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Sunday Start | What's Next in Global Macro

The Inelastic Economy

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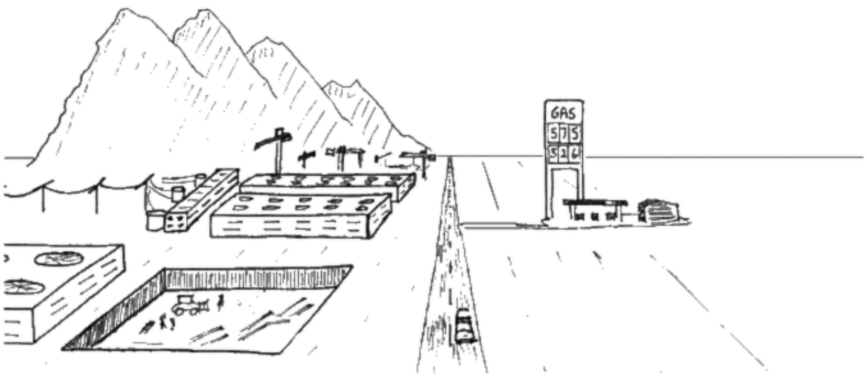

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Morgan Stanley Economics and Strategy teams recently published our Mid-Year Outlooks. This semi-annual exercise lays out our core views for the next 12 months and allows us to take stock of how much things have changed.

One shift has been in energy. Back in November, the world looked awash with oil. Now it looks uncomfortably short. Our base case assumes that the Strait of Hormuz opens in June, with a longer disruption a key risk to our views. We are watching inventory levels closely.

Yet even more notable has been the strength of activity *despite* geopolitics. Six months ago, we expected the US economy to grow +1.8% in 2026 and +2.0% in 2027. Those figures are currently +2.3% and +2.6%.

We estimated S&P 500 earnings growth would be (an above-consensus) +17% for 2026. We now see +23%.

Several factors explain this resilience. **One is inelasticity: demand that is proving surprisingly resistant to higher prices, higher financing costs, and higher geopolitical risk.** Strong balance sheets, from technology companies and households, are allowing it to continue.

It starts with the AI infrastructure buildout, this year's most important macro and micro story. The quantum of spending is vast and rising rapidly, both in absolute terms and relative to expectations.

A year ago, Morgan Stanley expected large US hyperscalers to spend $433bn on capex in 2026. We now think they will spend $805bn this year, $1.1tr next year, and almost $1.3tr in 2028. That 2026 figure would be roughly double 2025 spending

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and triple 2024 levels.

The more remarkable point is not just the scale. It is that this acceleration is happening despite rising costs. From copper to gas turbines to memory, large price increases in key components have done little to dent AI enthusiasm.

There's a term for demand that's relatively insensitive to price: **inelasticity.** You often find it in things that are essential (electricity) or deeply desired (concert tickets). In the case of AI investment, it may be both, with companies eager to shape what they see as *the* next big technology of the future, and also worried about falling behind if they don't.

For such an important long-term investment, inelasticity extends to the cost of financing it. We have seen record issuance from technology firms in 2026, even as yields have moved higher. The logic may be similar to the willingness to pay up for memory or power; for such a vital strategic priority, whether the borrowing costs 5.50%, 5.75%, or 6.00% is secondary to other considerations.

This is a long-term race, with most of the spending still ahead (see Sunday Start | What's Next in Global Macro: 11 Seconds (3 May 2026)). But inelastic demand can have an *immediate* impact on the economy and earnings.

Our stronger outlook for US growth this year despite geopolitical uncertainty? AI capex has caused our estimated growth rate for 2026 business fixed investment to more than *double*, relative to six months ago (from +3% to +7%).

The sharp rise in earnings? Higher demand at higher prices is a dream for margins. Consensus 2026 earnings estimates for Korea Equities (home of many key AI suppliers) are +235%. Many of the best single-name equity stories in 2026 are in the AI supply chain. (Note: our US equity strategists take great pains to emphasize EPS strength is not *just* about AI winners; growth for the median stock in the Russell 3000 is tracking +10%).

AI capex is the clearest example, but it is not the only one. Inelasticity is also visible in parts of household demand, where higher energy prices have yet to produce much retrenchment in the aggregate.

While US gasoline prices are up significantly, there is little sign that the US consumer is driving or spending less. US gasoline consumption in April 2026 was almost identical to April 2025. US retail sales last week, excluding oil and gas, were better than expected.

People are still driving, spending…and flying. My colleague Ravi Shanker notes that US airfares tracked +20.7% Y/Y through April as airlines passed along higher fuel costs. We are watching for signs that these higher prices are dampening demand. It hasn't happened yet.

These inelastic forces cut across the investment debate. We think they are strongest in the US, supporting a preference for US over RoW equities. With energy demand still robust as flows stay restricted, they skew oil prices higher, and we think expressions of oil upside are attractive hedges to our constructive cross-asset view.

These forces also hover over the outlook for bonds and central banks. Ultimately, we think AI-sensitive items have a relatively small weight within the inflation basket, allowing inflation to decelerate in 2H26 and supporting a more dovish path for ECB, BoE, and BoJ policy over the next 12 months than markets imply.

But if these inelastic forces prove more powerful or persistent, they may challenge our policy forecasts and expectation that bond yields will fall. These tech spenders have significant financial resources and strong balance sheets. US households are sitting on record wealth and European savings rates are historically high. For markets, the key question may not be whether prices have risen enough to matter, but whether demand has become too strategic, too essential, or too well-funded to care.

Enjoy your Sunday.

Send Us Feedback

Exhibit 1: Debt capacity: non-financial corporate borrowing is historically low, relative to equity market cap

Source: Federal Reserve Bank of St. Louis (FRED), Morgan Stanley Research

What I'm Reading This Week

US Credit Strategy Mid-Year Outlook: Financing the Future (19 May 2026)

Global Macro Strategy Mid-Year Outlook: Slippery When Oiled (15 May 2026)

US Economics Weekly: The other side of tariffs: Disinflation in the pipeline (22 May 2026)

Asia Energy Security and AI: Energy Meets Compute: Supercycle Recharges (21 May 2026)

Asia Economics: The Viewpoint: Is Asia's macro story all about semis? (20 May 2026)

What We Are Watching This Week

MONDAY, MAY 25

Israel Base Rate: We expect the elevated uncertainty about both the external and domestic outlook to keep the BOI on the cautious side and remain on hold.

TUESDAY, MAY 26

Hungary Base Rate: We see the NBH maintaining a cautious stance amid an uncertain global energy price outlook, as well as domestic fiscal and regulatory policy paths.

US Home Prices: Home price appreciation has slowed as demand remains challenged. Inventories of existing homes have picked up but are still low. However, the recent rise in mortgage rates means some of the improvement in affordability has reversed. Last year, the median income was 1.03 times the income needed to qualify for a loan on a median-priced home; that rose to 1.17 times in February but has since fallen back to about 1.08 times as of mid-May. Our housing strategists expect home price growth to reaccelerate later this year as rates decline, but it should remain limited at 2% this year and next.

US Conference Board: Consumer confidence remains low, though it picked up slightly in March and April despite the oil shock. The labor market differential has also improved over the past two months, matching the decline in jobless claims and rebound in payrolls.

WEDNESDAY, MAY 27

US Richmond & Dallas Fed: Both the Dallas Fed and Richmond Fed surveys posted solid manufacturing readings in April, supported by firm production and demand components. For May, regional signals have remained generally resilient, with strong readings from Empire and the S&P flash PMI partly offset by softer Philadelphia Fed survey data following a very strong March print. We are currently tracking May ISM manufacturing at 52.4, a decline from 52.7 in April.

THURSDAY, MAY 28

South Korea BoK Monetary Policy Meeting: We expect a unanimous hold decision from the BoK, and we expect it to start signaling its intention to shift to a hiking cycle on May 28.

South Africa SARB Monetary Policy Meeting: We expect a 25bp hike to 7.00%. We see potential for a split committee, with a majority in favour of policy tightening. The tone of the statement is likely to turn incrementally more hawkish, supporting market pricing for now.

Norway Mainland 1Q GDP: We expect exports to be supportive in 1Q due to higher oil exports in March. Government spending and household spending should positive contribute to the quarter, while we expect a correction in investments.

US Personal Income and Spending: We expect real personal spending rose 0.1% m/m in April, with goods down 0.2% and services up 0.3%. Despite the strong retail sales in nominal terms, control group prices were higher than expected as well, and auto sales declined. Strong April payrolls should support the strength in services in this initial print, as many categories are based on the establishment survey until they get QSS data.We expect nominal personal income rose 0.4% m/m in April, with labor compensation also up 0.4%. Proprietor's income was strong in March due to the Farmer Bridge Assistance Program. Applications for this program were open through mid-April, so we expect the strength to persist. Real disposable personal income is slightly negative due to high prices. We expect the saving rate fell from 3.6% in March to 3.5% in April.

US PCE Prices: We expect core PCE inflation rose 0.25% m/m in April and headline rose 0.42% m/m. The 3-month and 6-month annualized core PCE pace as of April comes to 3.70% and 3.74%, respectively (vs. 4.43% and 3.70% in March). The y/y rate is expected to be 3.27% in April (vs 3.27% in March).

US GDP: 1Q GDP revisions will reflect an altered pattern in consumption spending: upward revision to goods spending and downward revision to services, netting out to a 0.2 pct pt downward revision to real consumer spending growth to 1.4% and a 0.1 pct pt downward revision to real GDP growth to 1.9%.

US Durables: Durables orders were probably boosted by aircraft orders, but we forecast solid underlying gains as well.

US Jobless Claims: We forecast little change in jobless claims, with new claims at 210k and continuing claims at 1.775 mil.

US New Home Sales: Mortgage applications picked up, but starts, permits, and builder confidence were slipping in April. Our forecast for an almost unchanged 680k annual rate puts April new home sales at about the same pace as last year.

FRIDAY, MAY 29

Germany CPI: We forecast headline CPI down at 2.7%Y in May from 2.9%Y in April on the back of lower energy inflation due to a fuel tax cut

US Trade: Faster rising import prices probably pushed the deficit slightly wider in April, by $2 bn to $89.5 bn.

Japan Tokyo CPI: We project headline Tokyo CPI for May at +1.6%Y, with Japan-style core (all items less fresh food) at +1.5%Y and core-core (all items less fresh food and energy) at +1.9%Y.

Japan Unemployment Rate & New Job Offers/Application Ratio: Unemployment rate is expected to be at 2.7% in April and new job offers/ application ratio is expected to be at 1.18 in April.

Japan Industrial Production: We forecast April industrial production decreases by -0.9% MoM and increases by +0.6%YoY.

Japan Retail Sales: We forecast retail sales increase by +1.2% YoY in April.

Japan Housing Starts: We expect that new housing starts increases by 13.5%YoY in April.

Japan Consumer Confidence Index: We expect May consumer confidence index to be 32.0.