

A failure of trade talks with Canada and Mexico to renew the USMCA could add up to another 6% to tariff costs – roughly 3% to each country. That is unlikely but annual reviews, which stoke uncertainty are on the table.

Chart 2

Inflation hotter for longer

Personal Consumption Expenditures Index, year-over-year, %



Source: KPMG Economics, BEA

The rules on North American content could be raised. Currently, vehicles and certain auto parts that meet USMCA's 75% North American content requirement can cross the border tariff-free.

Those costs are in addition to an executive order signed in early June that strengthens the tariff enforcement. It targets loopholes used to mitigate tariff costs. Our estimates suggest those efforts shaved more than 1% from the effective tariff rate in early 2026.

Downside risks dominate

The Strait of Hormuz was effectively closed as of the writing of this report. No one knows how long it will take for traffic through the strait to normalize after reopening. In the interim, physical scarcities will worsen.

Emerging markets in Asia and Sub-Saharan Africa are most at risk. Production in the worst affected countries is slowing. Those disruptions could spread, while the humanitarian crisis worsens. That affects the ability of people to return to idled offices, schools and factories.

The conflict could turn Middle Eastern sovereign wealth funds further inward. The need to rebuild and repair infrastructure in the region is substantial, while those funds provide support for data centers. The Middle East is becoming a regional hub.

Policy uncertainty is another risk, on everything from trade to geopolitics and AI. It is elevated and moved from episodic to endemic. That is taxing and could delay major investments, including hiring later in the year.

Equity markets have proven remarkably resilient, rebounding quickly after corrections. An influx of funds from Europe intended to tap into the AI boom has helped.

Anything that derails those gains would dampen growth. Wealth effects tend to be asymmetric; they hurt more on the downside than boost growth when financial markets are booming.

Hot & sticky inflation

Chart 2 shows the forecast for the personal consumption expenditure (PCE) index, the Fed's favored inflation gauge. Inflation is expected to plateau at 4% later this year, double the 2% target.

Oil prices rebound as inventories are replenished over the summer. They fall more sharply in the fall, but do not return to pre-conflict levels immediately. A risk premium lingers through mid-2027.

Food inflation hits with a lag. Higher fertilizer and diesel prices along with acute scarcities will affect global harvests starting this September.

Making matters worse are the odds of an El Niño this year. That ups the risk of a catastrophic weather event, which could further stress electricity grids, reduce crop yields, threaten property and cause shipping disruptions.

The core PCE index, which strips out food and energy prices, peaks at a lower rate but stalls above target until 2028. Supply chain problems created by the Middle East conflict will take time to resolve.

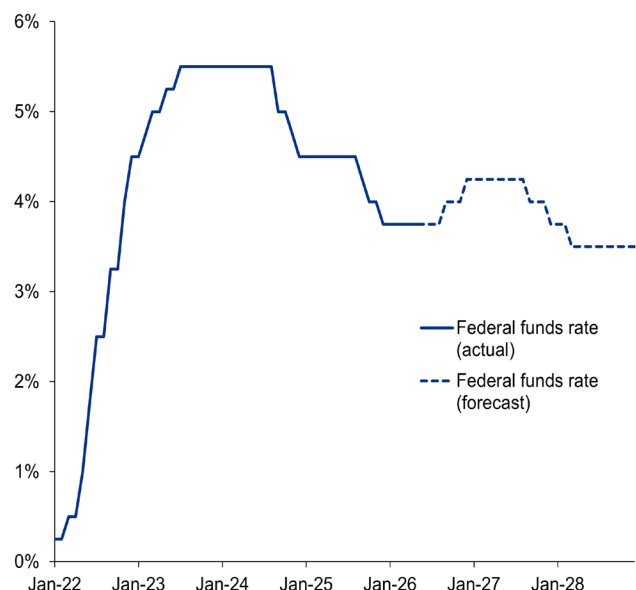
The AI boom has a sequencing problem. It is boosting costs before the productivity gains associated with those investments can be scaled and offset them. Those increases will add to the bump in prices due to tariffs, which will rise again over the summer.

A new [research](#) note by the Boston Fed reveals that oil shocks have smaller effects on both inflation and employment than they did in the past. The blow to employment is next to nothing, with gains in oil producing states offsetting losses elsewhere.

Chart 3

Fed needs to hike

Federal funds rate, percent



Source: KPMG Economics, Federal Open Market Committee

The problem is inflation, which still rises and lingers for longer without that blow to demand. The authors argue that shift “...allows policymakers [at the Fed] to focus more on the upside risks to inflation.”

Risks. We tend to get the inflation we expect, and after five years, we are starting to expect more of it. Inflation could be hotter for longer.

Warsh forced to hike rates

Chart 3 shows the forecast for the fed funds rate. The Fed is forecast to hike twice during the back half of the year. Rate cuts do not resume until late 2027.

The overall and core PCE indices are back above the levels hit when the Fed was raising rates to combat inflation in 2023. That is a red flag.

The current rate may be neutral or stimulative instead of modestly restrictive. That suggests rate hikes instead of cuts are needed.

Service sector inflation is showing signs of becoming entrenched, which is undermining the Fed’s inflation-fighting credibility. That last point is important given the shift in leadership at the helm of the Fed.

Chairman Kevin Warsh represents the largest leadership break at the Fed since Alan Greenspan replaced Paul Volcker in 1987. Bond markets will likely test his inflation-fighting resolve.

Risks. Delaying rate hikes is riskier today than it was as the economy emerged from the pandemic. Inflation has lingered longer and shows signs of taking on a life of its own. That is what the Fed is tasked to avert.

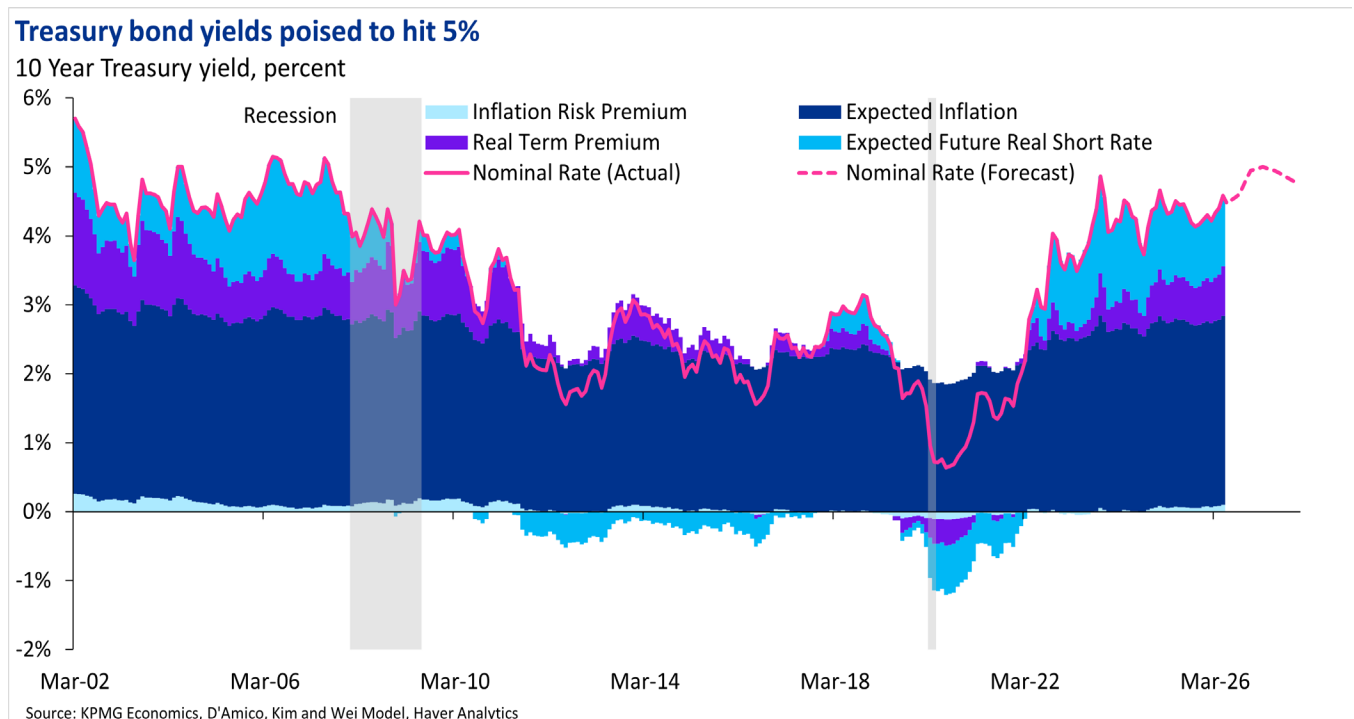
An oil shock made the post pandemic bout of inflation worse in 2022. There is no reason to believe that it would not do the same today. This is not a “look-through” event, like it once might have been. That is the lesson of the last five years.

Long-term bond yields jump

Chart 4 shows the breakdown of the factors that determine the yield on the 10-year Treasury bond. The stars have aligned to push bond yields up after years of ultra low rates. The 10-year bond yield is forecast to hit 5% and stay there for the first time in 20 years.

The Fed directly affects the 10-year yield via two levers: what market participants expect the inflation-adjusted fed funds rate to be in the future and whether it is able to anchor inflation expectations.

Chart 4



Everything else reflects forces the Fed does not fully control: changes in inflation expectations due to supply shocks, the term premium, fiscal deficits, Treasury bond issuance and shifts in investor demand.

That is why it is misguided to assume a Fed cut translates one-for-one into lower long-term borrowing costs. The Fed cut rates three times at the end of 2025, yet bond yields barely budged.

The 10-year bond yield will only fall after inflation cools more decisively. That is not expected to occur until well into 2027. The bond market will front-run the Fed on a rate cut, if that occurs.

Risks. A shift in the composition of Treasury bond buyers from central banks to hedge funds and more price-sensitive investors adding to bond market volatility. The marginal buyer of our debt is now more likely to sell should anything arise that erodes their confidence in its value. That is biasing yields upward.

A host of factors could fall into that category and provide a floor under rates or worse, push bond yields higher. They span persistently high inflation to the surge in debt issuance we will see as deficits and debt continue to mount.

Bottom Line

The lesson of *Being There* is not that the economic seasons do not change, but that people often see in them what they want to see. The outlook has improved: growth is holding up better than expected, the labor market is stabilizing and the AI boom is broadening.

That strength has come with a price – hotter, stickier inflation and a tougher path for the Fed. The persistence of inflation is the hand that Warsh has been dealt; nothing can wish it away.

Rising inequality is buoying measures of aggregate growth and masking the pain of inflation most households are feeling. This is not the 1970s; in some ways it is worse.

Measures of inequality were still falling in the 1970s; those for income inequality hit a post WWII low in 1980. That meant the economic pain associated with an ugly decade was shared.

That is not the case today. The gap between the haves and have-nots has exploded; we are closer to the Gilded Age than the 1970s.

Those shifts have made it harder to relate to each other and are stoking the political divisions we are enduring. That is reason to take a moment and pause. Be kind; pay it forward.

Economic Forecast — June 2026

	2025 (A)	2026	2027	2026:1(A)	2026:2	2026:3	2026:4	2027:1	2027:2	2027:3	2027:4
National Outlook											
Chain Weight GDP1	2.1	2.2	2.2	1.6	2.9	2.1	2.2	2.2	2.2	2.0	2.0
Personal Consumption	2.6	2.0	1.9	1.4	2.0	1.6	1.8	1.9	1.9	1.8	1.9
Business Fixed Investment	4.1	7.2	8.1	10.1	9.5	8.1	9.0	8.0	7.8	7.4	7.3
Residential Investment	-2.2	-2.7	0.3	-6.2	3.4	-0.1	-2.2	-0.4	2.1	2.3	-0.2
Inventory Investment (bil \$ '17)	29	3	55	-26	5	12	19	33	54	62	70
Net Exports (bil \$ '17)	-1091	-1144	-1349	-1064	-1123	-1166	-1225	-1270	-1329	-1377	-1420
Exports	1.6	6.8	3.6	13.1	12.7	5.6	2.7	3.3	1.7	2.2	3.3
Imports	2.7	6.3	7.7	21.1	15.8	8.5	7.9	6.8	7.0	6.1	6.3
Government Expenditures	1.1	1.0	1.4	4.4	1.6	2.1	3.0	0.9	0.8	0.7	0.4
Federal	-1.2	0.4	3.2	9.5	3.2	4.5	7.7	2.1	1.8	1.5	0.6
State and Local	2.5	1.3	0.3	1.5	0.7	0.7	0.3	0.2	0.3	0.3	0.3
Final Sales	2.2	2.3	2.0	1.5	2.3	2.0	2.1	2.0	1.8	1.9	1.9
Inflation											
GDP Deflator	2.8	3.7	3.0	3.5	4.9	3.2	3.7	2.4	2.3	2.9	3.3
CPI	2.7	3.6	2.6	3.6	6.5	2.9	2.9	2.3	1.3	2.3	2.7
Core CPI	2.9	2.9	3.0	2.8	3.1	4.0	3.5	2.5	2.5	3.1	3.2
Special Indicators											
Corporate Profits ²	73	15.7	4.6	12.0	20.6	18.0	12.4	12.1	4.5	1.9	0.5
Disposable Personal Income	1.7	0.1	3.3	0.8	-2.6	1.2	2.9	4.7	4.5	4.1	3.7
Housing Starts (mil)	1.36	1.35	1.26	1.41	1.37	1.33	1.30	1.28	1.29	1.26	1.23
Civilian Unemployment Rate	4.3	4.3	4.2	4.3	4.3	4.3	4.3	4.2	4.2	4.2	4.2
Total Nonfarm Payrolls (thous) ³	745	521	726	120	369	195	147	181	158	171	165
Vehicle Sales											
Automobile Sales (mil)	2.7	2.6	2.8	2.5	2.6	2.7	2.7	2.8	2.8	2.9	2.9
Domestic	1.8	1.7	1.8	1.7	1.7	1.7	1.8	1.8	1.8	1.8	1.8
Imports	0.9	0.9	1.0	0.9	0.9	0.9	1.0	1.0	1.0	1.1	1.1
LtTrucks (mil)	13.5	13.2	13.4	12.9	13.4	13.3	13.3	13.4	13.4	13.4	13.4
Domestic	10.8	10.6	10.8	10.3	10.7	10.7	10.7	10.8	10.8	10.8	10.8
Imports	2.7	2.6	2.6	2.6	2.7	2.6	2.6	2.6	2.6	2.6	2.6
Combined Auto/Lt Truck	16.2	15.9	16.2	15.4	16.0	16.0	16.0	16.2	16.2	16.3	16.3
Heavy Truck Sales	0.4	0.4	0.5	0.4	0.4	0.5	0.5	0.5	0.5	0.5	0.5
Total Vehicles (mil)	16.6	16.3	16.7	15.8	16.4	16.5	16.5	16.7	16.7	16.8	16.8
Interest Rate/Yields											
Federal Funds	4.2	3.7	4.0	3.6	3.6	3.7	3.9	4.1	4.1	4.1	3.8
10 Year Treasury Note	4.3	4.6	4.9	4.2	4.5	4.6	5.0	5.0	5.0	4.9	4.8
Corporate Bond BAA	6.1	6.3	6.9	6.1	6.2	6.4	6.8	6.9	6.9	6.9	6.8
Exchange Rates											
Dollar/Euro	1.13	1.18	1.21	1.16	1.17	1.17	1.18	1.19	1.20	1.21	1.21
Yen/Dollar	149.6	158.2	148.0	154.1	156.8	160.0	158.0	156.0	154.0	150.0	146.0

¹ In 2025, GDP was \$23.9 trillion in chain-weighted 2017 dollars.

² Corporate profits before tax with inventory valuation and capital consumption adjustments, quarterly data represents four-quarter percent change.

³ Total nonfarm payrolls, quarterly data represents the difference in the average from the previous period. Annual data represents 4Q to 4Q change.

Quarterly data are seasonally adjusted at an annual rate. Unless otherwise specified, \$ figures reflect adjustment for inflation. Total may not add up due to rounding.

Some or all of the services described herein may not be permissible for KPMG audit clients and their affiliates or related entities.

Learn about us:  [kpmg.com](https://www.kpmg.com)

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act upon such information without appropriate professional advice after a thorough examination of the particular situation.

© 2026 KPMG LLP, a Delaware limited liability partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved. The KPMG name and logo are trademarks used under license by the independent member firms of the KPMG global organization. USCS030372-1A