September 1, 2026 04:10 AM GMT

US Public Policy | North America

Thoughts Ahead of a Full Fall: Midterm Elections, DC Pushback, US-China & AI Sovereignty, Fiscal, and Tariffs

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Whether it's back-to-school or late summer reading, we offer our thoughts around three key policy themes to watch into the fall: 1) US midterm elections, 2) US-China relations & broader AI sovereignty, and 3) fiscal catalysts, as well as some quick thoughts on US-Canada tariffs.

Below are some quick thoughts on key political catalysts into the fall. We plan to revisit views on these topics in more depth in the coming weeks, but please reach out in the interim to discuss in detail.

Key takeaways:

- Midterms: Data center pushback continues to be a wedge issue into the elections; we highlight races to watch where impending projects could be subject to a shift in policy
- Midterms are in & of themselves unlikely to drive sustained market rotation, but we see negative seasonality into the election. We could see a potential initial market reaction if Democrats outperform expectations and investors question the durability of the existing policy regime
- We don't see midterm outcomes disrupting the policy variables that have introduced elevated uncertainty over the past ~15 months, given that many of them will remain under the president's control
- US/China: We think the overarching incentive is to maintain managed stability but see potential for nearer-term tensions into the summit on September 24 and potential tech restrictions in line with the AI sovereignty theme
- Fiscal catalysts in the fall: government funding & FY27 National Defense Authorization Act (NDAA) (likely both in December)

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1) US Midterm Elections

1) What's the likely outcome? While we don't maintain in-house forecasts, the baseline expectation is divided government, per third party modeling of existing data. As mentioned in our previous research, to get a sense of the state of the race we rely on an amalgamation of indicators: prediction markets, polling, the president's approval rating, economic indicators, and more. We'd note that prediction markets have steadily moved in the Democrats' favor over the past few months: that's in line with our expectation that fundamentals into this election (historical precedent and turnout dynamics chief among them) should benefit Democrats. The Senate remains close per most third-party ratings, although factors like the persistence of the US-Iran conflict & the President's approval rating has provided tailwinds to Democratic candidates in those races as well.

2) How should we think about data center pushback into the races? We've been flagging this as the key wedge issue into the 2026 election (see notes linked below) since it began to percolate last fall. That being said, we still see this as a state and local policy risk rather than a federal one for the time being: federal policy has remained accommodative toward data center construction, by streamlining permits, opening some federal sites for data centers and power generation, and encouraging new energy infrastructure to support AI, while addressing rising local concerns recently on a voluntary guideline basis. We think that likely continues, in particular due to the geopolitical incentives that federal lawmakers have to respond to. Some of the most frequent questions we receive on this topic:

- **What's a realistic timeline for this political risk?** Given that federal policy remains supportive, we see the political risk potentially translating into more concrete federal policy changes following the 2028 elections. The midterms will be instructive in drawing the political fault lines (i.e. which policy restrictions resonate with voters and are providing clues about the overall direction of travel) while potentially laying the groundwork for broader efforts to constrain the buildout in the future. In the nearer term, we could see greater scrutiny of state and local tax incentives, while a shift in the federal political backdrop could eventually put provisions such as the OBBBA's 100% bonus depreciation in focus.
- **How are hyperscalers mitigating this constraint?** We don't see a one-size-fits-all response, as efforts are mirroring the three constraints we outline here: 1) higher electricity prices: a number of hyperscalers signed the Ratepayer Protection Pledge (promises to build/buy their own generation, cover grid upgrade costs, and pay separate large-load rates whether or not they use the power). 2) Environmental concerns: Google is pushing a water framework & Amazon disclosed global data center water use for the first time this year. 3) Quality of life: Meta launched a $1bn fund for host-community teachers, first responders, and infrastructure.
- **What does this pushback mean for AI capex?** We are still constructive on AI capex this year - in fact, our analysts see hyperscaler capex growing to >$1T next year. It's overly simplistic to say none of this spend could be affected by the political backlash, but we think the more likely outcome is a conditional buildout. That means, in our view, there will be certain regions of the country that still allow

the data center construction while others are more restrictive.

- **Which races should we watch in the midterm elections?** The table below summarizes races with pending data center projects that could be targeted following a change in leadership. Note - this list is not exhaustive, and we don't think Senate races are as relevant as local (governor, PUCs, and county boards) for enactment of restrictions. The table below covers just races to watch for identifiable projects in scope where a candidate has proposed something that would materially impede it.



Exhibit 1: Summary: races to watch & key projects

Race	Project(s) in scope	Mechanism
HOUSE RACES		
House PA-08 Bresnahan (R) v. Cogbeth (D)	• Archbald — six proposed campuses; the most of any PA municipality; Lackawanna County has 14 in total • Project Hazelnut / NorthPoint, Hazle Twp — 15 buildings; township denied the plans and a Luzerne County judge has already denied NorthPoint's appeal • PA Glacial Till, Tobyhanna — 500 acres; zoning validity challenge • Smithfield Twp — two-building campus	Bresnahan's Local Control Protection Act would limit developers' ability to sue municipalities that push back, but it has no cosponsors and has not left committee. Cogbeth is running on the issue rather than on a mechanism.
House-MI-07 Barrett (R) v. Lawrence (D)	• Ypsilanti Twp, near Mason — ~406.8 acres; ~$1B; developer undisclosed • Saline Twp is outside the district — reference case only.	Lawrence backs a federal moratorium, the vehicle being the Sanders–Ocasio-Cortez AI Data Center Moratorium Act. Barrett introduced the Protecting Local Control of Data Centers Act and the No Data Center NDAs Act on 20 Aug. All three need federal legislation.
SENATE RACES		
Senate TX Paxton (R) v. Talarico (D)	• ERCOT large-load queue — ~47.4 GW across ~1,800 requests; ~80% data centers, estimated in Abbott's letter. • Only projects requesting ≥75MW are subject to the Batch Zero process; ~250–300 projects >= 75 MW+ are in Batch Zero; a further ~8,766 MW sits in the 25–75 MW band not subject to Batch Zero. • Meta El Paso — 1 GW; ~$10B; building since Oct 2025. Outside ERCOT, so Abbott's interconnection pause does not reach it.	Talarico's Hold Data Centers Accountable Plan would end the state sales tax break; set federal minimums and require closed-loop water; but Paxton also backs repealing the exemption, plus rural siting limits and a Chinese-technology ban. Neither can set Texas siting law from the Senate.
Senate-MI Rogers (R) v. El-Sayed (D)	• Saline Twp / Stargate — 1.4 GW; $16B. Related Digital and Blackstone for Oracle and OpenAI. Building since Nov 2025; MPSC approved the DTE contracts in Dec 2025 and the AG has appealed. • Google, van Buren Twp (Project Cannoli) — 1 GW; preliminary site plan approval Feb 2026. DTE's contracts are in a contested MPSC case, unlike Saline's fast-track.	Rogers came out for a one-year Michigan moratorium on 20 Aug, while stating he does not support a federal ban. El-Sayed wants comprehensive federal zoning guidelines, local veto power and community-benefit deals. Neither could impose the Michigan pause.
Senate OH Husted (R) v. Brown (D)	• Central Ohio Meta / Amazon / Google — state, local and utility approvals.	Husted's Ratepayer Protection Act only requires states to consider cost-allocation standards for loads at 100 MW+; not shifting costs. No Senate cosponsors; the House companion cleared Energy and Commerce in July. Husted calls siting a local issue. Brown targets the tax breaks. Neither explicitly supports a pause.
GOVERNOR RACES		
Gov-NY Hochul (D) v. Blakeman (R)	• 48 large-load projects, ~12 GW, sit in the NYISO queue — but NYISO says the order does not touch that queue, because it pauses environmental permitting, not grid connection. NYISO expects only ~3 GW to materialise within ten years. • Carve-outs are wide: local permits, ministerial permits, applications already deemed complete, and manufacturing, research, education / medical sites are all exempt.	Executive Order 52 (14 Jul) holds DEC applications for new data centers of 50 MW+ in abeyance until DPS completes a Generic Environmental Impact Statement, for up to one year.
Gov-TX Abbott (R) v. Hinojosa (D)	• The Batch Zero cohort (~250–300 projects, 75 MW+); • Community-impact review also covers 25–75 MW loads.	Abbott's 3 Aug directive bars any further data centre from advancing through interconnection until a PUCT/ERCOT audit is done — a pause on approvals, not a development moratorium. Hinojosa wants a broader emergency-order moratorium plus a special session. The governor controls PUCT appointments and the 2027 session agenda.
Gov-OH Ramaswamy (R) v. Acton (D)	• Unapproved and pre-permit projects are the target pool; ~200 already operate statewide. • Project Mila, Trenton — Prologis; 141 acres; 253 MW; 899,055 sq ft across four buildings. Already zoned industrial, so no rezoning vote was needed; the site plan passed 4–0 in a ten-minute meeting on 30 Mar with no questions taken; groundwork is underway, and completion is targeted for early 2029. • Ten-plus Mahoning Valley municipalities already have moratoriums.	Acton would bar projects failing any of six conditions: 100% of utility costs (exclusive), union labour, transparency, and no NDAs; environmental standards; community benefit; brownfields. Ramaswamy rejects a ban but promises a day-one order halting new approvals until the legislature codifies three conditions — free electricity, health, full property taxes, air and water standards.
Gov-PA Shapiro (D) v. Garrity (R)	• Over 100 proposals statewide. DEP says permit applications relate to 20 proposed facilities; the governor's office separately says 15 projects have applied for at least one DEP permit and five have all permits needed for their first phase. • QTS / Blackstone Salem — 1,700 acres bought for $500M+; $10B build; 12 buildings. • Project Hazelnut — denied locally; appeal rejected.	Executive Order 2026-05 (18 Aug) applies to projects over 25 MW. Developers that sign a binding GRID consent order may receive rolling DEP review, but permits cannot be issued until required local approvals are obtained; developers that do not sign face deferred review until local and other prerequisites are satisfied. The order also removes data centers from Fast Track, ties the sales tax break to compliance and bars state agencies from signing NDAs. Not a moratorium, but Garrity wants one, so there is no deregulation alternative in this race.
Gov-NV Lombardo (R) v. Ford (D)	• Applicants for state tax abatements, and projects relying on evaporative cooling. • Manse Technology Campus, Fernley — 830 acres; $18B. Gigawatt Development Partners, stacked to the five-County basin ban, though the county has not commented on its status. • Townsite / Boulder City — 167 MW on an 80-acre BLM parcel approved 25 Jun via an amended solar right-of-way, with no fresh environmental review. Boulder City and two green groups have appealed to the IBLA. The developer withdrew its separate city-land application in Jul.	Ford's 19 Aug plan would pause abatements for new projects pending a GOED review, require developers to bring their own power, water and grid spending, and ban evaporative cooling. Lombardo remains a local backer; approved abatements are contractual and should not be assumed to lapse.
Gov-GA Jackson (R) v. Bottoms (D)	• River Park / Butts County — 11M sq ft of data centres inside a ~$10B mixed-use DRI that also has a hospital and medical offices; 4.5M gallons a day, more than tripling county water use. • The DRI review is advisory — the county decides the rezoning. • 2026 session produced several restriction bills; none reached the governor.	Bottoms backs a temporary statewide pause to gather facts, and has said explicitly she would not make it permanent. Rick Jackson opposes a moratorium and would leave it to host communities. Local zoning sinds under either.
Gov-FL Donalds (R) v. Jolly (D)	• Fort Meade — ~1,300 acres; 4.4M sq ft approved; a city of 5,300; two lawsuits and a recall pending; and the water permit still sits with a water management district whose board the governor appoints. • Project Tango, Palm Beach — 600 MVA; $2.6B; denied 5–1 on 15 Jul without prejudice; the county also advanced a one-year moratorium.	Jolly wants an immediate statewide moratorium. Donalds opposes one but has backed federal rules requiring private power and water. SB 484 (effective 1 Jul) preserves local approval, so the governor holds no clear veto.

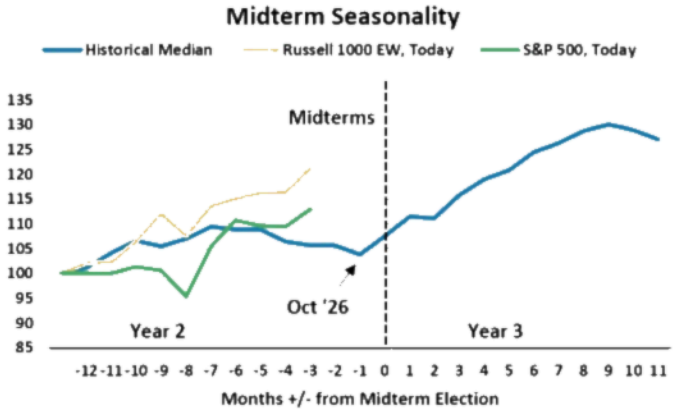
Source: Public information/widespread reporting, Morgan Stanley Research

3) How should we be positioning for the elections and what should we expect in the immediate aftermath? Two points on this front:

i) our US equity strategy team sees midterms themselves producing muted results

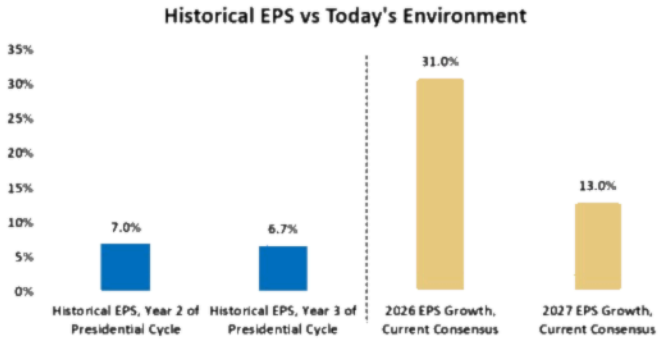
across the broader market, although we see a potential knee jerk near-term reaction if Democrats outperform expectations. Specifically, we think this could lead the market to question the durability of the current policy path – specifically, de-regulation, the full scope of the OBBBA, and the rebalancing from government to the private sector. In our view, this could lead to an initial risk-off reaction function either before mid-terms if polling/prediction markets convincingly point in this direction or post midterms. Why not a more sustained risk-off move? The President has veto power and the 2028 Presidential election would still be two years away. If there was risk to US equities overall, our equity strategy team thinks it's more likely from rates and liquidity rather than midterms.

Exhibit 2: Seasonality is typically negative from April to October into the Midterms...



Source Bloomberg, Morgan Stanley Research

Exhibit 3: ...However Strong Earnings Have Been the More Impactful Equity Market Driver

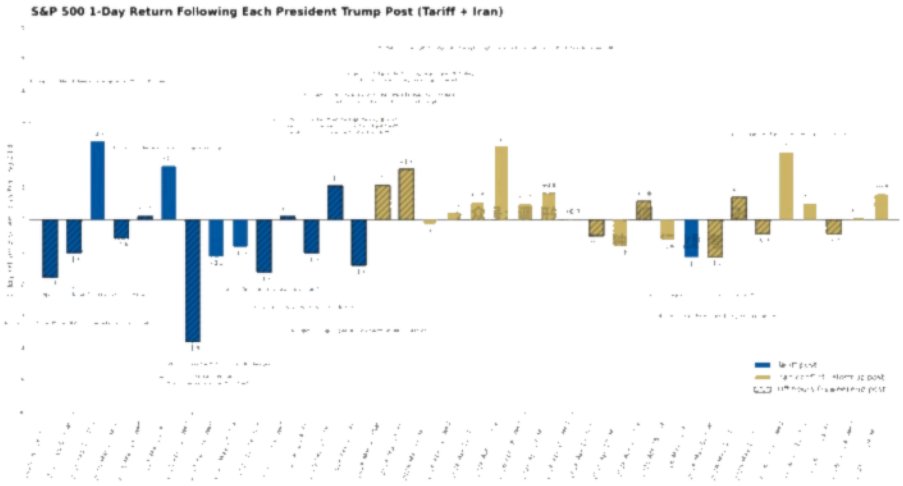


Source Bloomberg, Morgan Stanley Research

ii) Secondly, if there were a divided government outcome we don't think it would derail the policy variables that have introduced elevated uncertainty over the past ~15 months, given that many of them will remain under the president's control. Looking back over the past year and a half, instances of elevated policy uncertainty (and associated market volatility) were tied to executive, rather than legislative, action. That being said, our work suggests (see Exhibit 4) that for equities, headline risks from social media posts are having less impact on markets outside of possible intraday trading. For bonds, headline risks from social media posts have had an impact on volatility, but we think only if there's a clear macro read-across from any policy/ policy shift announced.

Broadly speaking we see policy durability across the variables that will remain in the president's control following the elections: de-regulation, tariffs/trade, geopolitics, immigration controls, and more. We think deficit expansion is less likely in a thin Democratic win (i.e. winning the House and not the Senate), while a sweep could produce an outcome in which Democrats in Congress utilize their leverage around fiscal deadlines to pursue policy objectives that could be additive to the deficit (delaying SNAP/Medicaid cuts, for example, as we note here). We see a Republican win outcome as broadly maintaining status quo.

Exhibit 4: US equities show diminishing sensitivity to headline risks from social media posts over time



Source: Morgan Stanley Research

More of our views on the midterms, in particular sector and macro impacts, can be found in the links below:

- **US Public Policy: Mapping the Midterms: A First Look (21 Apr 2026)**
- **US Public Policy: Pricing Policy Risk (10 Jul 2026)**
  - **US Public Policy: US Midterm Elections Pulse Check: Puts & Takes from the Primaries (25 Jun 2026)**

And more of our views on data center pushback & the political constraints:

- **US Thematics: Power Struggle: AI, Data Centers & Local Backlash (14 Jul 2026)**
- **US Thematics: Power Struggle: Data Center Pushback Update & Expert Call Takeaways (17 Aug 2026)**

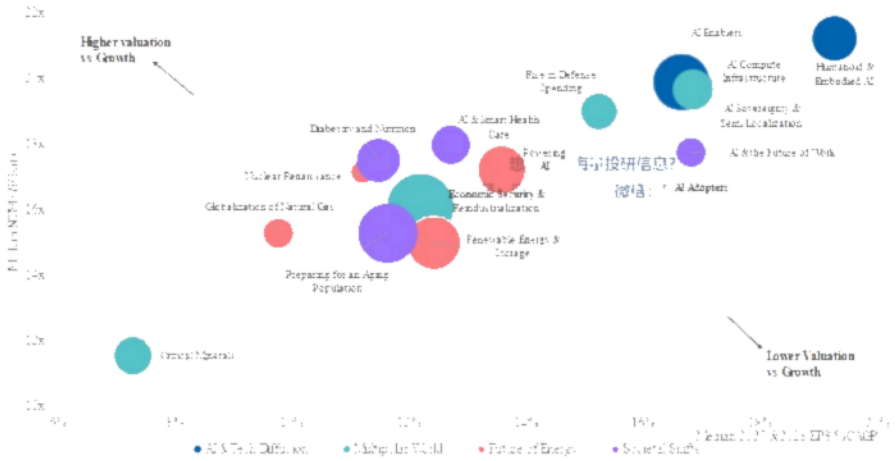
2) US-China & AI Sovereignty

President Xi is expected to visit the US for a joint leaders summit on September 24. We think the overarching incentive is to maintain managed stability given mutual dependencies. That being said, we could see some escalation into the planned summit, as evidenced by recent policy actions (including MOFCOM's June 22 rare-earth listings, the FCC humanoid-robot and inverter ban, Beijing's Aug 5 sanctions-plus-drone-licensing package, and US polysilicon and drone tariffs, to name a few examples). A key tail risk is that reciprocal trade measures broaden into the AI sphere ahead of the planned meeting, resulting in a further escalation of tariffs.

This nearer-term dynamic is occurring against a broader backdrop of competitive confrontation between the US and China, which underpins our thematic prediction for a 'Two Worlds' divergence in tech ecosystems (as we discuss here and here). In short, as AI progresses into the national security arena we see an increasing probability of both US and Chinese AI policy intervention, which could lead to a greater bifurcation of the global market. US restrictions likely lean toward controls over advanced chips and semi equipment as well as limits on cloud, compute access, procurement, and distribution, while we think Chinese areas of focus are more likely to be around regulation and local model integration/platform and app store access, for example. From a US perspective, we see a middle path that seeks to balance two objectives: 1) permitting a certain degree of open-weight models (for a discussion of the merits of open vs. closed weight, see here) to facilitate proliferation, model development, and access; and 2) safeguarding American frontier LLM IP. In our view, that could be potentially be achieved, for example, by putting certain Chinese AI model developers on a restricted list and prohibiting usage of those companies' models by American firms. Although technology restrictions and geopolitical tensions may create 'winners' and 'losers' across the technology stack, duplicating AI capacity across the stack leads to a larger and longer-lasting global AI capex cycle. The biggest beneficiaries are likely to be infrastructure providers and companies that can enable localized AI deployment while maintaining compliance, security, and governance requirements.

Ways to play AI sovereignty: Our new global Thematic Map includes an AI Sovereignty & Semi Localization sub-theme, which identifies the materiality of company exposure to the trend across our >3,800 stock global coverage. From a sector perspective, this brings in a raft of global companies that have exposure to compute infrastructure and the AI model and application layer, including trusted vendors in infrastructure software, cyber-security, and IT services. Overall, we see AI Sovereignty & Semi Localization as one of the fastest-growing themes in the market

Exhibit 5: Thematic Forward P/E ratio vs consensus EPS growth (2027+28 CAGR) – AI Sovereignty stands near the top of the growth and valuation map



Source: FactSet, Morgan Stanley Research, Data as of 3 August 2026

Source: FactSet, Morgan Stanley Research; Data as of 3 August 2026

More of our views on AI Sovereignty and the US-China summit:

- **US Public Policy & Global Thematics: AI Sovereignty: Policy, Market, and Economic Implications (19 Aug 2026)**
- **US Public Policy / China Economics & Equity Strategy: US/China Summit: Managing the Relationship (18 May 2026)**
- **Global Economic Briefing: The Weekly Worldview: Managed Stability, Manageable? (24 Aug 2026)**

3) Fiscal Factors

We see a latent shutdown risk in the fall. The federal government is currently funded through September 30, the end of this fiscal year. Congress appears to be coalescing around a continuing resolution (CR) to keep the government funded through that deadline (see here) into December: the House passed a stopgap through 12/4, and the Senate has since passed an amended version through 12/11, which the House must take up after the August recess. That shifts the funding risk into December, at which point lawmakers post-election will have to either finish FY27 appropriations or agree to another CR. We think the path forward will depend on the outcome of the midterm elections, which could change elected officials' incentive structures. Hence, there's a risk that the CR in December is not extended, allowing funding levels to lapse again. In general, we see limited impacts of government shutdowns for markets/economic activity, but note the potential for interrupted data releases the longer it lasts (see here for more).

Beyond appropriations, other catalysts include the FY27 NDAA (which should be passed by year-end) and the debt ceiling (which is projected to be reached in 2027, though extraordinary measures would likely push the binding constraint into late 2027 or beyond per public estimates).

More of our views on the impacts of a government shutdown:

- **US Economics Weekly: Lower data quality because of the federal shutdown (10 Oct 2025)**
- **US Public Policy: 100 Days Brief (October 3, 2025)**

4) Quick Thoughts on Canada Tariffs & USMCA

We highlighted US-Canada tariffs as a potential escalation route into the USMCA review, as outlined in our note here. Our Canada economists frame the direct hit of the new Section 338 tariffs as manageable, covering roughly US$20bn of Canadian exports, about 6% of total US imports from Canada (nearer US$18bn once goods already under Section 232 are netted out), lifting the trade-weighted tariff rate on Canadian goods by ~2pp to 5–6% and the overall US rate by just ~0.2pp. While we think the broader risk of escalation should be monitored, statements from the administration have suggested flexibility on the implementation of these tariffs. In that vein, the Section 338 tariffs, in our view, can't be separated from the political backdrop surrounding the announcement, particularly the USMCA negotiations that are progressing much more rapidly with Mexico than with Canada. Hence, given the limited economic impact of these tariffs (~$20bn as our economists cite), we think this fits into the playbook for USMCA negotiations that we outlined earlier this year, as we pivoted toward our bear case for the talks: more escalation as the negotiations progress and the deadline is postponed until next July (unless an agreement is again not reached, in which case we shift to annual reviews). All else equal, in our view further implementation of tariffs or an expansion into other sectors shifts the balance of risks toward a bilateral/fragmented USMCA, the implications of which we delve into here.

More of our views on US-Canada trade and the USMCA:

- **US Public Policy: USMCA Review: Revisiting Our Bear Case (10 Mar 2026)**
- **US Public Policy: Thinking Through the USMCA Review (29 Oct 2025)**
- **Canada Economics and G10 FX Strategy: Section 338 Tariffs and Canada: Limited Macro Effect, Rising Strategic Risks (21 Jul 2026)**
- **Metals & Mining: U.S. Canada Trade Deal Reversal (24 Aug 2026)**
- **Autos & Shared Mobility: U.S.-Canada Deal to Reportedly Cut Auto Tariffs to 15% (20 Aug 2026)**