



Economic Compass

Under pressure

The view from Argentina

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May 8, 2026



*It's the terror of knowing what this world is about
Watching some good friends screaming, "Let me out."*

"Under Pressure" 1981

David Bowie's words from "Under Pressure" stayed with me on the flight back from Argentina, which hosted one of the most intense gatherings of economists I can remember.

The discussions were held under Chatham House rules, so I can share the insights but not attribute them. The song fits this moment because it captures not just strain, but how pressure frays the ties that hold people, markets and institutions together.

This is where the global economy now stands. It is still moving, but with less capacity to coordinate and a growing temptation to turn inward.

These fractures have been building for years. The war in Iran has been an accelerant, deepening fissures across economies.

The policy buffers that dampened earlier shocks are gone. Pandemic-era stimulus has faded; zero interest rates are a distant memory as rising government debt limits the scope for further support. The war and its costs add to fiscal constraints.

Central banks are still dealing with the aftershocks of earlier disruptions. Inflation was sticky ahead of the war. The added upward pressure from the war has many central banks weighing rate hikes.

This *Economic Compass* distills those discussions into a top ten list of forces reshaping the global economy. These shocks are difficult to model with precision because they interact and amplify one another, but they point in the same direction: weaker growth, persistent inflation and a fragile expansion. It could easily be the weakest year since the pandemic.

War effects hit second half harder

Real GDP rose at a 2% annualized rate in the first quarter, four times the subdued pace of the fourth quarter and well in line with our forecast. Consumer spending slowed but did not collapse, with tax cuts blunting the blow of higher prices at the gas pump. Affluent consumers continued to spend despite higher inflation. Home buying and building contracted for its fifth consecutive quarter, as mortgage rates spiked with the onset of the war.

Business investment picked up, aided by the AI boom and earlier tax cuts. Inventories were liquidated. Government spending rebounded after a six-week shutdown last quarter. The war in Iran largely drained weapon inventories. We saw a similar phenomenon during the first war with Iraq in 1990-91. The administration has proposed a larger defense budget.

The trade deficit widened. Imports jumped in response to the AI boom and front-running. Most inputs into data centers are imported and are subject to tariff waivers. The section 122 tariffs the administration used to bridge those ruled illegal by the Supreme Court have created an arbitrage opportunity before additional tariffs this summer.

Exports were subdued. The rest of the world was hit harder by the energy disruptions of the war, while soft boycotts of US goods are occurring across our trading partners.

Prospects for the second quarter are slightly weaker than in the first quarter, with growth at 1.8%. The loss of the catch-up due to the shutdown is a main reason. Fiscal stimulus is abating as well, while the effects of higher energy prices are a headwind.

Growth is poised to weaken in the second half of the year. Inflation due to the war weighs more heavily on consumers and investment. Even the sheen on AI could lose some of its luster due to escalating costs.

The Fed pivots to rate hikes. We now expect the Federal Reserve to raise rates twice in the back half of the year to contain a stickier bout of inflation. The boost to inflation from the closure of the Strait of Hormuz will worsen before year-end. We do not see a resumption of rate cuts until well into 2027.

The consequences of the crisis will far outlast the closure of the Strait of Hormuz, which we assume will open by the end of the second quarter. Financial markets appear impervious to those lags, which leaves them vulnerable to correction.

A top ten list

1. The world order frays. Support for open trade has weakened, trade-distorting policies have expanded and foreign direct investment no longer binds economies.

The post-WWII rules-based order depended on the economic and political dominance of the US and its allies. As that dominance faded and rival powers gained influence, the system weakened.

At the same time, the institutions underpinning globalization lost legitimacy. They became less effective at resolving disputes as they focused more on the winners than the losers of free trade.

Globalization lifted growth, but gains were uneven. Inequality widened within countries. The pandemic dealt another blow, revealing the downside of how intertwined our economies had become, which only further entrenched the backlash.

The result is a more fragile order, with less capacity to absorb shocks and pressure to turn inward. We risk throwing the baby out with the bath water by retreating instead of reforming global institutions.

2. Trade policy turns inward. US tariffs sit below their April 2025 peak but still are more than three times 2024 levels. After the Supreme Court struck down earlier measures, the administration fast-tracked investigations into other tariffs to replace revenue lost.

The United States-Mexico-Canada Agreement is up for review this year. The administration says it wants to preserve the multilateral nature of the agreement, but that does not rule out more tariffs.

The risk of retaliation is rising, especially in Europe. At the same time, the Middle East conflict is adding supply-chain disruption, shortages and higher costs.

Firms now face both trade-policy risk and chokepoint risk, with no clear end date. The result is not just higher costs, but greater hesitation around major investment decisions, which further weakens growth.

3. Energy shocks linger. About 20 million barrels per day of oil and nearly one-fifth of global liquefied natural gas (LNG) trade moved through the Strait of Hormuz before the conflict. The disruption pushed up oil and LNG prices, trapped ships and choked off fertilizer flows.

Saudi Arabia's bypass pipelines can replace only part of the lost flow. Refined product shortages are acute because much spare refining capacity sits inside the strait. Jet fuel is especially exposed. Airlines have cut flights - one airline has already closed its doors.

Even when the strait reopens, traffic will not normalize quickly. Many shippers will not return until mines are cleared, security is restored and a ceasefire holds.

Higher insurance, the need to reroute and inventory costs will keep trade expensive even after the immediate disruption fades. Production and refining will take weeks to months to normalize. The drag on growth will outlast the conflict, much as we saw in the wake of the pandemic.

4. Inflation sticks. Supply shocks from energy, tariffs and supply-chain rerouting are hitting at once and pushing inflation higher for longer.

The International Monetary Fund [expects](#) inflation to rise in 2026 before easing in 2027. In a severe energy scenario, inflation could top 6% as global growth falls to 2%.

The result is a stagflationary squeeze: higher costs compress margins, trigger layoffs and limit room for central banks to respond. It is a worse growth-inflation tradeoff, not a temporary price shock.

Households respond with greater caution. Higher prices and uncertainty raise saving rates and curb spending, reinforcing the slowdown.

That creates a feedback loop. Weaker consumption slows growth, which deepens anxiety and fuels more protectionist politics.

5. AI's payoff is delayed. AI can lift productivity, but its benefits are spreading through the economy more slowly than many expected. Adoption takes time, capital and organizational restructuring.

The disruption to existing business models and labor demand hits sooner. The gains are real, but not yet broad enough to offset inflation.

Enterprise adoption is broad but shallow. Many firms remain stuck between pilots and scaled deployment, while employee resistance is intensifying.

The bottlenecks are both physical and organizational. Data centers are pushing up electricity demand, while chips, transformers, turbines and grid constraints are slowing buildouts and raising costs.

AI is reshaping business models and displacing workers before its productivity gains appear. The result is a timing mismatch: disruption arrives first, while the benefits are delayed.

AI backlash is growing, with concerns over jobs, privacy and ethics causing employees, consumers and policymakers to resist rapid adoption. This resistance complicates enterprise rollouts and slows progress.

Europe is regulating AI more aggressively than the US, which is slowing adoption. However, if Congress fails to act before the midterm elections, state and local governments could step in. That would create a more fragmented regulatory framework.

6. Demographic strains deepen. Aging is slowing labor force growth and raising pension, healthcare and long-term care costs across advanced economies. Life expectancies have risen to record highs among developed economies.

Immigration could ease some of that strain, but political backlash makes it unviable. At the same time, many emerging economies struggle to turn younger demographics into sustained growth.

Productivity gains may help over time, but not fast enough to ease the near-term squeeze. That leaves economies with fewer workers, heavier fiscal burdens and less resilience when the next shock hits.

7. Debt pressures central banks. When debt becomes too large to manage, governments run out of easy options. Faster growth is hard to generate, austerity is politically costly, inflation is dangerous and default is too painful.

What is left is financial repression. That occurs when policy levers are used to keep government borrowing costs artificially low. The tools are familiar but destructive: central bank bond buying, rules that channel savings into government debt and sometimes caps on long-term yields.

They do not prevent crises; they delay them. The costs show up as weaker currencies, higher inflation, losses for savers and a blow to central bank independence and credibility. Argentina's history with such measures is a case in point.

The open question is whether the US remains as insulated from rising borrowing costs as in the past. The term premium has risen, suggesting a floor is forming under long-term yields. That increases pressure on policymakers to intervene on rates.

8. Dollar dominance erodes slowly. There is still no clear alternative to the dollar. It dominates foreign exchange transactions.

The renminbi remains constrained by capital controls while the euro lacks a unified sovereign bond market. Diversification by central banks away from dollar holdings is happening gradually

The bigger near-term risk is less about displacement. Capital flows are fragmenting in response to the war.

The closure of the strait has left some countries asset-rich but cash-poor, unable to convert oil reserves into revenues. They have tapped sovereign wealth funds, drawn down reserves and issued debt – leaving fewer petrodollars available for global investment.

9. Financial fault lines widen. The global financial system is increasingly exposed to risks migrating beyond traditional banks. Private credit has filled the gap, but the liquidity and resilience of these credit vehicles remain untested.

Investors – including insurers and pension funds – have moved into these assets in search of yield. That increases their exposure to hidden risks.

The problem is not just the assets themselves, but their interconnectedness. Collateral damage is difficult to map. Regulators struggle to track how stress could spread across markets.

As shocks compound – geopolitical, financial and technological – traditional risk models are less able to capture how quickly markets can sell off. The system appears stable until it isn't.

10. Uncertainty amplifies an erosion of trust. Chronically elevated uncertainty is colliding with a loss in trust. The two reinforce one another, creating a less visible but powerful drag on growth.

As credibility weakens, households become more cautious, firms delay investment and markets demand a higher premium for uncertainty. Policy transmission weakens: rate cuts are less effective, while inflation expectations become more entrenched.

A feedback loop develops – slower growth deepens anxiety, which fuels more protectionist and short-term behavior. Over time, the damage compounds. Recessions become harder to escape. Their scars reshape economies.

Latin America offers a cautionary example: decades of policy instability, inequality and repeated crises entrenched uncertainty and weakened institutions. That left economies more vulnerable to shocks.

Bottom Line

The global economy is not facing a single break, but a compression of risks: trade fragmentation, energy insecurity, sticky inflation, slower productivity diffusion, aging populations, heavier debt loads and weaker policy credibility. There is no reliable way to model how these shocks escalate and amplify one another in real time.

What we do know is that, over time, they bias the global economy toward weaker growth, higher inflation and greater financial vulnerability. AI may yet boost productivity, but gradually. Before those gains are realized, the costs of adoption, business disruption and job displacement are likely to deepen the strains already in place.

“Under Pressure” remains the right frame for this moment. Prolonged strain does more than expose weakness; it erodes empathy, frays trust and makes retreat feel safer than solidarity. The song’s counterpoint is that care is not automatic. Under pressure, it has to be chosen.

I left the conference thinking less about forecasts than about the people behind them: colleagues who have become close friends over the years, and whose families have grown up alongside mine across countries and cultures. In a more fractured world, those ties feel more precious—and more vulnerable. They remind us that interdependence is lived, not abstract. If pressure makes withdrawal the easier instinct, preserving those bonds is itself a choice. That is worth holding onto. Be kind; pay it forward.

Economic Forecast – May 2026

	2025	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	1.9	1.8	2.0	1.8	1.3	1.3	1.8	1.9	2.3	2.7
Personal Consumption	2.6	1.9	1.7	1.6	1.8	1.3	1.7	1.7	1.7	1.8	2.3
Business Fixed Investment	4.1	5.8	4.3	10.4	6.4	4.2	4.3	4.3	4.0	4.0	3.9
Residential Investment	-2.2	-3.2	-1.0	-8.0	6.0	-3.0	-4.8	-3.8	0.2	3.9	6.5
Inventory Investment (bil \$ '17)	29	3	61	-8	-7	7	20	38	52	71	84
Net Exports (bil \$ '17)	-1091	-1135	-1231	-1068	-1119	-1156	-1199	-1220	-1236	-1236	-1231
Exports	1.6	5.5	3.0	12.9	7.0	4.5	1.8	2.9	2.2	3.0	3.1
Imports	2.7	5.1	4.6	21.4	10.7	7.1	5.7	4.2	3.1	2.1	1.7
Government Expenditures	1.1	0.6	0.6	4.4	1.0	0.7	0.8	0.8	0.5	0.4	0.0
Federal	-1.2	-0.6	1.3	9.3	1.8	1.6	1.9	1.8	1.0	0.5	-0.6
State and Local	2.5	1.3	0.2	1.6	0.6	0.3	0.1	0.2	0.3	0.3	0.3
Final Sales	2.2	2.0	1.5	1.6	1.8	1.0	1.1	1.5	1.6	2.0	2.5
Inflation											
GDP Deflator	2.8	3.8	2.7	3.6	5.3	3.5	3.2	2.6	2.1	1.7	1.7
CPI	2.7	3.5	2.4	3.6	6.5	2.2	2.6	2.7	1.8	1.5	1.1
Core CPI	2.9	3.0	3.0	2.8	3.5	4.2	3.2	3.0	2.5	2.3	2.1
Special Indicators											
Corporate Profits ²	73	16.6	2.8	16.4	21.8	17.4	11.3	6.3	1.6	1.4	2.0
Disposable Personal Income	1.7	0.7	2.7	1.5	-0.7	0.3	2.7	3.5	3.5	3.5	3.7
Housing Starts (mil)	1.36	1.29	1.19	1.42	1.30	1.28	1.16	1.15	1.18	1.19	1.23
Civilian Unemployment Rate	4.3	4.4	4.6	4.3	4.3	4.4	4.5	4.5	4.5	4.6	4.6
Total Nonfarm Payrolls (thous) ³	317	-52	-503	133	-5	40	-219	-239	-222	-72	30
Vehicle Sales											
Automobile Sales (mil)	2.7	2.8	3.0	2.7	2.7	2.8	2.8	2.9	3.0	3.0	3.0
Domestic	1.8	1.8	1.9	1.8	1.8	1.8	1.9	1.9	1.9	1.9	1.9
Imports	0.9	0.9	1.0	0.9	0.9	1.0	1.0	1.0	1.0	1.1	1.1
LtTrucks (mil)	13.5	12.9	12.9	13.0	13.0	12.8	12.8	12.9	12.9	12.9	13.0
Domestic	10.8	10.3	10.3	10.3	10.4	10.2	10.2	10.3	10.3	10.3	10.3
Imports	2.7	2.6	2.6	2.6	2.6	2.6	2.6	2.6	2.6	2.6	2.7
Combined Auto/Lt Truck	16.2	15.6	15.9	15.6	15.7	15.6	15.6	15.8	15.9	15.9	16.0
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	16.1	16.4	16.0	16.1	16.1	16.1	16.3	16.4	16.4	16.5
Interest Rate/Yields											
Federal Funds	4.2	3.8	3.9	3.6	3.6	3.8	4.1	4.1	4.1	3.8	3.6
10 Year Treasury Note	4.3	4.5	4.5	4.2	4.4	4.5	4.8	4.7	4.6	4.4	4.1
Corporate Bond BAA	6.1	6.4	6.6	6.1	6.2	6.4	6.8	6.8	6.8	6.6	6.4
Exchange Rates											
Dollar/Euro	1.13	1.18	1.21	1.17	1.17	1.18	1.19	1.20	1.21	1.21	1.21
Yen/Dollar	149.6	157.4	148.0	156.8	158.0	157.0	156.0	154.0	150.0	146.0	142.0

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.

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