What is the "K-Shaped Economy"?

by Paul Arieti

We started hearing the term "K-shaped economy" more frequently about two years ago. The term started being used during the COVID years and later popularized by economists and journalists. The "K shape" refers to the segment of the population who have rising income and wealth, represented by the up leg of the letter, and those that have shrinking wealth and income, represented by the down leg of the letter. The direction of the two legs highlights the fact that those that have significant wealth are experiencing it increase year over year and those that don't have significant wealth are experiencing it decrease year over year.

Applying specifics to the "K" legs, the "up" leg represents wealth of the top 10% that has more than doubled over the past five years while the "down" leg represents the wealth of the bottom 50% which has been flat or shrinking. The top 1% now hold roughly 32% of all wealth in the US and the top 20% hold over 70% of all wealth while the bottom 50% hold only 2.5% of all wealth. Much of the gain in wealth can be attributed to the stock market which has approximately doubled in the past four years. Since the top 10% of Americans own over 85% of stock market wealth while the bottom 50% own less than 2%, the stock market increase has been a major factor in the uneven wealth distribution. Real estate wealth is the other major factor in uneven wealth distribution where currently the top 10% own approximately 50% of all real estate wealth while the bottom 50% own less than 10%.

While the bottom half of the population is finding it more and more difficult to make ends meet, the overall economy has been doing well in the short term because those that have wealth are spending it freely. This phenomenon may not hold into the future. Recently the widely respected Michigan Consumer Sentiment Index plunged to a record low of 44.8. Prior to COVID the index was typically above 90 but since it has steadily reduced from the 70's to below 50. Some of the decrease to record territory may be the effects of the Iran War on the economy, but consumer sentiment was heading to record low territory before the War. With 70% of the economy driven by consumer spending this wealth squeeze on a majority of the population does not bode well for a healthy economy in the future. A healthy economy includes strong job growth, low inflation and increasing wage growth that exceeds inflation. All of these measures of a healthy economy are currently headed in the wrong direction.

The K-shaped economy term has led to other terms used to describe our current economic condition such as "inequality" and "affordability". A majority of our citizens on the wrong side of the inequality gap. They are experiencing an "affordability squeeze" and a "cost of living crisis". The difficulty is that there is no easy fix and it may take a cataclysmic event such as a major recession or even a depression to bring a halt to the rising inequality and to provide more balance to wealth distribution and affordability. It's happened before during the 1930's Great Depression and the 2008/2009 Great Recession. Let's hope our leaders can find a way to get us out of this fix this time without a disastrous social or economic event.