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US Economics Outlook: Capex over consumption

September 2026

Michael Gapen
Chief US Economist
Michael.Gapen@morganstanley.com
+1 212 761-0571

Sam Coffin
Economist
Sam.Coffin@morganstanley.com
+1 212 761-4630

Diego Anzoategui
Economist
Diego.Anzoategui@morganstanley.com
+1 212 761-8573

Heather Berger
Economist
Heather.Berger@morganstanley.com
+1 212 761-2296

Lingdi Xu
Economist
Lingdi.Xu@morganstanley.com
+1 212 761-2957

Arunima Sinha
Global Economist
Arunima.Sinha@morganstanley.com
+1 212 761-4125

All information as of September 3, 2026, unless otherwise stated.

For important disclosures, refer to the Disclosure Section, located at the end of this report.

Michael Gapen



Michael joined Bank of America in 2022 from Barclays, where he was head of US Economics Research and, following his appointment as Asset Allocation Strategist in January 2012, he took on additional responsibility for forming the firm's asset allocation views and marketing them to clients. Prior to this, he was Section Chief in the Division of Monetary Affairs at the Federal Reserve Board, where he supported the FOMC in developing its policy response to the global financial crisis.

Michael holds a PhD in economics from the Department of Economics at Indiana University. He has taught finance and economics at the Kelley School of Business and Department of Economics at Indiana University, Mendoza College of Business at the University of Notre Dame, and the Department of Economics at Johns Hopkins University. He has also guest lectured at the School of International and Public Affairs at Columbia University. He is a frequent commentator on news media outlets, including Bloomberg TV, CNBC, and TV Tokyo, and is often cited in print and online media.

US Outlook: Key themes

- **A Multipolar World means rewiring of supply chains:** Our outlook for the economy includes a modestly higher oil risk premium, which complements trends where more countries, including the US, desire domestic inventories of key imports, encourage resource hoarding, reconfigure supply chains, and reduce reliance on foreign supplies.
- **Capex over consumption:** Higher gasoline prices are likely to neutralize the effects of the OBBBA on households, suppressing spending on goods in the process. In the other direction is nonresidential business investment, where AI-related spending continues apace and interest in building out domestic resilience and self-sufficiency remains high.
- **Low-hire/low-fire labor market:** After rebounding in 1Q 26, hiring has slowed and the labor market appears stable with a low unemployment rate. The drop in LFPR, and lack of turnover, remain a concern. AI is raising unemployment in some occupations.
- **Disinflation:** Payback from tariffs, diminishing shelter inflation, and pending revisions should put inflation on a downward trend. We see the Fed on hold through the end of 2026, followed by 50bp of policy rate easing in 2027.

	4Q/4Q % change										
	2025A	2026E	2027E	1Q26A	2Q26A	3Q26E	4Q26E	1Q27E	2Q27E	3Q27E	4Q27E
Real GDP	2.0	2.2	2.6	2.1	1.5	2.7	2.5	2.4	2.6	2.6	2.6
Final Domestic Demand [2]	1.8	2.6	2.8	2.2	3.3	2.7	2.3	2.6	2.8	2.8	2.8
Final Private Domestic Demand [3]	2.4	2.8	3.1	1.7	4.2	2.9	2.5	2.8	3.1	3.2	3.2
Personal Consumption Expenditures	2.1	2.1	2.1	0.5	3.4	2.4	1.9	1.8	2.2	2.2	2.2
Nonresidential Fixed Investment	5.6	7.7	8.0	10.6	8.5	5.9	5.9	7.9	7.9	8.0	8.0
— Structures	-5.5	-3.1	2.0	-4.7	-1.8	-3.0	-3.0	2.0	2.0	2.0	2.0
— Equipment	9.6	11.3	10.5	15.8	13.6	8.0	8.0	10.5	10.5	10.5	10.5
Civilian Unemployment Rate (%)	4.5	4.3	4.1	4.3	4.3	4.1	4.3	4.3	4.2	4.2	4.1
Average Monthly Change in Nonfarm Payrolls (Thous.)	10	57	59	73	77	32	45	57	60	60	60
PCE Price Index	2.8	3.5	2.1	3.1	3.9	3.7	3.5	3.0	2.2	2.1	2.1
PCE ex Food & Energy	2.9	3.2	2.4	3.1	3.4	3.3	3.2	2.8	2.4	2.3	2.4
Fed Funds Target (%, midpoint of target range)	3.625	3.625	3.125	3.625	3.625	3.625	3.625	3.375	3.125	3.125	3.125

2) GDP less contributions from inventory investment and trade 3) GDP less contributions from inventory investment, trade, and the government sector. (Private final consumption plus

Alternate Scenarios

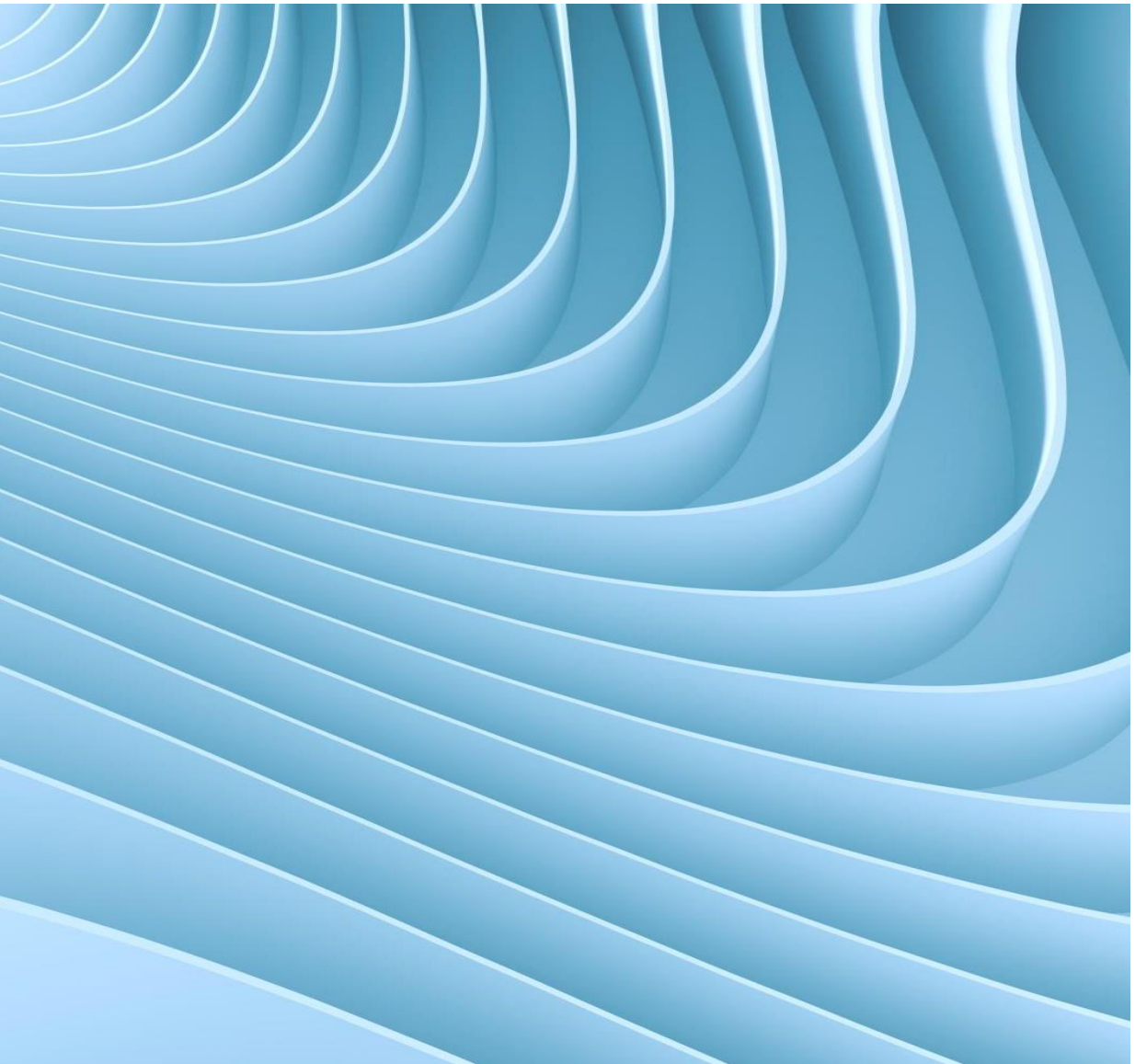
Scenario 1: Aggregate demand upside (15%). The oil shock fades, while stronger confidence and wealth support consumption and business investment. Demand accelerates GDP growth to 2.9% in 2026 and 3.1% in 2027, with unemployment falling to 3.5% by the end of next year. Stronger demand keeps inflation elevated, with headline inflation reaching 3.7% in 2026 before easing in 2027. The Fed waits to confirm growth is demand-driven, then begins hiking in 4Q26, raising rates by 100bp to 4.50-4.75%.

Scenario 2: AI productivity boost with labor displacement (10%). AI has boosted productivity without major labor market disruption so far, but broader adoption could lead to greater layoffs. In this scenario, firms maintain output growth while reducing headcount, pushing unemployment to 4.5% in 2026 and 4.8% in 2027. Weaker employment weighs on consumption, investment, and hiring. The Fed begins cutting rates in early 2027, delivering three cuts to bring the funds rate to 2.875%.

Scenario 3: Permanent oil premium (20%). Oil prices stay above $100 through 2027, weighing on consumption while AI-related investment remains strong. GDP growth slows modestly versus the base case, while unemployment holds near 4.2-4.3%. Persistent energy costs keep inflation elevated, with core PCE at 3.1% in 2026 and 2.8% in 2027. The Fed remains cautious and keeps rates unchanged at 3.50-3.75% through the end of 2027.

Scenario 4: A global recession (15%). Oil prices surge to $140-160/bbl through 3Q26, causing supply shortages and demand destruction that push the economy into recession. GDP contracts in 2H26 while unemployment rises to 5.5%. Inflation spikes initially as oil prices jump, but weaker demand later slows inflation pressures. The Fed cuts rates by 200bp in 2026 to 1.50-1.75%. Recovery in 2027 is supported by lower rates and moderating inflation, allowing the Fed to begin hiking back to 2.5-2.75%.

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Consumption: A neutralized fiscal impulse

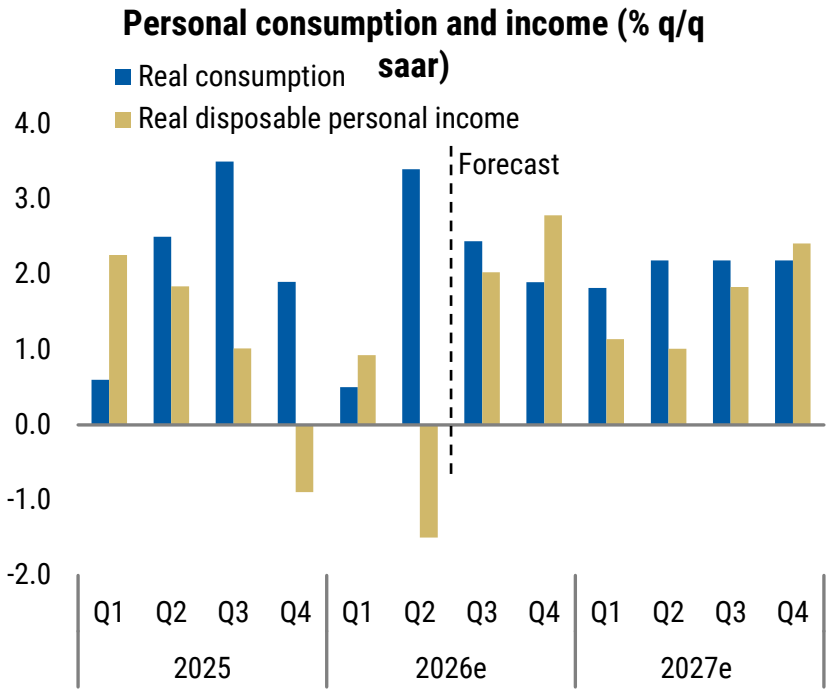
Our view on the consumer in 2026 has turned more neutral. With the drag from higher oil prices, we expect that real consumption growth in 2026 will be unchanged (2.1% 4Q/4Q). Previously, we penciled in a fiscal-induced bump to spending in 2026, but that assumption no longer seems plausible. As we move into 2027, we expect further resilience in spending as the pass-through effects of tariffs and energy prices fade (2.1% 4Q/4Q).

We are more cautious on our outlook for spending by low- and middle-income cohorts. The focus is back on the upper-income consumer, where we assume higher levels of wealth allow for resilient spending.

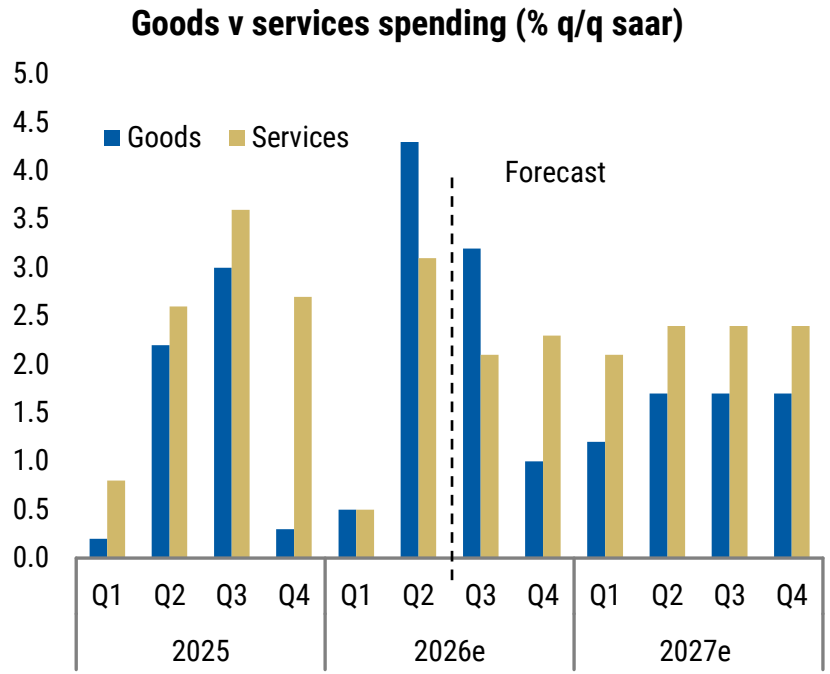
Soft real income but resilient consumption

Real income growth declined in 2Q with high inflation. While we expect a rebound in 2H, real income remains relatively soft for the year. Consumption has been resilient as consumers have pulled down the saving rate and tax refunds provided some support. As real income recovers, we expect continued moderate consumption growth, ending the year close to last year's pace at 2%.

Consumption has been resilient



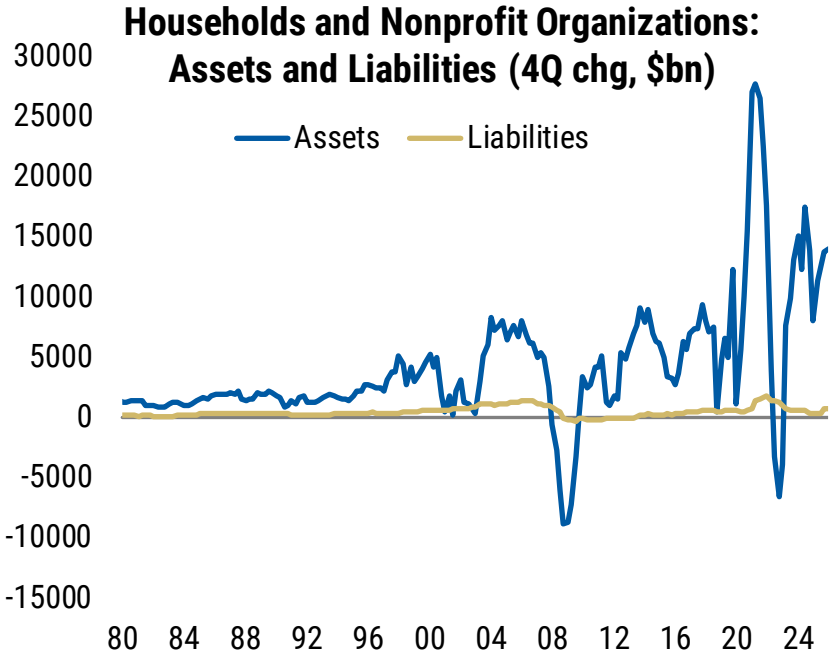
Goods rebounded in 2Q



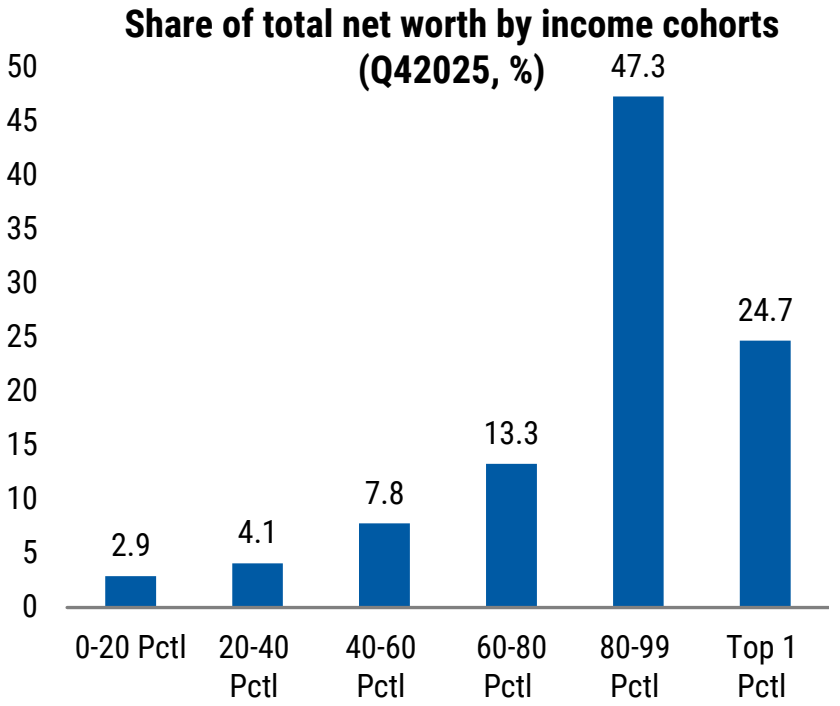
Changes in assets drive household spending

Changes in household assets are more important in our outlook for consumer spending than changes in household liabilities. The top 20% of income earning households hold about 75% of household net worth. This is the link between AI-expectations, asset market returns, and spending by upper income cohorts

Growth in household assets has far outpaced the modest rise in household liabilities



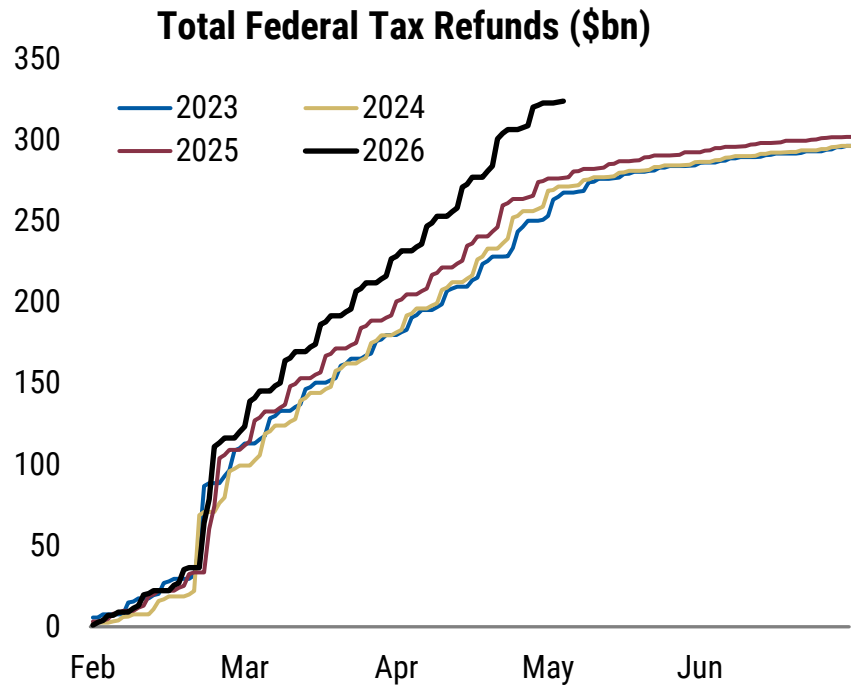
Upper-income households hold about 75% of household net worth



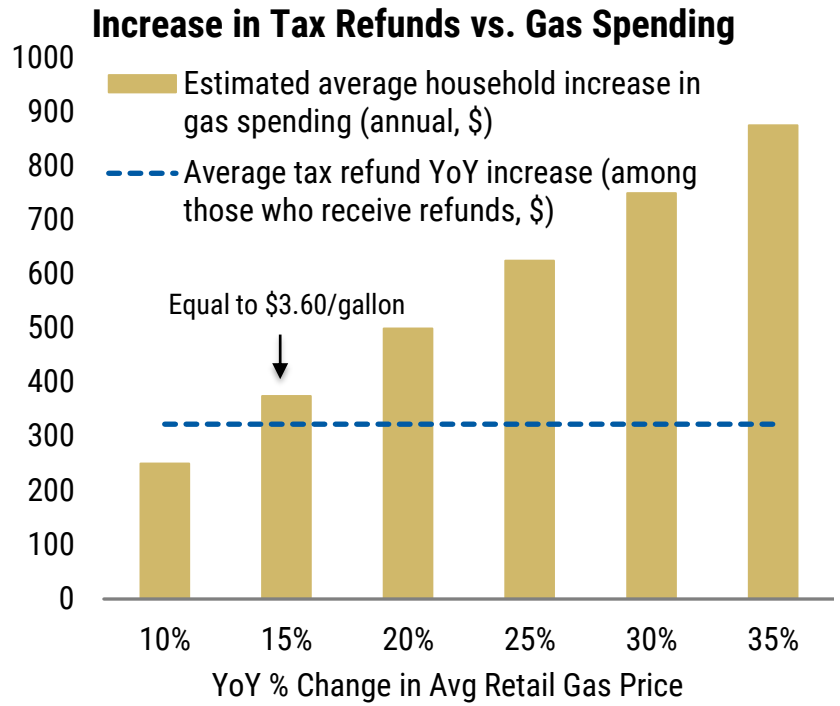
Higher gas prices offset the fiscal boost

Tax refunds are up about 17% y/y as of the most recent data, or about $47bn year-on-year (additional saving accrues to households who owe less, but do not receive a refund). The average refund is up about $320. According to our calculations, if retail gas prices in the US average $3.60/gallon, then higher energy prices will neutralize the effects of higher tax refunds on spending.

Tax refunds are up 17% y/y



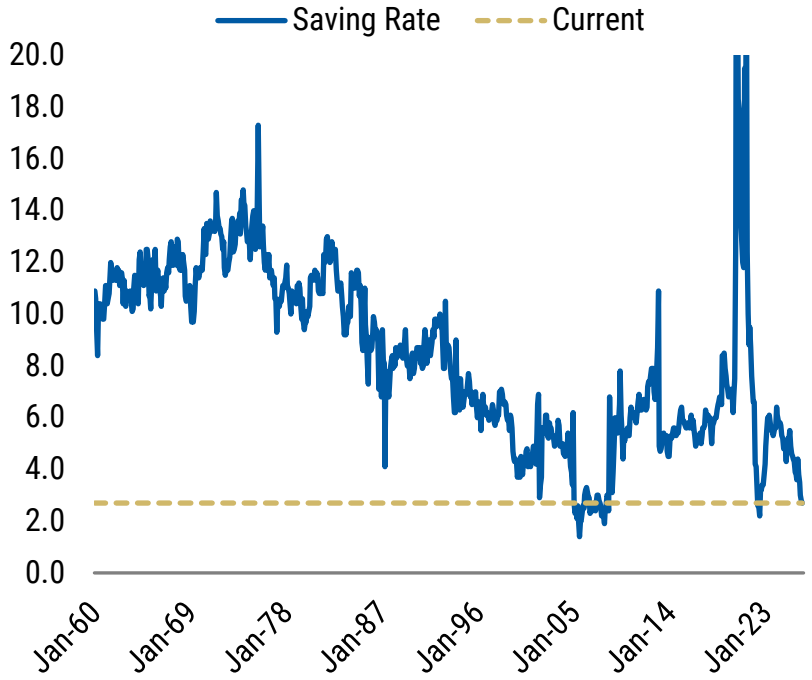
A 15% increase in gas prices would more than offset the avg tax refund increase



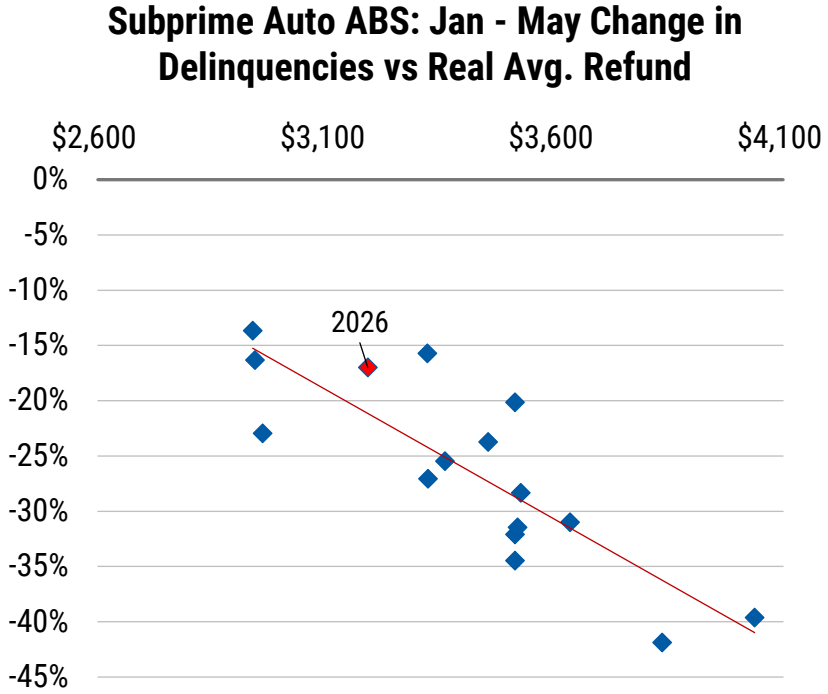
Households pulled the saving rate lower and paid down less debt

With spending outpacing income, the saving rate has declined considerably. Households often use tax refunds to pay down existing debt, but they did this to a lesser degree in 2026 than prior history would suggest. The data suggest consumers drew down on cash resources – from saving and tax rebates – to support spending.

Consumers pulled the saving rate lower as tariffs and oil pushed up inflation



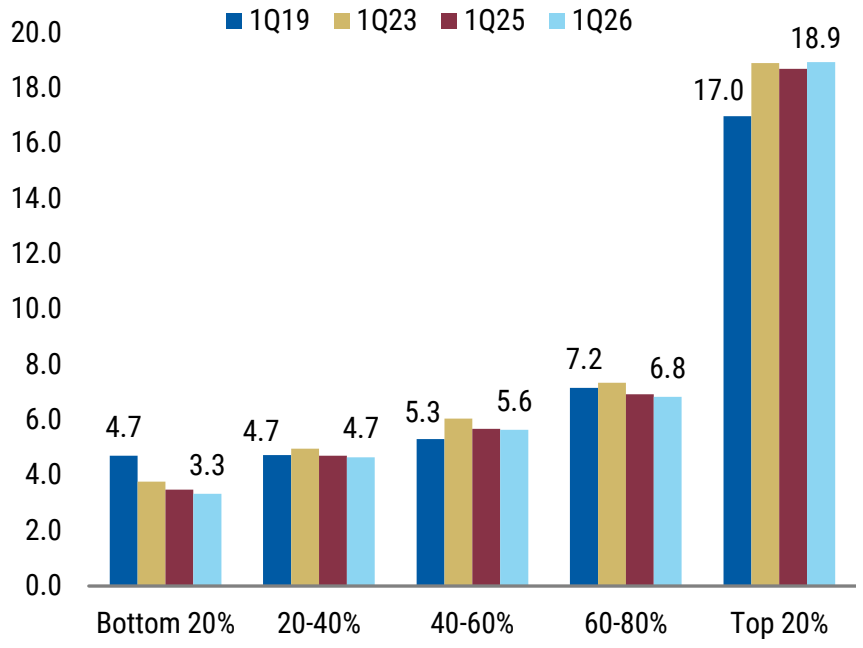
Delinquency rates fell in early 2026, but not by as much as the increased in tax refunds would suggest



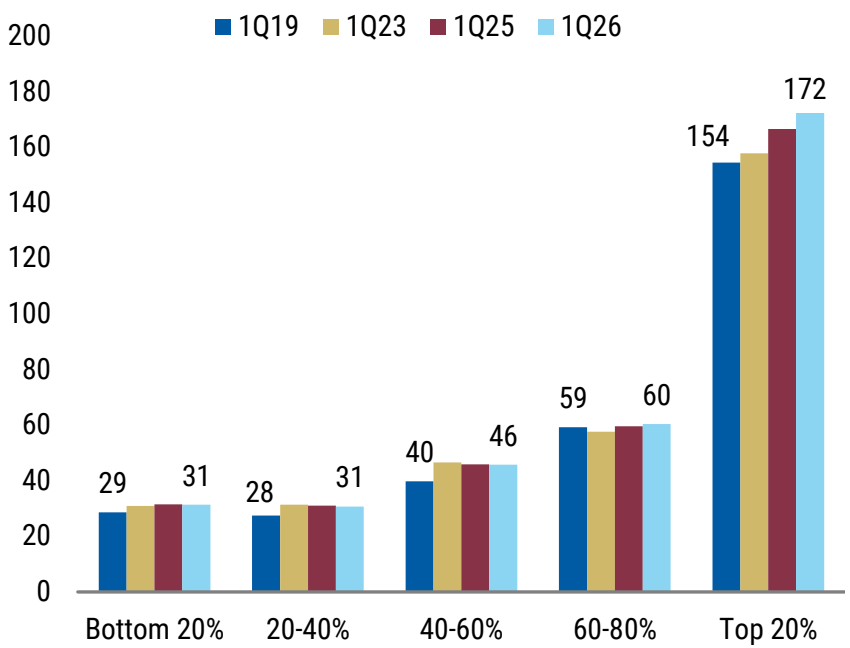
Low-income households have less room to maneuver; High-income well off.

For the bottom 20% cohort, liquid savings cover 3 months of spend, down from 5 in 2019. For the middle-income groups, savings cover 5-7 months of spend, similar to pre-Covid. For the top income quintile, savings could cover 19 months of spend, up from 17 in 2019. The bottom 20% cohort could cover around 2.5 years of spend with their total wealth, up slightly vs 2019, while the top could cover around 14 years, up more considerably.

Months of Spend Covered by Liquid Savings, by Income Quintile

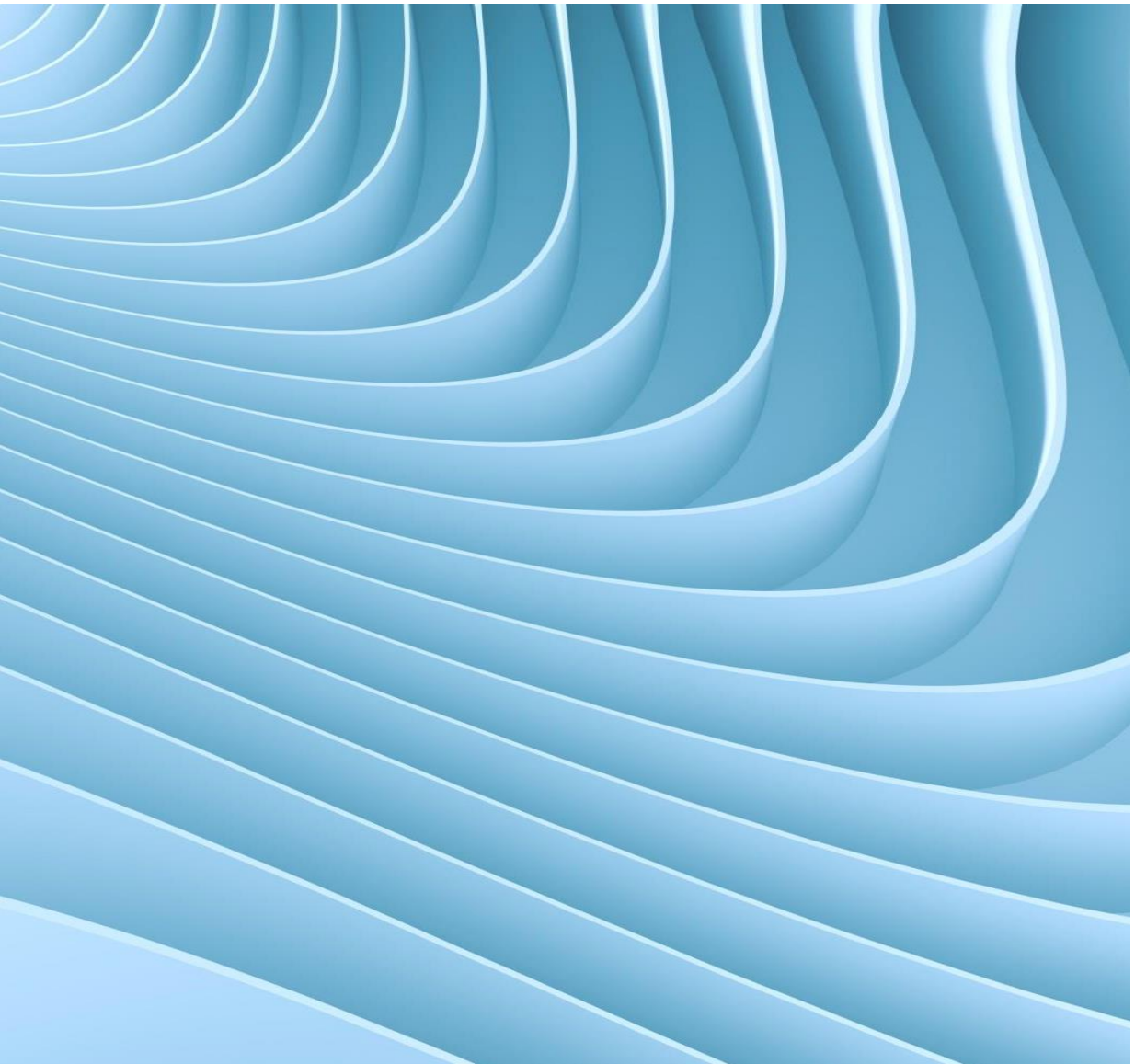


Months of Spend Covered by Total Net Worth, by Income Quintile



Note: In lefthand chart, “liquid savings” is defined as deposits and money market fund shares. “Spending” by cohort is calculated using total PCE and distributing shares in-line with historical shares of spend by cohort from Consumer

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Business spending: Full steam ahead

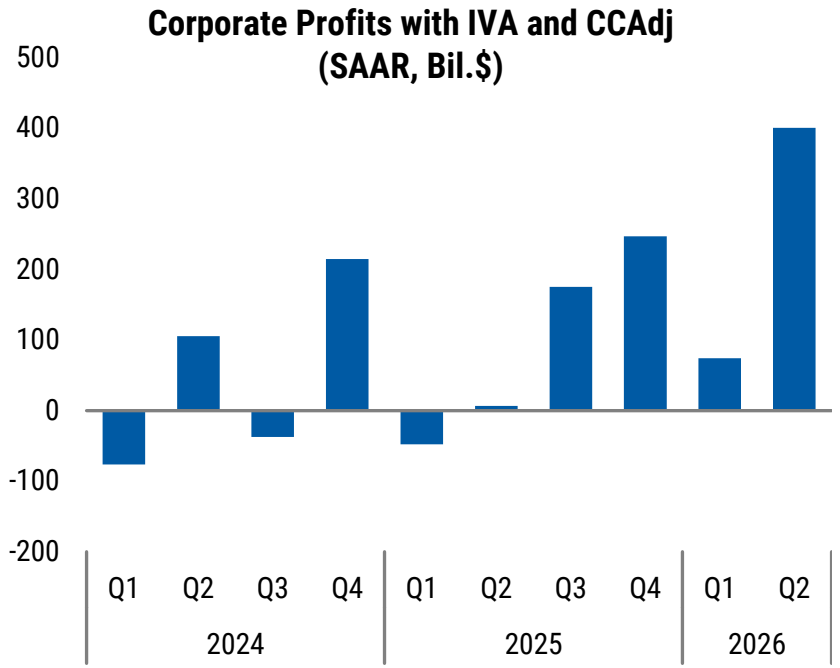
Business spending should maintain its two-speed story over the forecast horizon. We expect nonresidential business fixed investment to grow by 7.7% in 2026 and accelerate to 8% in 2027. AI-related capex should continue to drive overall growth, supported by sustained hyperscaler spending – which should exceed $1tn in 2027 – and the ongoing buildout of compute and power capacity.

In contrast, non-AI investment has been weaker but is beginning to show early signs of stabilization. As cyclical conditions improve in 2027, we expect a gradual broadening of the investment cycle, though AI-related spending will remain the dominant driver.

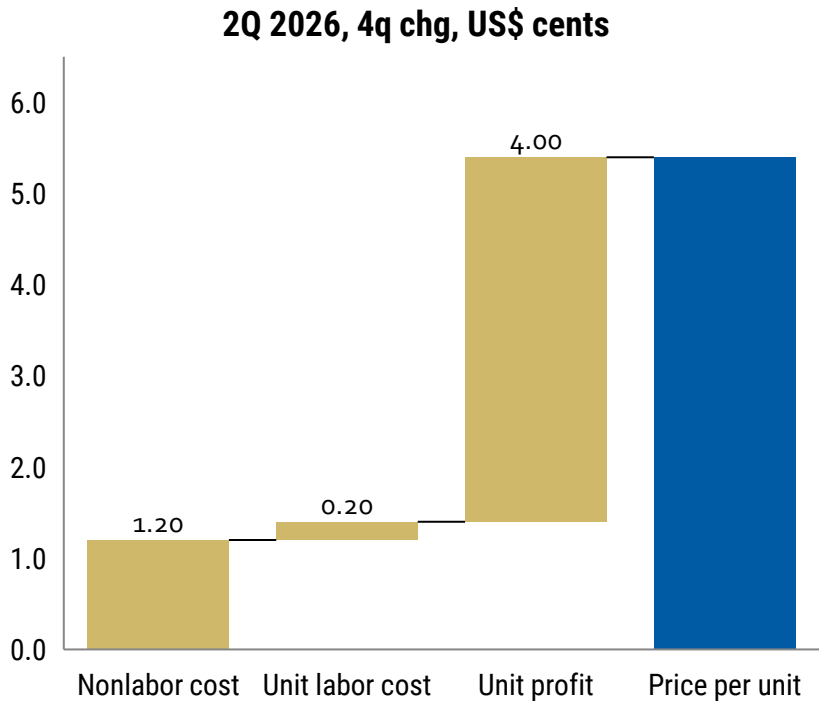
Corporate prices up, costs flat, profits soar

The 2Q26 profit surge is a pricing-power story, not simply a nominal-growth story. Firms raised selling prices substantially while unit labor and nonlabor costs were essentially flat, allowing the entire increase in per-unit prices to flow to profits. That dynamic looks difficult to sustain.

The $400.9bn increase in corporate profits in 2Q 26 was the largest quarterly percentage increase since 2010 (outside the pandemic)



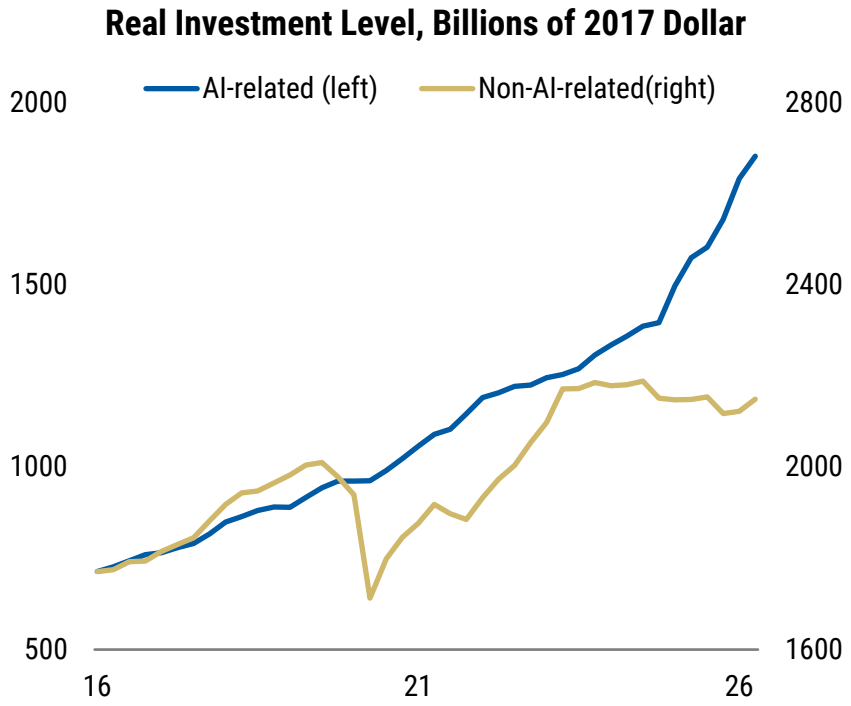
Since Liberation Day, firms have held labor costs in check and pushed prices well beyond any tariff-induced rise in nonlabor costs



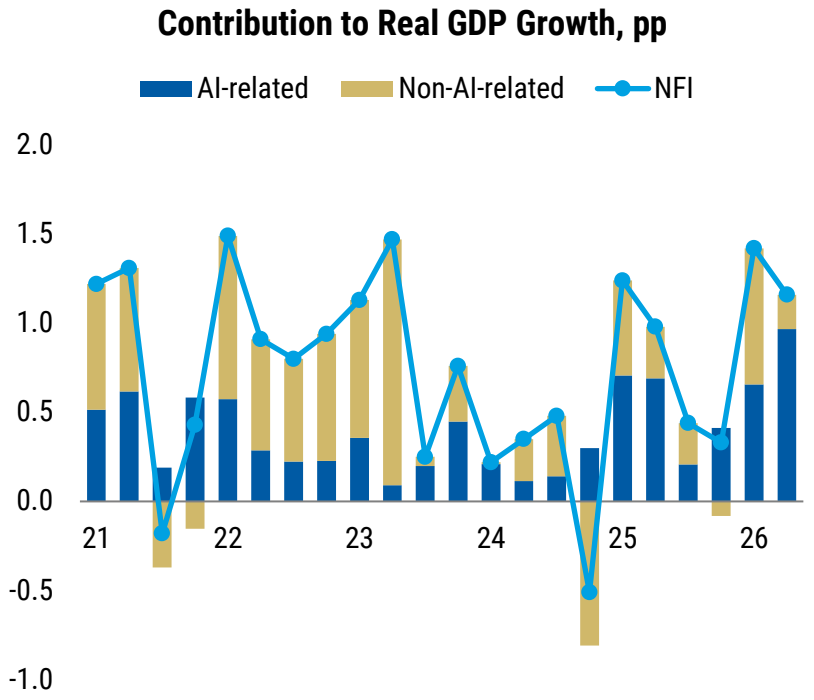
AI spending to remain robust despite the energy price shock

We expect business spending, measured by nonresidential fixed investment, to grow by 7.7% in 2026 and 8.0% in 2027, driven primarily by continued strength in AI-related investment. AI-related expenditures display little cyclical volatility and have provided the bulk of the contribution to growth from business spending.

AI-related spending appears more structural than cyclical…



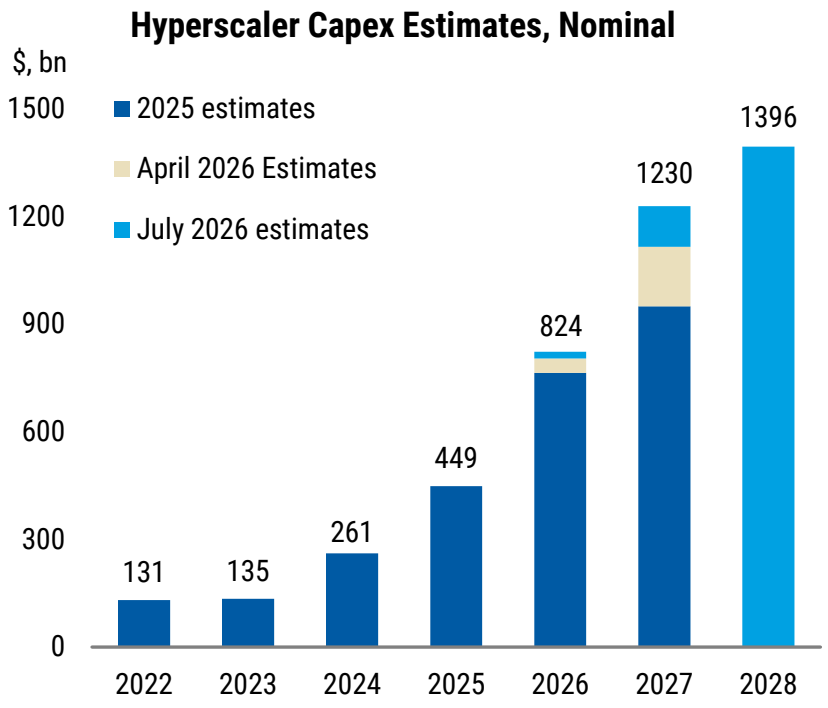
...which has led to consistent contributions to GDP growth



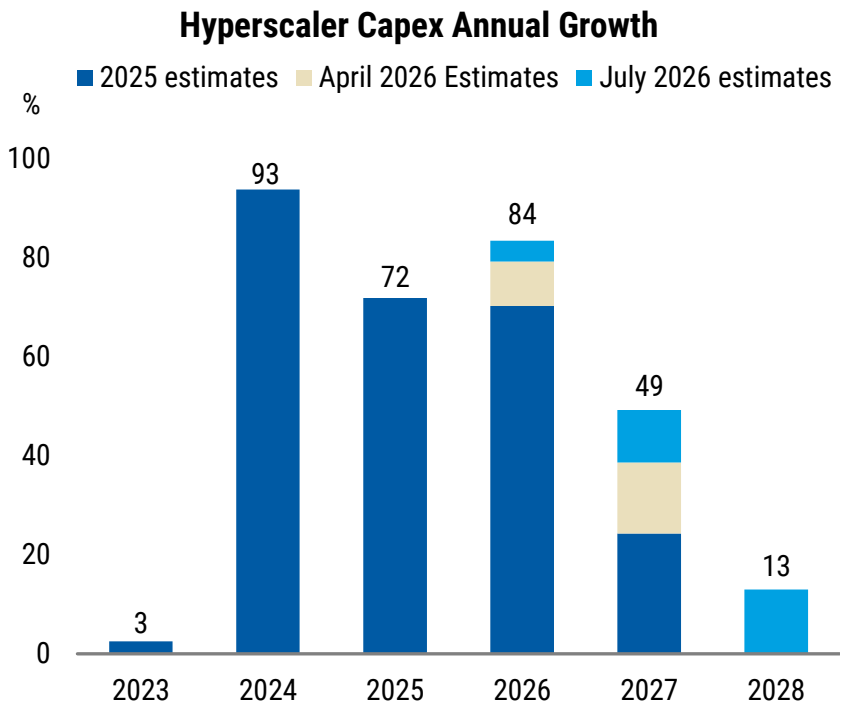
Hyperscaler capex estimates keep moving higher

The speed and strength of AI capex have repeatedly surprised to the upside. Our equity analysts have again revised up their estimates of hyperscaler capex and have pushed the expected deceleration further into 2027. The persistence of upward revisions suggests the AI investment cycle remains in an early phase, with any overinvestment risks likely a medium-term consideration.

Our equity analysts have recently revised higher their estimates for hyperscaler spending.



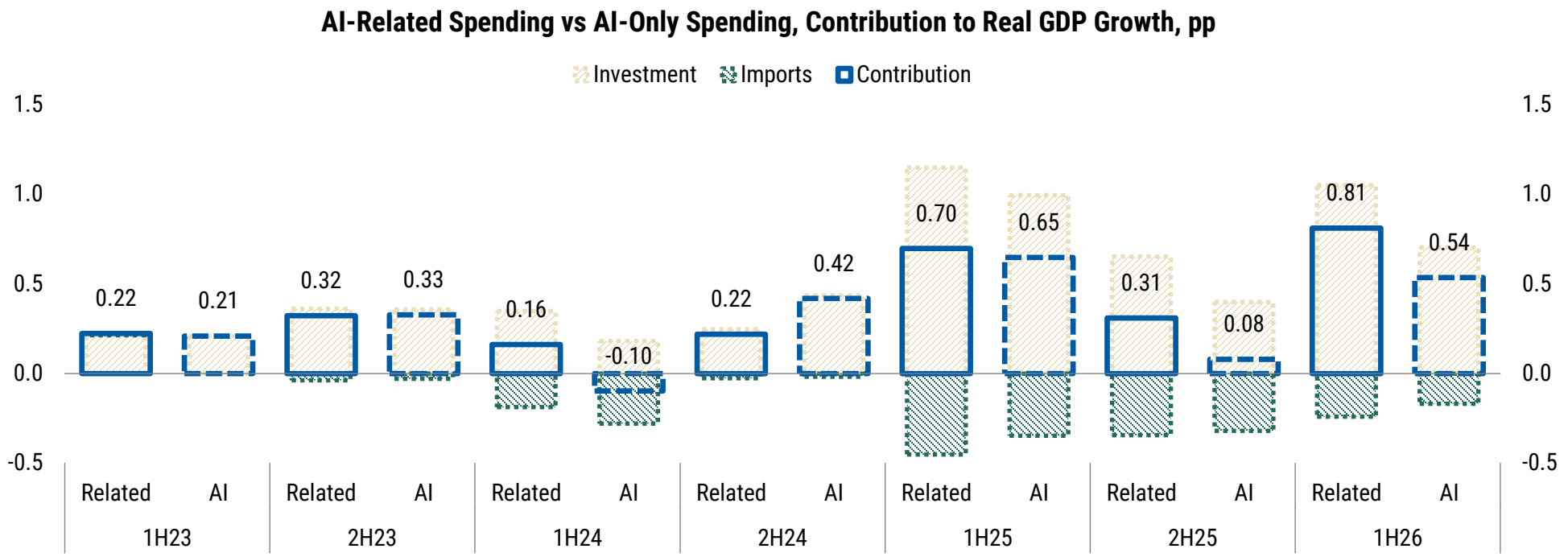
Level versus growth rate: The growth rate of hyperscaler capex is expected to slow in 2027



Corporate AI capex does not translate one-for-one into U.S. GDP.

Corporate capex measures what firms spend, including intermediate goods and imports that do not show up in GDP. We estimate the broad contribution of AI-related spending to GDP growth at 0.6pp from 2025 to mid-2026. When we isolate AI-only activities, we find that AI contributed an average of 0.4pp over the same period.

"AI-related" investment contributed 0.8pp to annualized real GDP growth in 1H while "AI-only" spending contributed 0.5pp

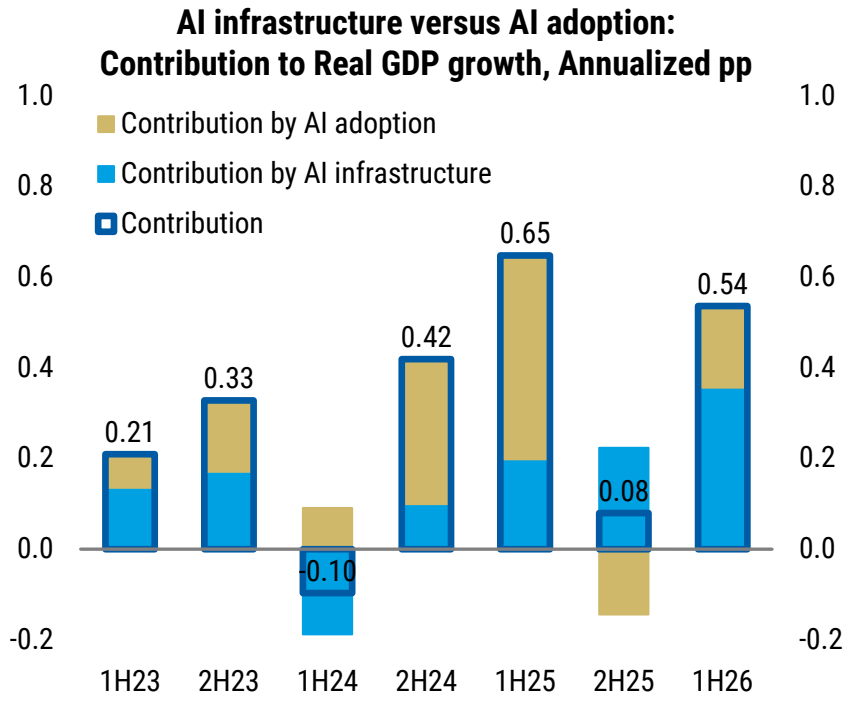


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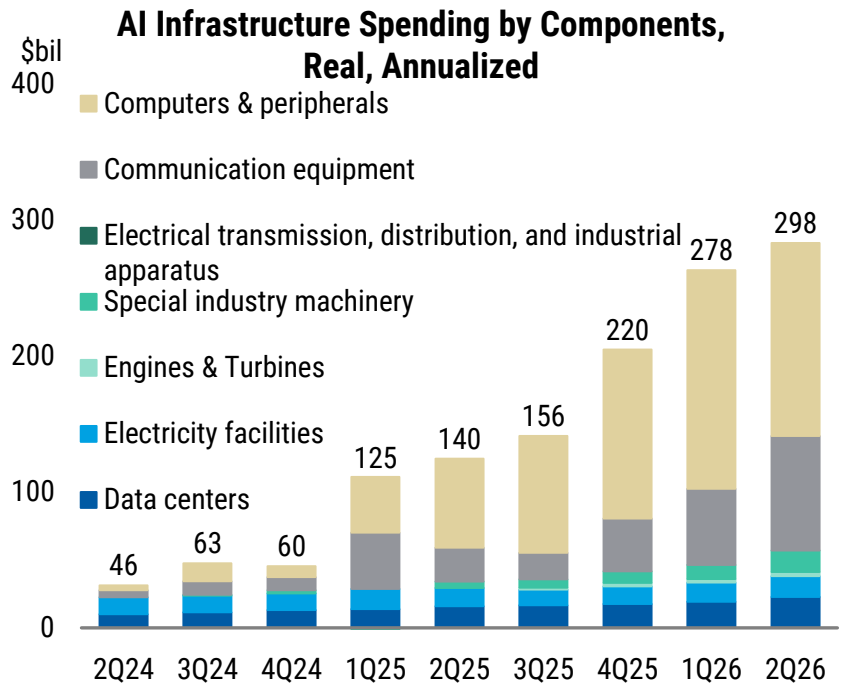
AI diffusion will increase the relative importance of adoption spending over time.

We distinguish between AI infrastructure spending and AI adoption spending. Infrastructure investment, primarily hyperscaler build-out, creates the computing capacity required to develop and run AI models and applications. Spending by AI adopters, mainly through software, provides a window into the diffusion of AI across U.S. businesses.

AI-adoption contribution has bee more volatile



Computers and peripherals account for 60–70% of the AI infrastructure spending



High hyperscaler capex estimates keep AI's contribution to growth elevated

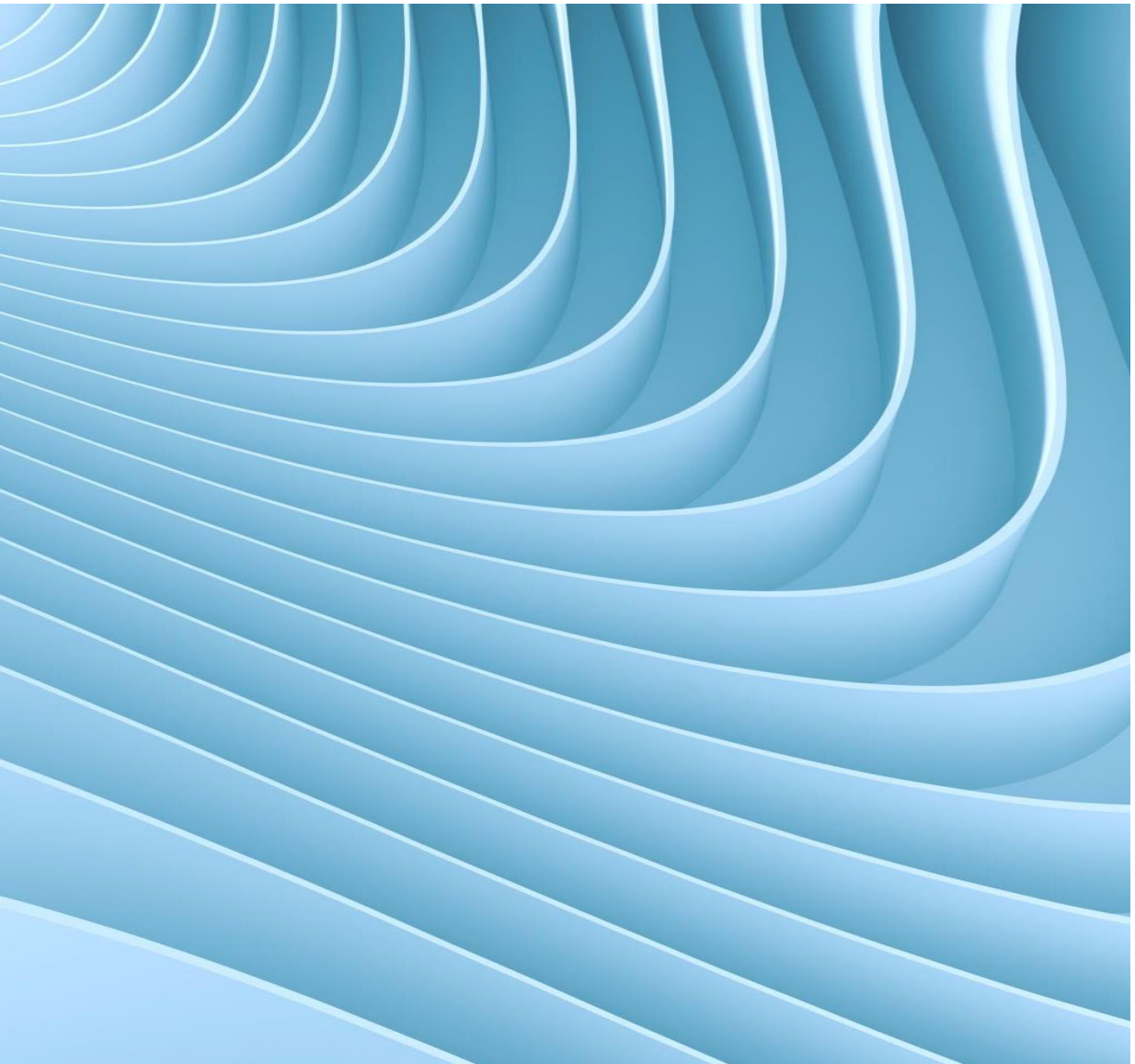
We expect AI capex to be the dominant driver of growth in NFI in 2026 and 2027. It has become a structurally driven macro force that is less sensitive to geopolitical uncertainty and traditional business cycle dynamics, supported by the buildout of foundational capacity rather than near-term demand conditions. Even after adjusting for imports, we estimate that AI-related investment and its associated productivity improvements will contribute 0.8-0.9pp to growth in 2026 and 2027.

AI and non-AI business investment contributions to GDP growth

Contribution to Real GDP Growth, pp					
	2023	2024	2025	2026	2027
Nonresidential fixed investment	0.90	0.14	0.75	1.07	1.18
AI-related	0.31	0.26	0.90	1.05	1.04
Non-AI-related	0.59	-0.12	-0.15	0.02	0.14
Imports	-0.03	-0.20	-0.40	-0.45	-0.44
Contribution by AI-related investment	0.28	0.05	0.50	0.60	0.60
Productivity	0.00	0.00	0.10	0.20	0.25
AI total	0.28	0.05	0.60	0.80	0.85

Note: AI-related investment includes spending on computers and peripherals, communications equipment, engines and turbines, special industry machinery n.e.c., electrical transmission, distribution, and industrial apparatus, software, data centers, and electric power facilities. Remaining categories are defined as non-AI-related spending. AI-related imports are computers and peripherals, semiconductors

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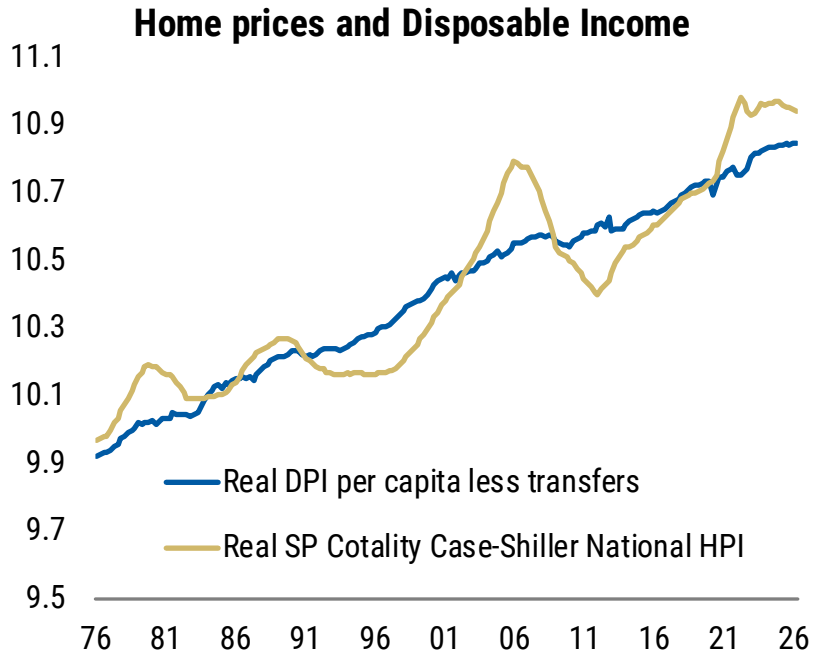
Residential investment: House arrest

Challenged affordability and the locked-in state of the housing market continue to weigh on housing activity. A less supportive rates backdrop than we previously expected prolongs the weakness. Real residential investment declines 1.3% (4Q/4Q) in 2026 before rising 1.5% in 2027.

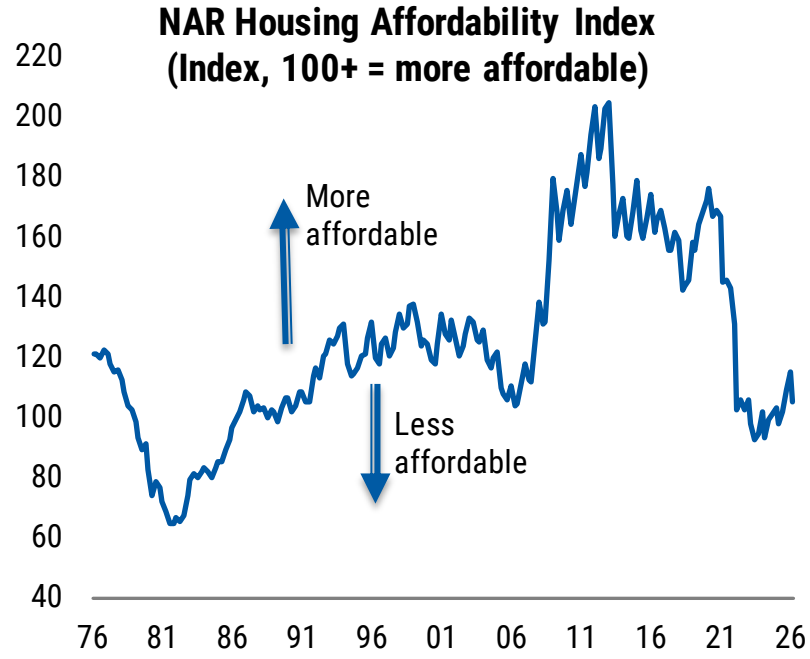
Housing affordability remains challenged

In the long run, home prices track real disposable income per capita. While home price appreciation has stalled out, disposable income has yet to catch up. With high mortgage rates and high purchase prices, housing affordability is at four-decade lows.

Housing remains expensive: Disposable income has yet to catch up with home price appreciation



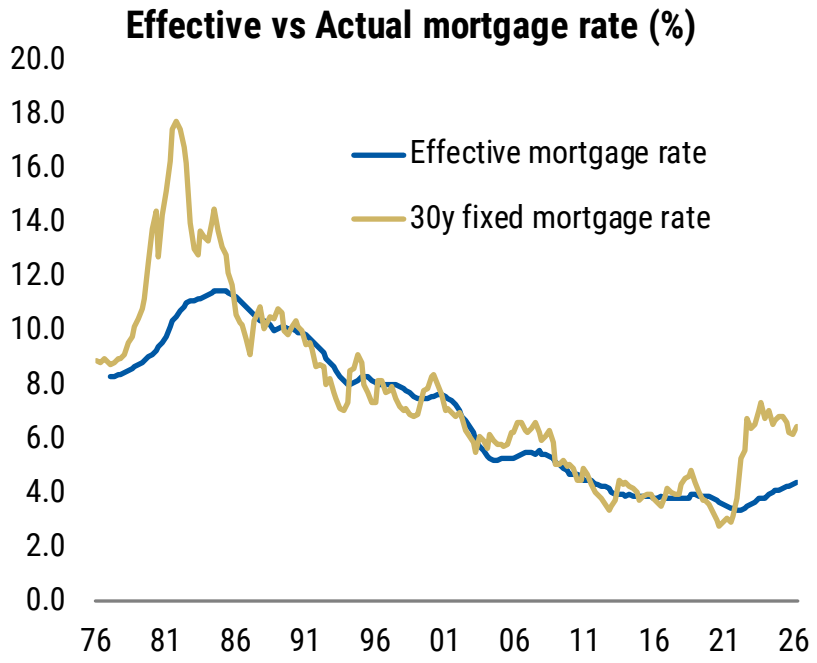
Housing affordability is still near four-decade lows



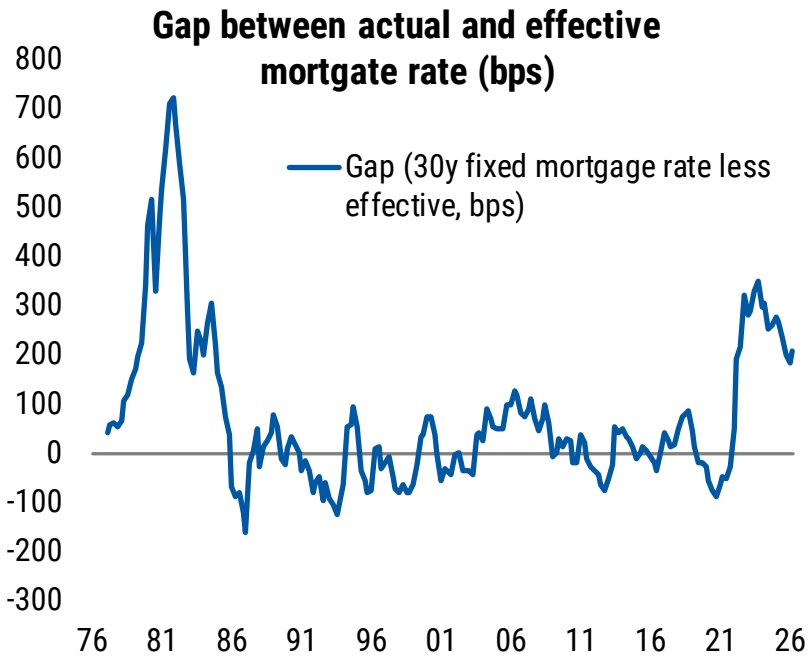
Elevated mortgage rates have locked homeowners in place

The picture in housing has not changed in several years. The sharp rise in the mortgage rate has locked homeowners in place, slowing down transaction volumes. The gap between the actual and effective mortgage rate is as wide as it has been in four decades. The gap needs to close further to improve transactions.

The effective mortgage rate is well below the actual mortgage rate, keeping homeowners in place



The gap has not been this wide since the 1980s, and is closing only slowly



A large lock-in effect reduces existing home sales

The FHFA estimates that each 1 percentage-point increase in the gap between the market mortgage rate and the homeowner's existing rate reduces the probability of sale by 18.1%.

Existing home sales are stuck near GFC era levels with little sign of improvement



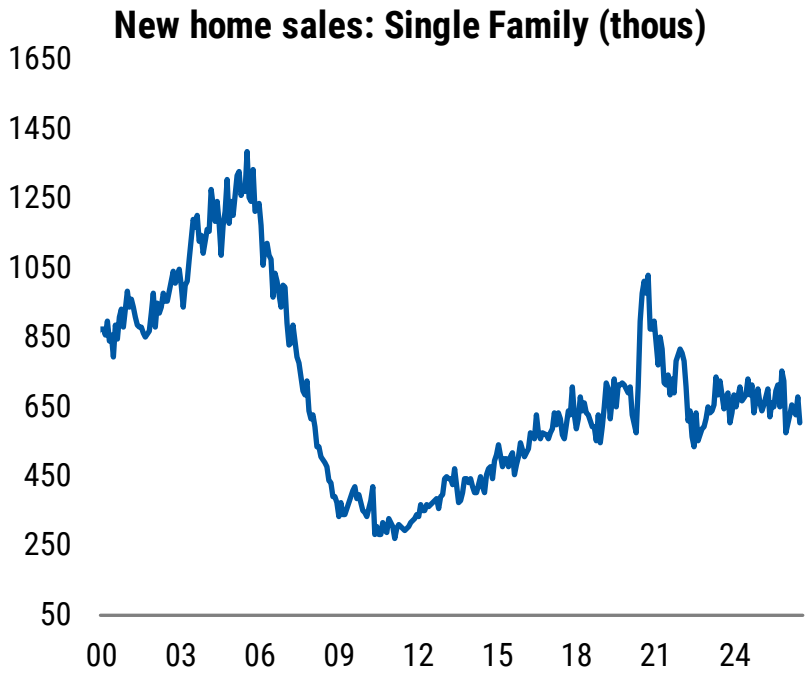
FHFA estimates that lock-in reduced fixed-rate home sales by 57% in 2023Q4 and prevented about 1.33 million sales between 2022Q2 and 2023Q4.

At 210bp, the current gap is still putting significant downward pressure on existing home sales.

New home sales have stagnated, leading to an inventory buildup

New home sales have been stuck at current rates since the end of the pandemic. Inventories – in terms of units and months of sales – are near GFC-era levels. New starts will remain subdued until backlogs have cleared.

New home sales have stagnated coming out of the pandemic…



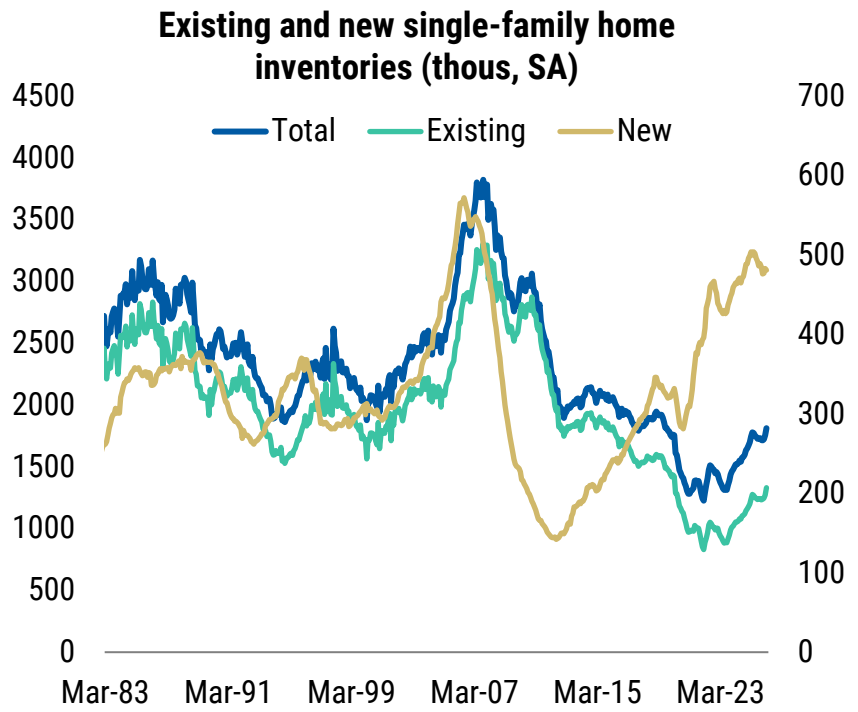
…leading to elevated inventories of new homes and in months of sales



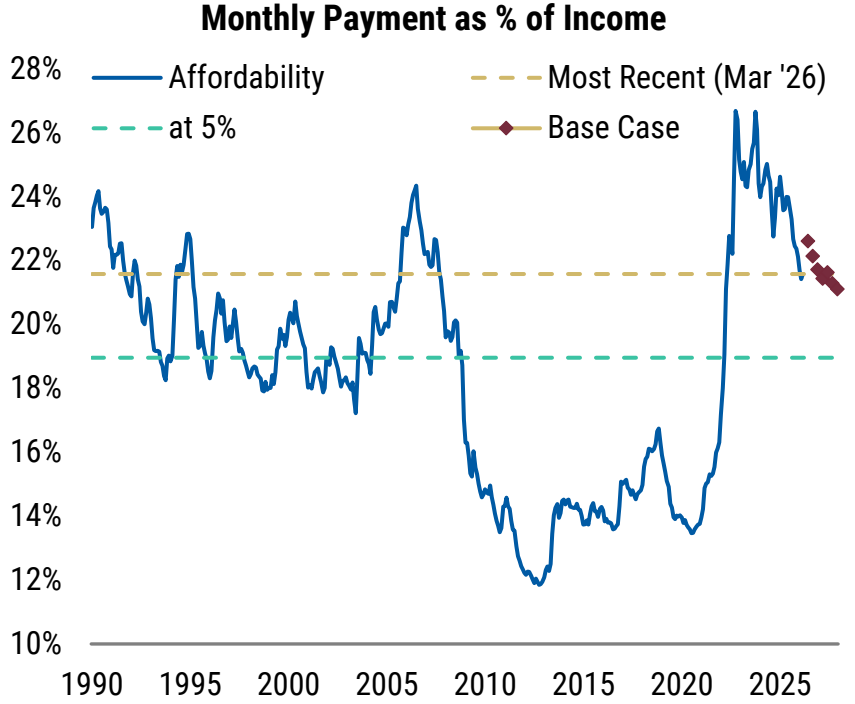
Elevated mortgage rates keep sales slow, also limiting growth in starts

Housing supply and demand both remain challenged, but demand has been the larger constraint on home sales recently. Lock-in effects and affordability challenges will keep both supply and demand limited, leading to flat to slightly negative sales growth this year. We think elevated new home inventories keep starts subdued as well, flat this year before a slight pickup in 2027.

Inventories of new homes remain high while inventories of existing homes are low historically

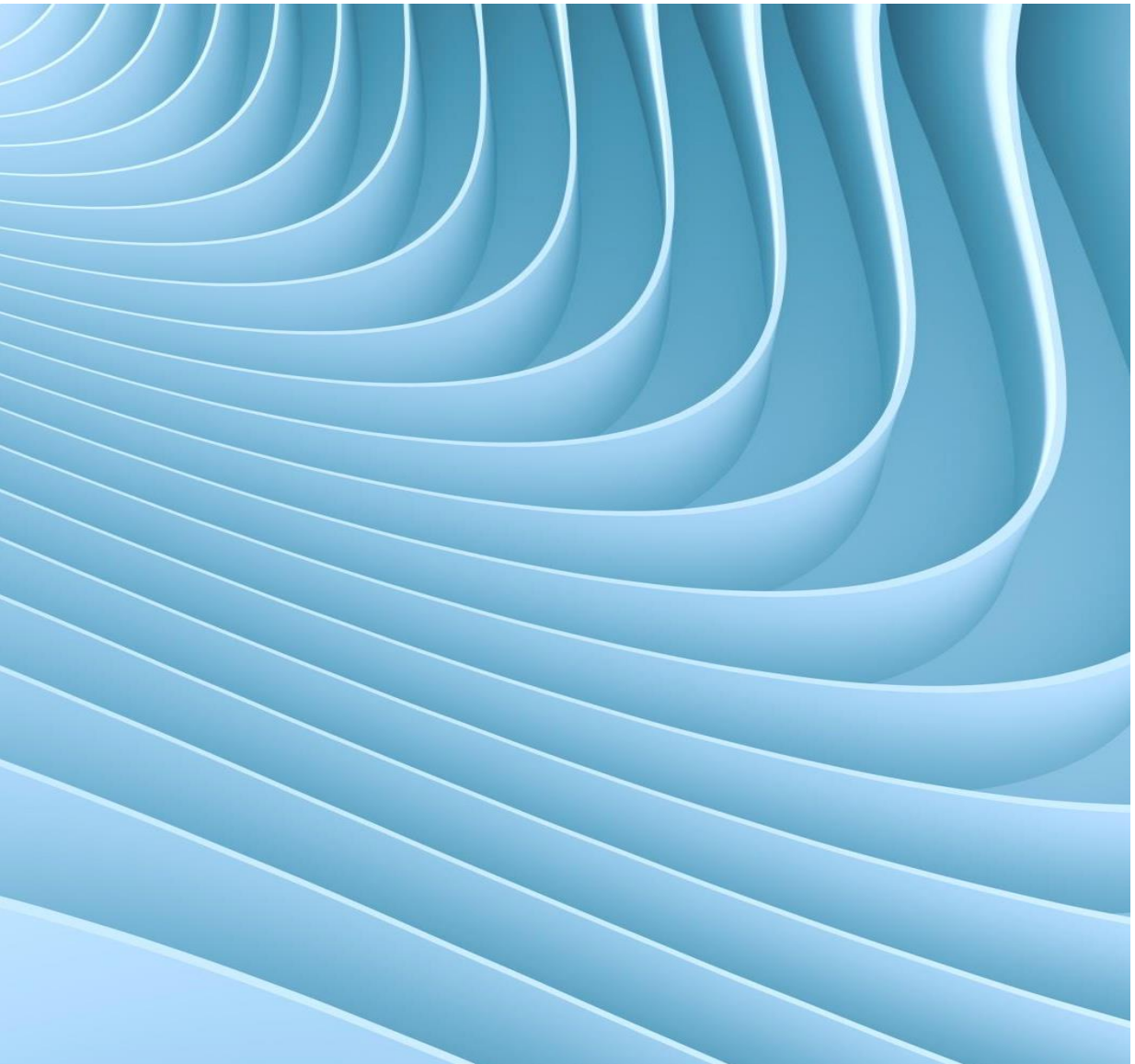


Housing affordability will improve slightly as mortgage rates fall but will still remain challenged



Note: "Affordability" in righthand chart is measured as average monthly mortgage payment as a percent of average monthly income using current mortgage rates. The dashed lines indicate the payment as

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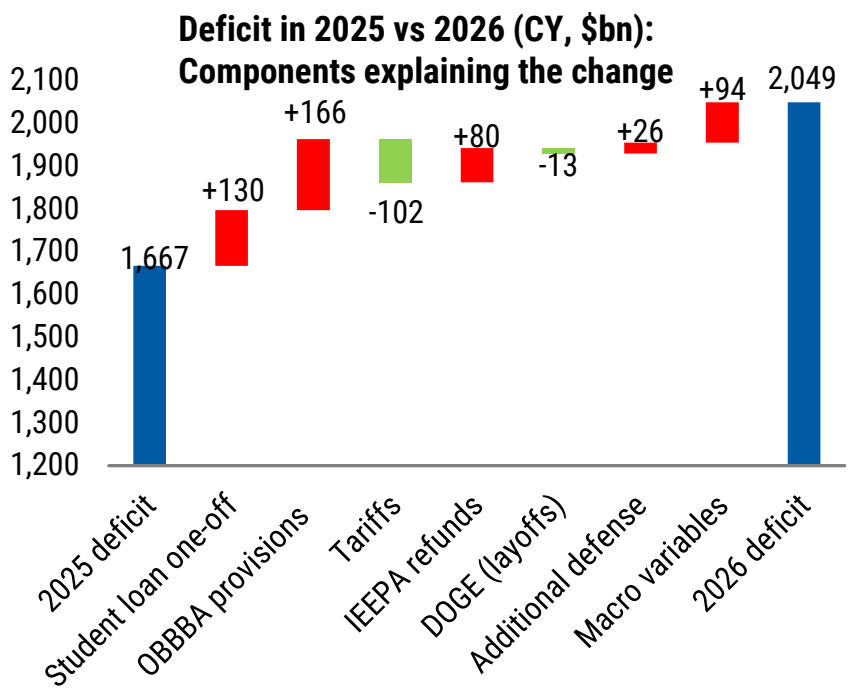
Fiscal Policy: OBBBA, tariff refunds, and more defense spending

We continue to expect fiscal deficits to remain around 6% of GDP over our forecast horizon. IEEPA tariff refunds and additional defense spending will add to deficits. An upside risk for FY27 is a large reconciliation bill passed ahead of the midterms that boosts defense spending more than we assume and could also include infrastructure investment and affordability measures.

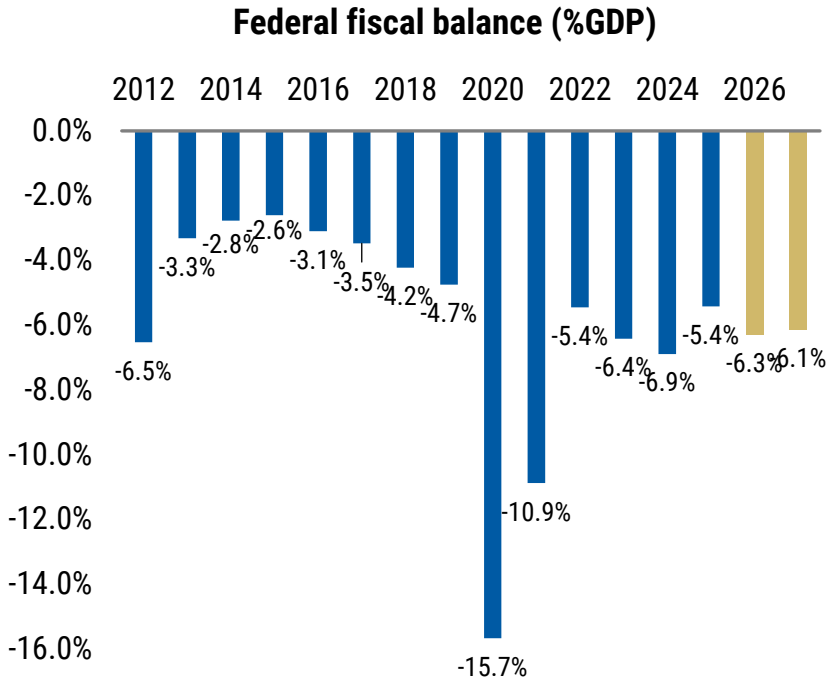
Deficit widens in 2026 and remains elevated

We project a wider fiscal deficit in 2026, reaching $2.05tn (6.3% of GDP). This is driven by no repeat of one-off student loan savings, OBBBA provisions adding to deficits, IEEPA tariff refunds, additional defense funding, and macro factors.

Deficit expansion in 2026…



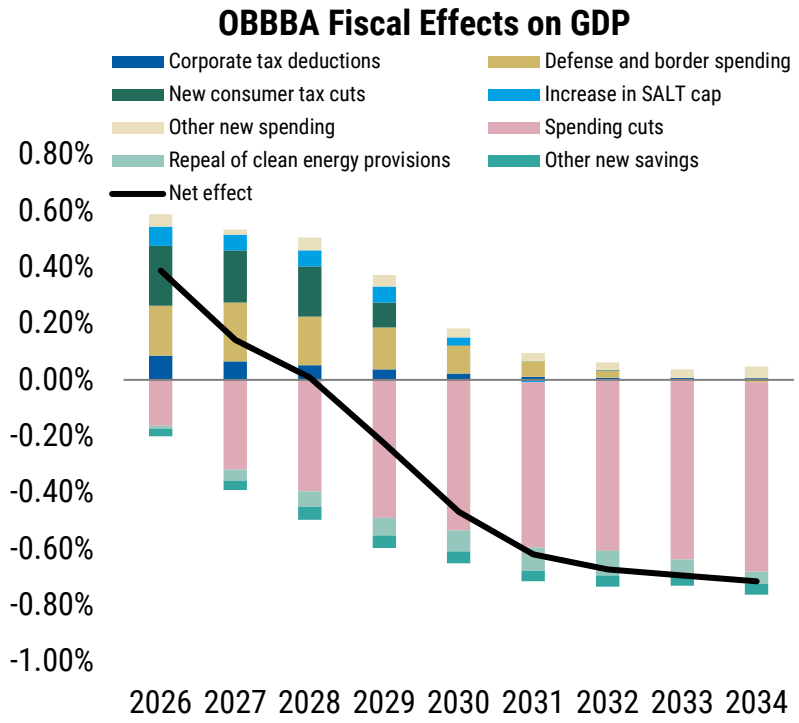
… and overall elevated deficits in our forecast horizon



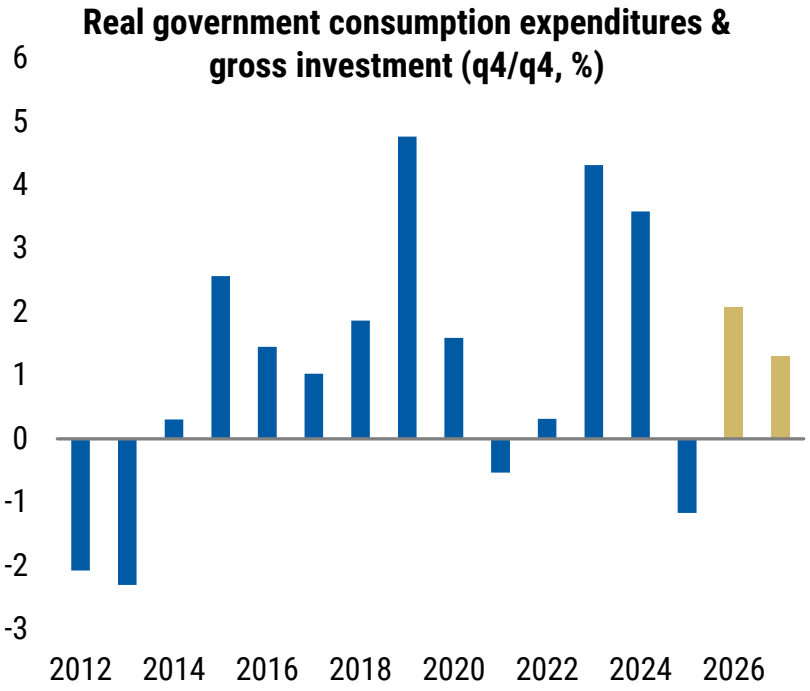
OBBBA boosts GDP near-term, and government consumption accelerates

We estimate that the One Big Beautiful Bill Act (OBBBA) will boost GDP by approximately 0.4 percentage points in 2026 and 0.14 percentage points in 2027. That said, the net effect of the OBBBA on GDP turns negative in the medium term. We project real government consumption and investment to grow by 2.2% (4Q/4Q) in 2026 and 1.3% in 2027, following a contraction of -1.2% in 2025.

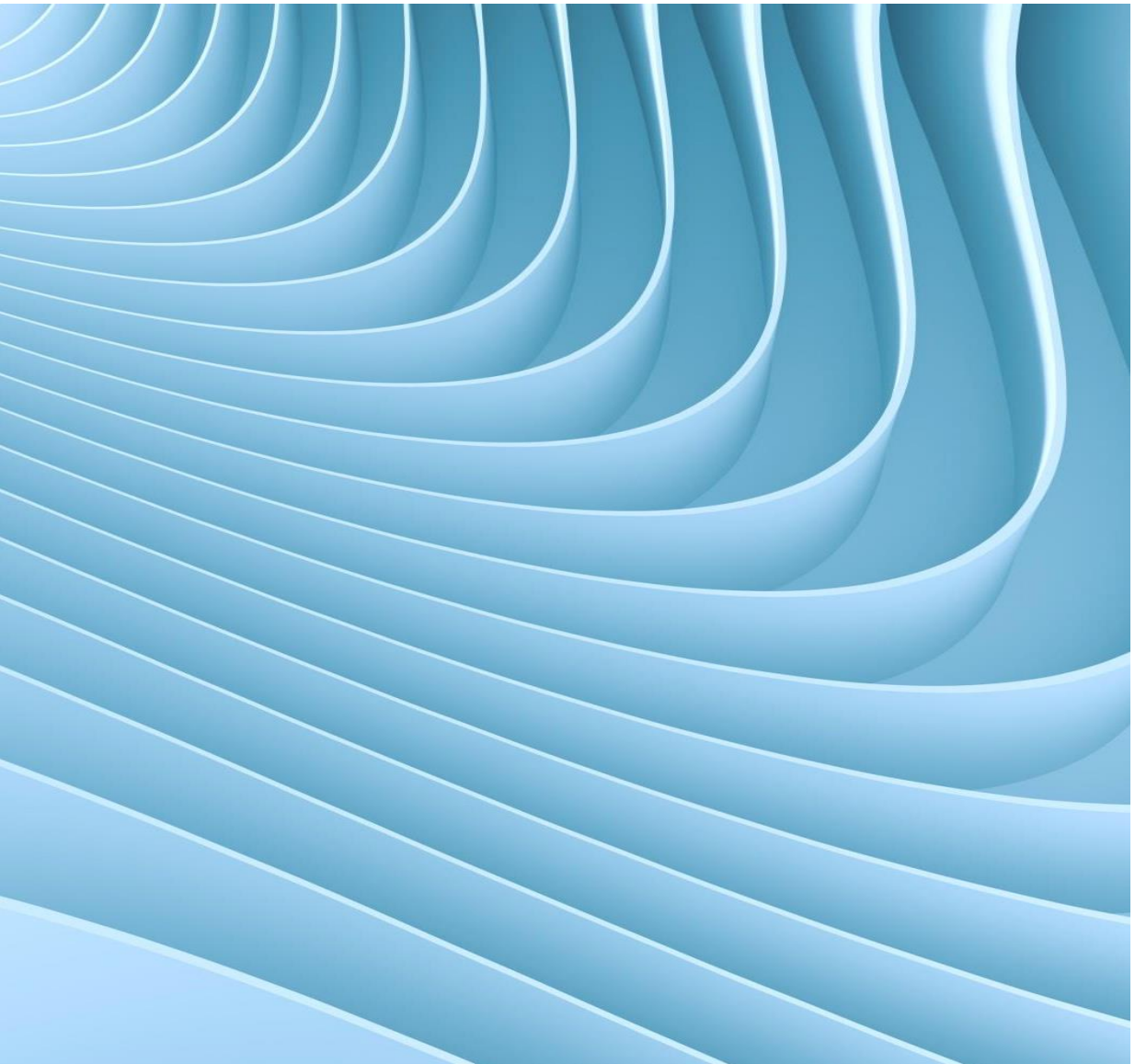
The OBBBA pushed GDP, but only in the short run



Gov spending boost large relative to 2025, but modest relative to recent history



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Trade and Inventories: A more durable tariff regime

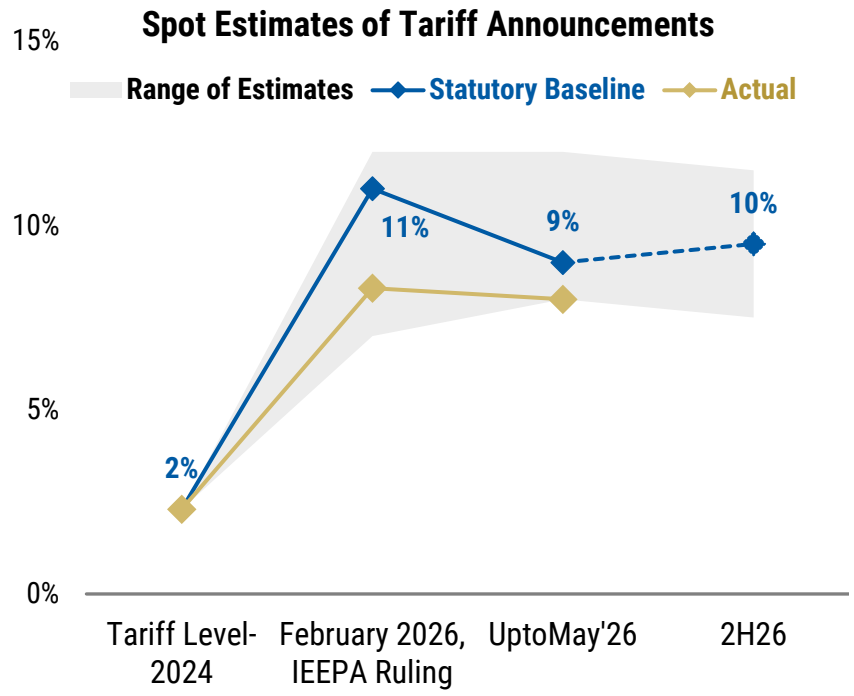
The shift toward Sections 301 and 232 authority has put the tariff regime on more durable statutory footing. The final forced-labor Section 301 action now provides a broad country-level tariff floor, while Section 232 remains the targeted sectoral overlay. We continue to expect the statutory effective tariff rate to converge toward roughly 10% by year-end.

The remaining uncertainty is increasingly around implementation, pending Section 232 actions, and country-specific escalation rather than the persistence of the broad tariff floor. On USMCA, recent US-Canada tariff escalation points to heightened tensions as negotiations progress and the deadline is pushed to next July; further tariff actions would shift risks toward a more bilateral or fragmented USMCA.

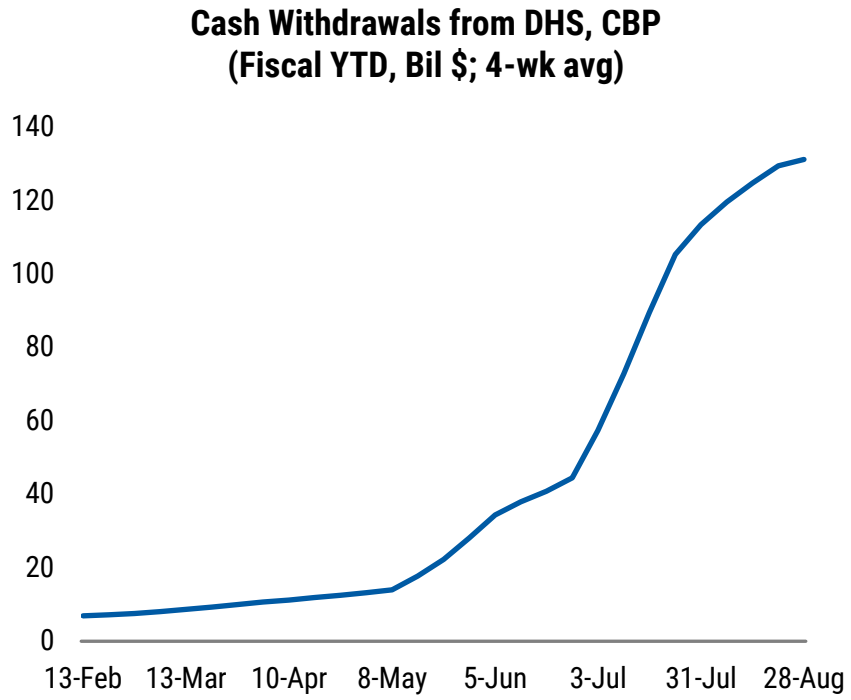
Tariffs averaged 6.8% over April-June, and we expect it to rise to near 10%

The transition to a more durable tariff regime is largely complete. The final forced-labor Section 301 action establishes a broad country-level tariff floor, while Section 232 remains the targeted sectoral overlay. We continue to expect the statutory effective tariff rate to converge toward roughly 10% by year-end, with remaining uncertainty centered on implementation, pending Section 232 actions, and country-specific escalation.

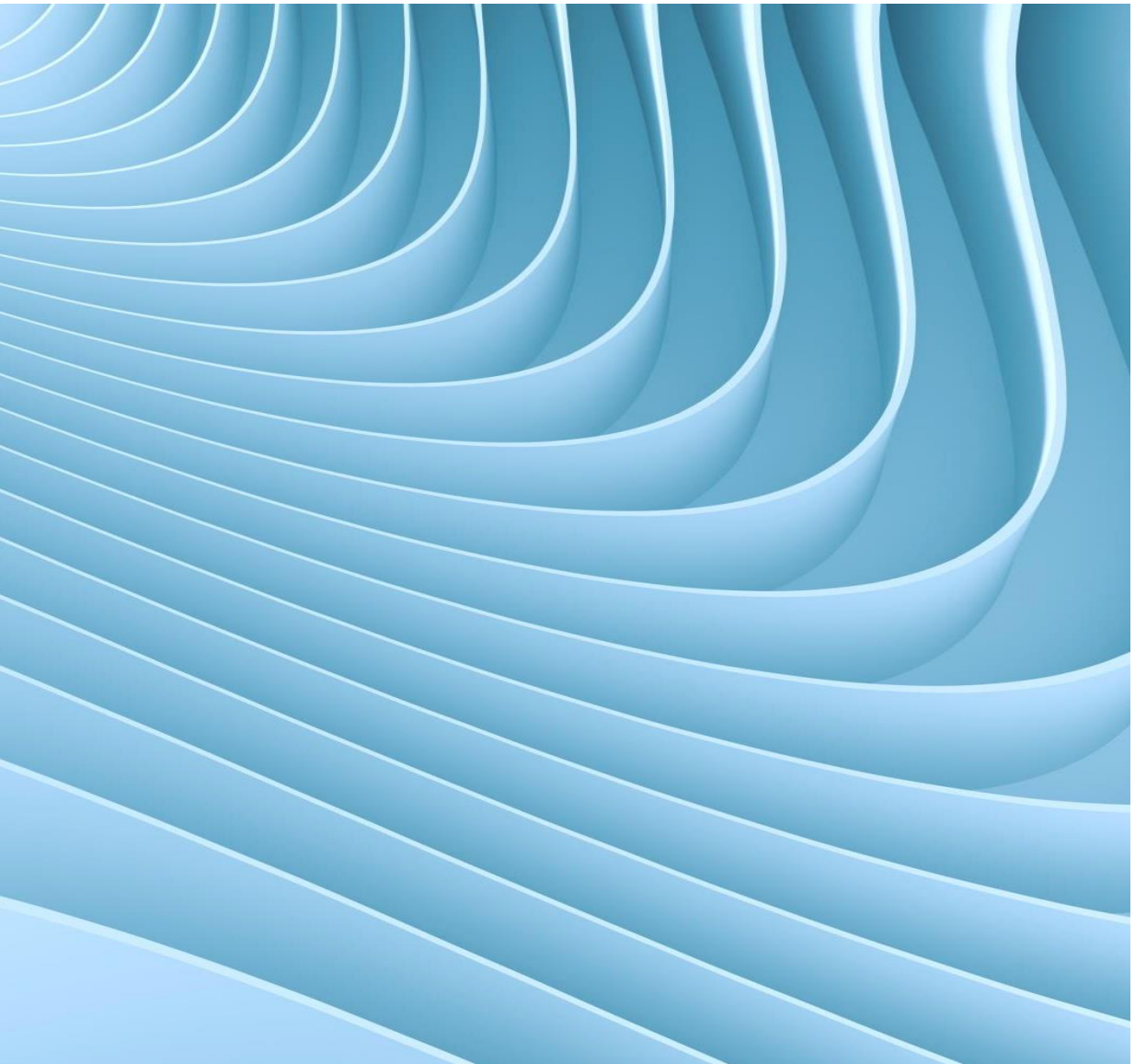
Tariffs averaged 6.8% over April-June



Cash withdrawals from the DHS - CBP, as a proxy for tariff refunds



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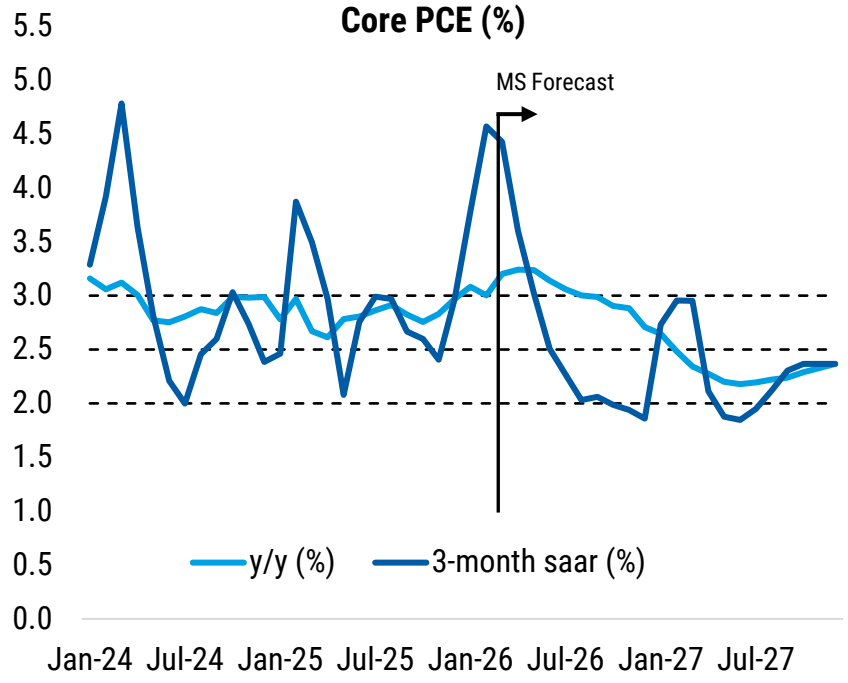
Inflation: A gradual descent

We believe the recent firming in sequential core PCE inflation in 1Q is temporary and should begin to decelerate from 2Q onward. However, the 12-month rate of inflation will remain elevated until year end on prior tariff pass through and higher energy prices. We see core PCE at 3.2% 4Q/4Q in 2026, and 2.4% in 2027. Risks are in the direction of inflation persistence.

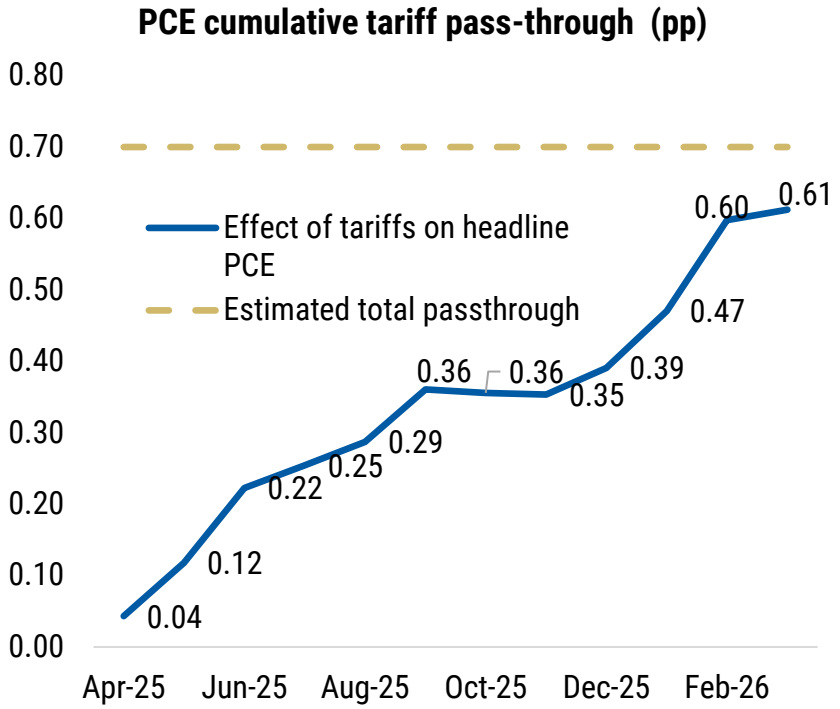
We expect core inflation to decelerate, helped by tariff pressures fading

Following the latest data, we estimate that tariffs have contributed roughly 60bp to core prices so far this year. Our models suggest that the total pass-through is likely to be around 70bp, so we expect tariff pressures to fade. We also expect seasonal distortions to mechanically contribute to softer inflation prints in the coming quarters.

Acceleration in 1Q is confirmed, but deceleration is coming



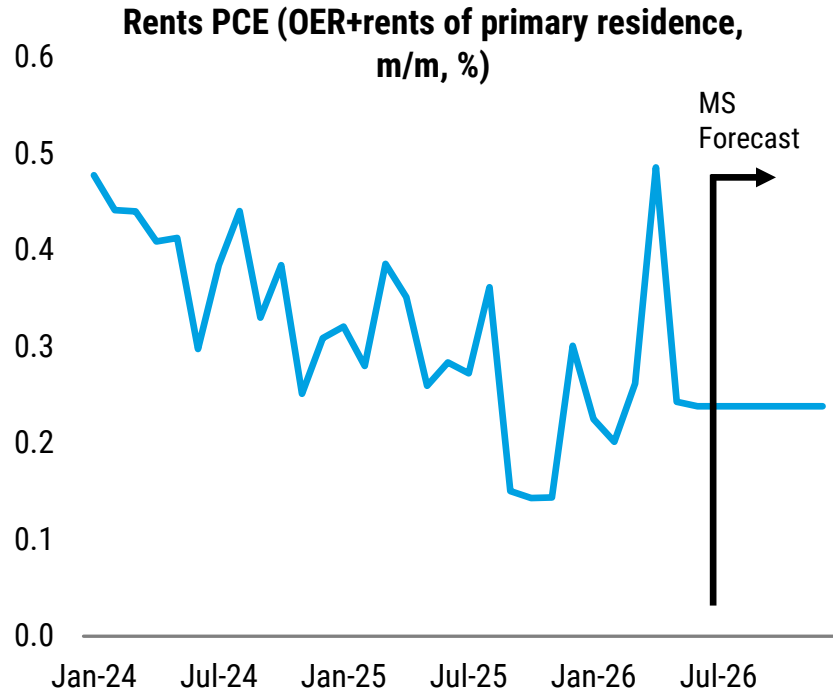
Tariff passthrough is getting closer to the finish line



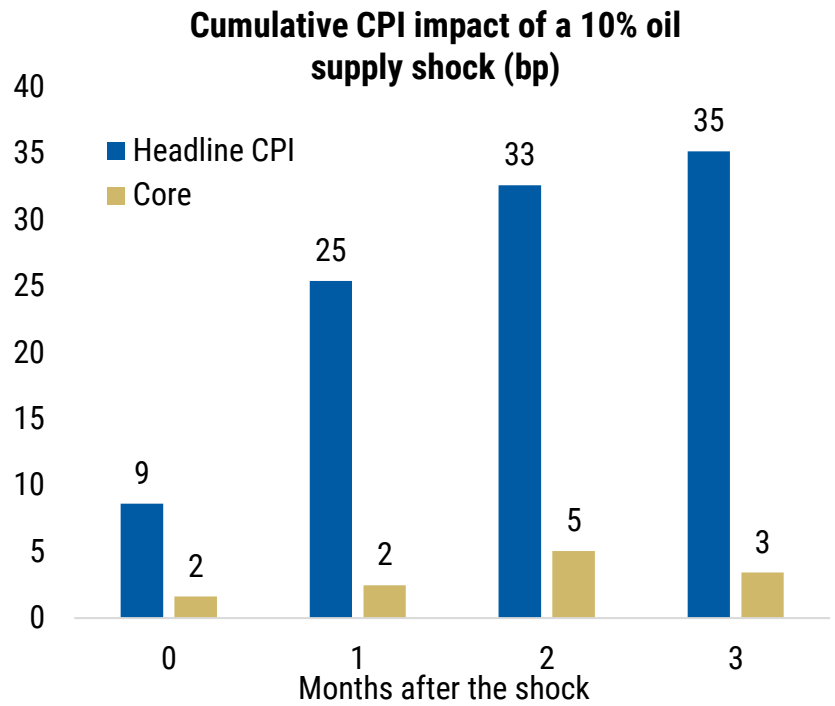
Shelter should help deceleration, and we expect limited oil effects on core

Shelter inflation continues to slow. Recent data confirm a gradual but persistent deceleration in rent measures, and we expect this trend to continue through 2026. Meanwhile, we think risks of the oil shock derailing the disinflationary path are limited. Higher oil prices are likely to push up headline inflation in the near term, but the pass-through to core inflation has historically been modest.

Shelter has decelerated and will likely continue with low m/m readings



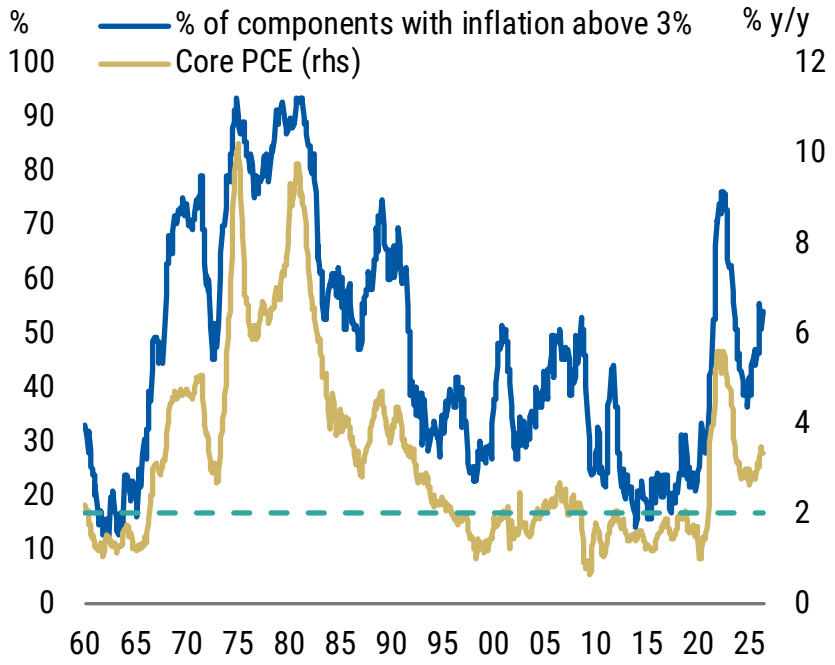
We expect only a small effect on core inflation from the oil shock



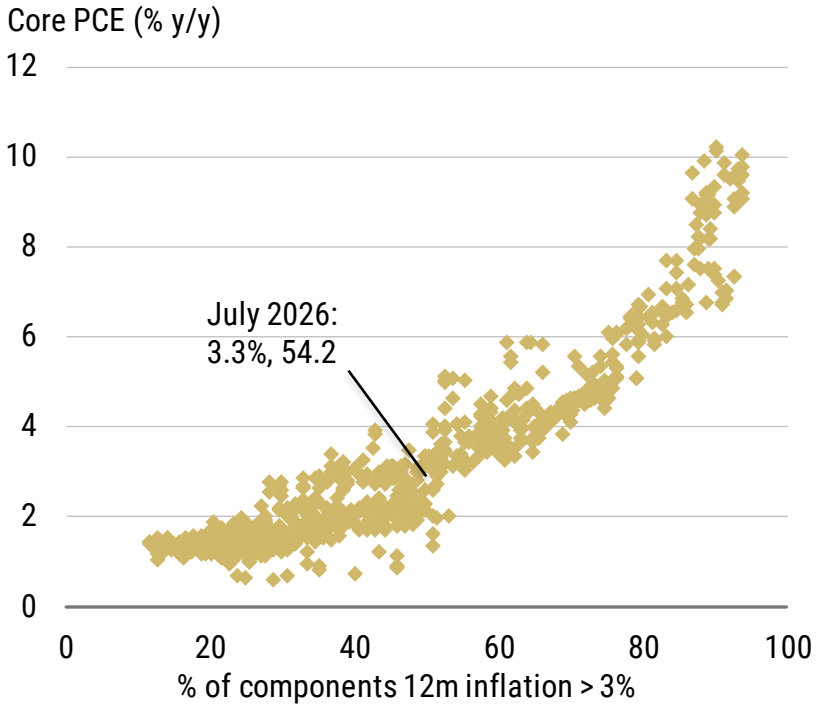
The newest measure of underlying inflation

Chairman Warsh unveiled a measure of underlying inflation he monitors: over the past 12 months, what percent of goods and services in the PCE basket showed price increases above 3 percent?. We are not sure the statistic provides much additional signal beyond the y/y change in PCE inflation.

54% of the components of PCE inflation are running above 3%, up from 38% in 1Q 25



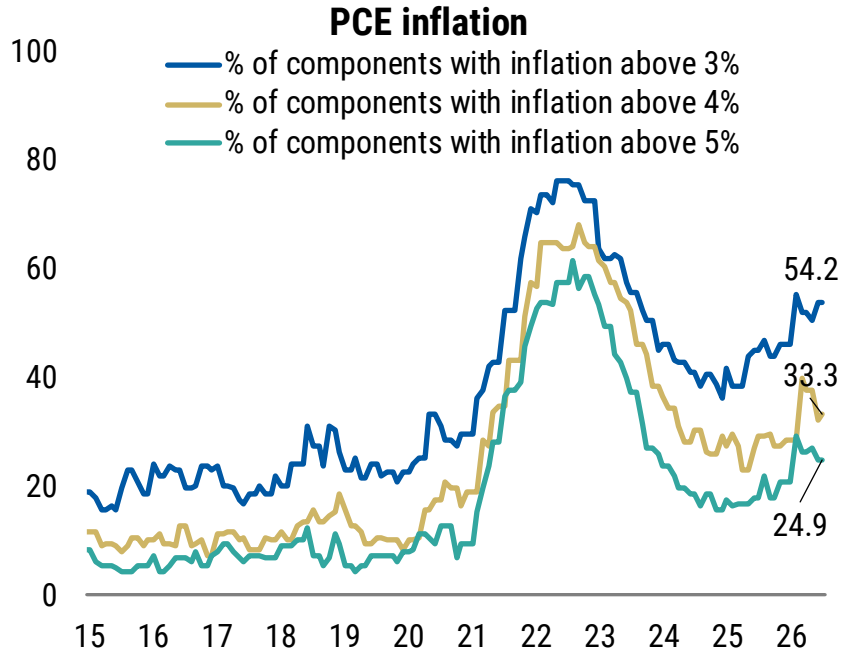
The share of components running above target is highly correlated with actual inflation



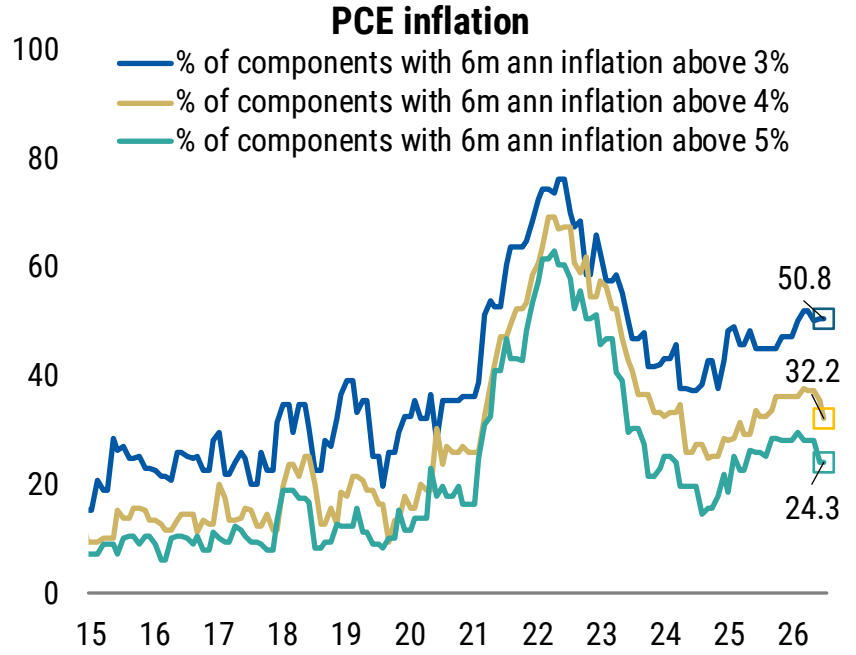
The newest measure of underlying inflation

The share of PCE components with six-month annualized changes above 3%, 4%, and 5% have started to move lower. Will this continue to pass through to lower inflation in the y/y readings?

The share of components with y/y increases above 4% and 5% have turned lower



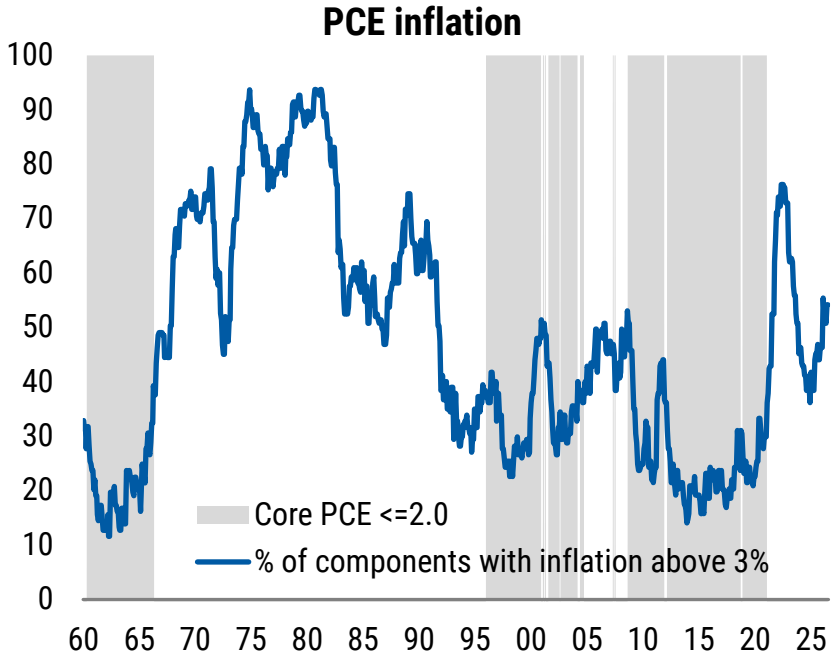
The share of components 6m annualized increases above 3% are moving lower



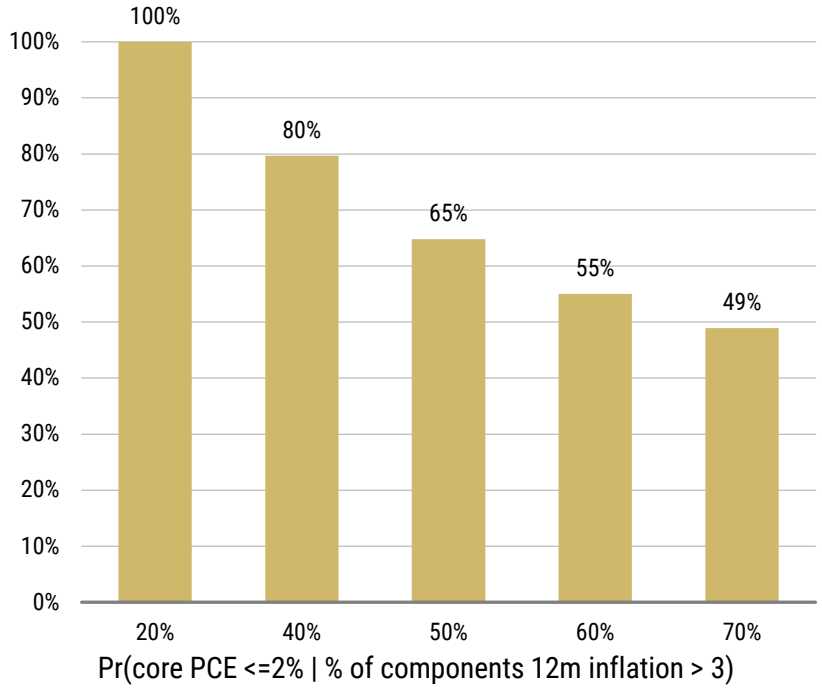
Core PCE inflation against the share of PCE components above 3%

Using monthly PCE component data, we compute the share of components whose 12-month price change exceeds 3%. For each level of that share, we then report how often, historically, core PCE inflation was at or below 2% y/y. When the diffusion index is between 50-60%, core PCE was below 2% 55-65% of the time.

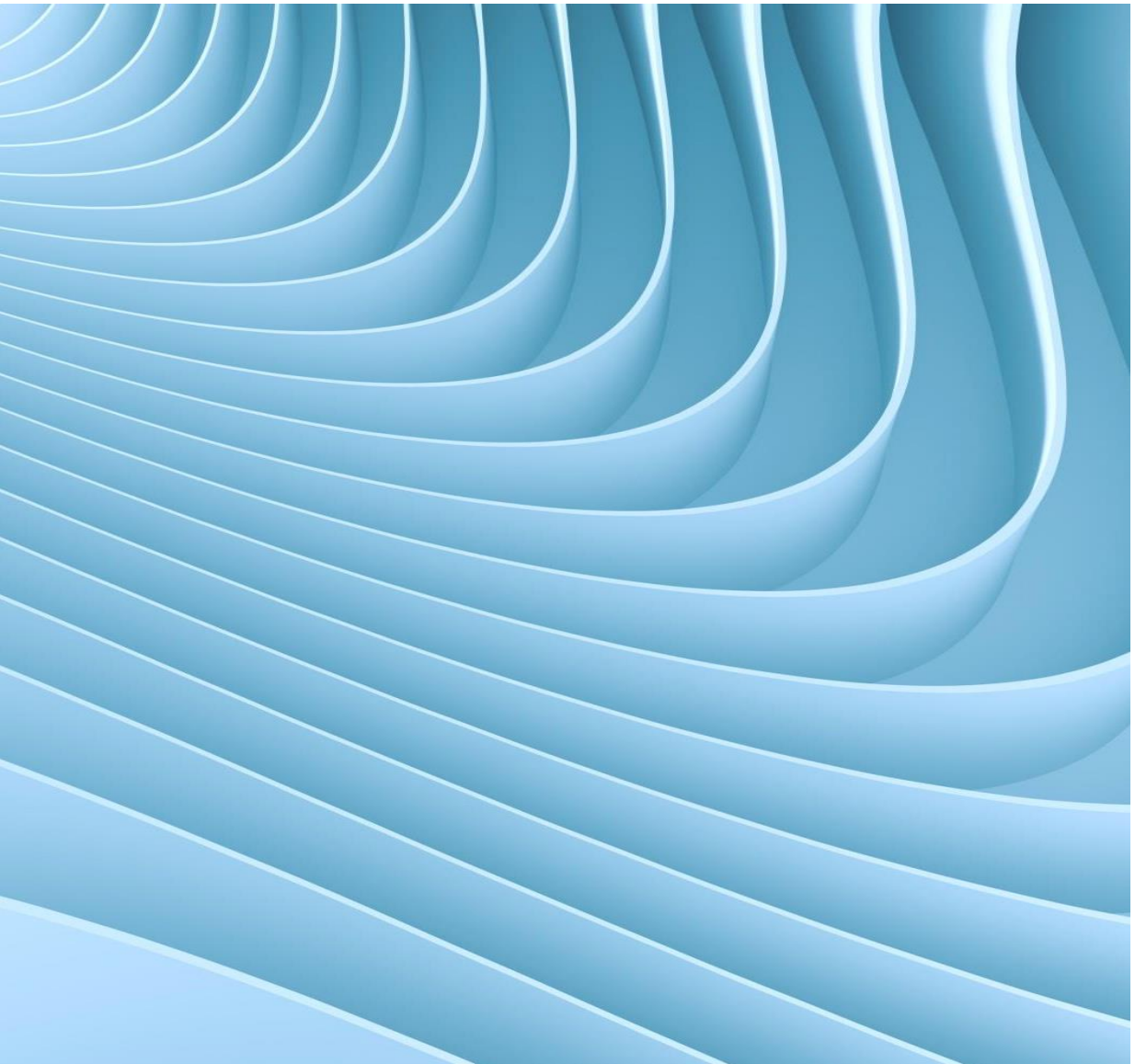
When the share of components with 12m inflation above 3% exceeds 50%, it gets harder to achieve 2% outcomes



Frequence of core PCE less than target conditional on components with 12m inflation higher than 3%



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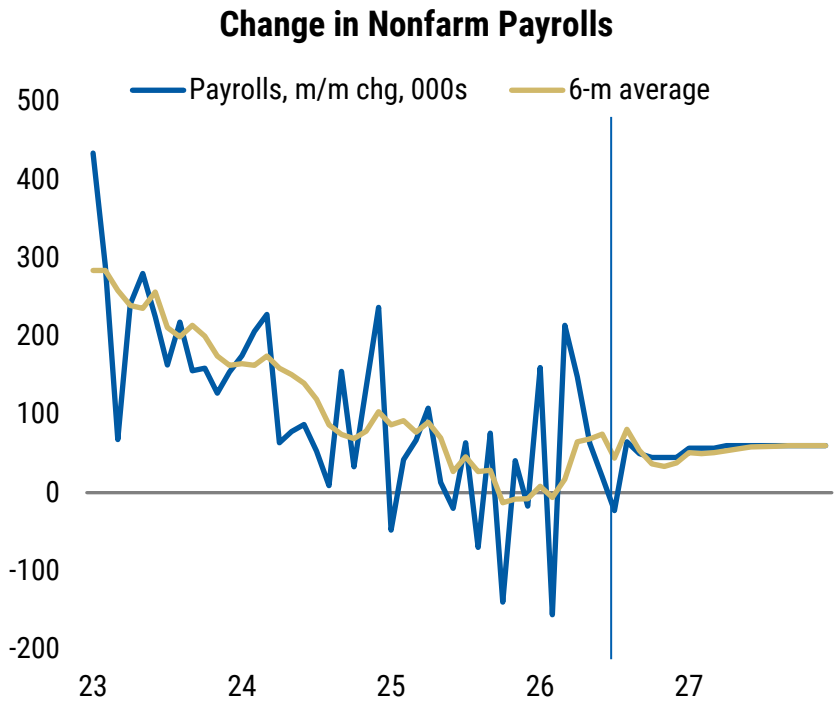
Labor Market: The 'curious balance' persists

We expect a steady labor market: slow payroll growth, low turnover, little change in the unemployment rate, and wages continuing to rise at about their recent pace. Immigration restriction and domestic demographics continue to limit labor supply. Businesses remain cautious about hiring or firing. AI investment and adoption put some minimal upward pressure on the unemployment rate but do not meaningfully disrupt employment. A benign de-escalation should leave these forces in place.

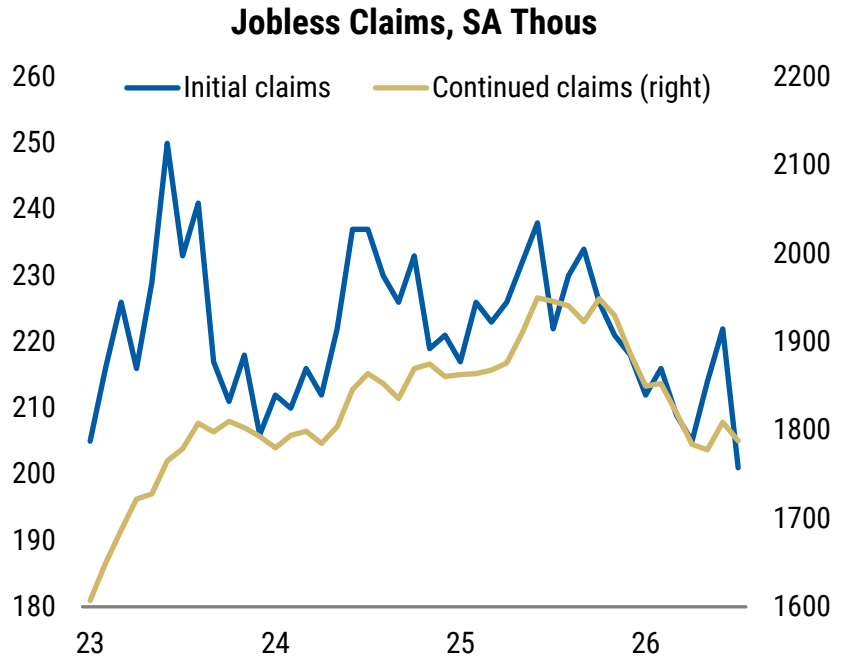
Labor market: "curious type of balance" over the past two and a half years.

Business caution and government cutbacks have limited labor demand. The low-hire, low-fire labor market across most industries continues as firms eked out increasing labor productivity and lower unit labor cost in recent years.

We expect payrolls accelerate slightly from the 2025 pace as federal employment becomes less of a drag.



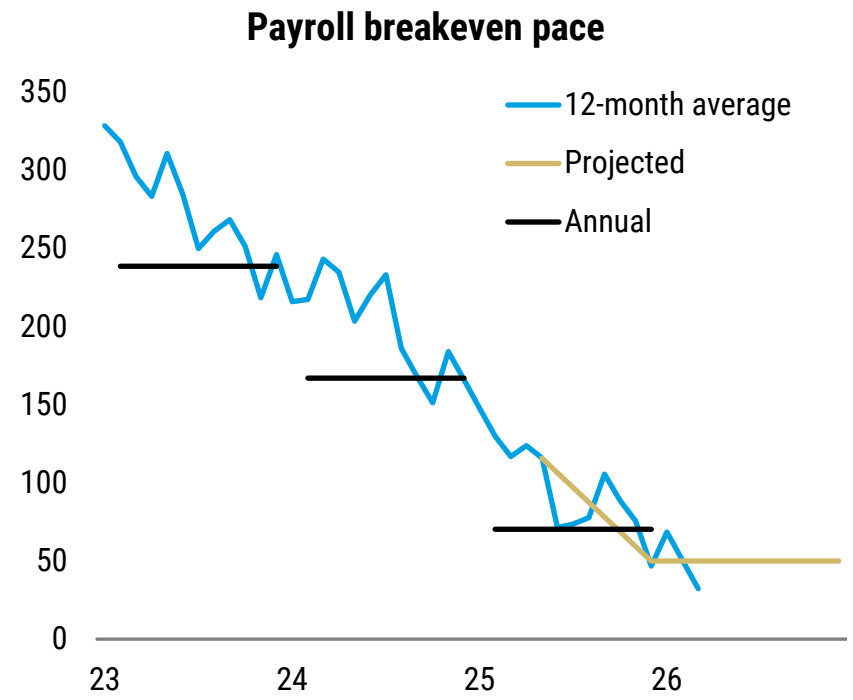
Both initial claims and continuing claims have trended lower since late 2025.



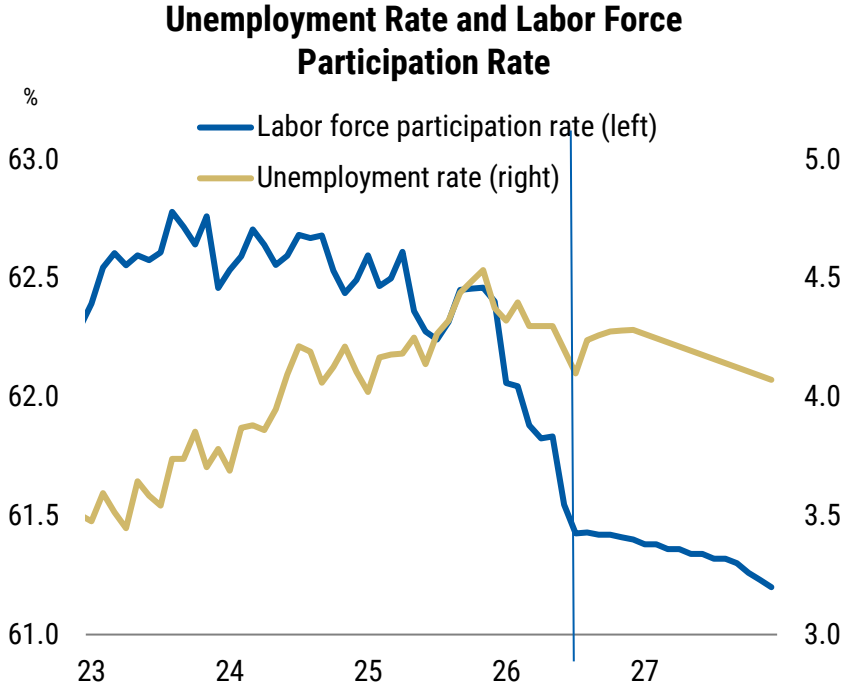
We estimate the breakeven payrolls at 50k per month in 2026 and 40k in 2027

Immigration and slow domestic population growth continue to limit labor supply. A return to that faster labor supply or job growth is extremely unlikely: Immigration policy could change somewhat, however, the major change in immigration flows was the closing of the border.

The breakeven pace for payrolls has fallen.



The unemployment rate inches down. The decline in labor force participation reflects the correcting for distortions from the population control and an aging population.

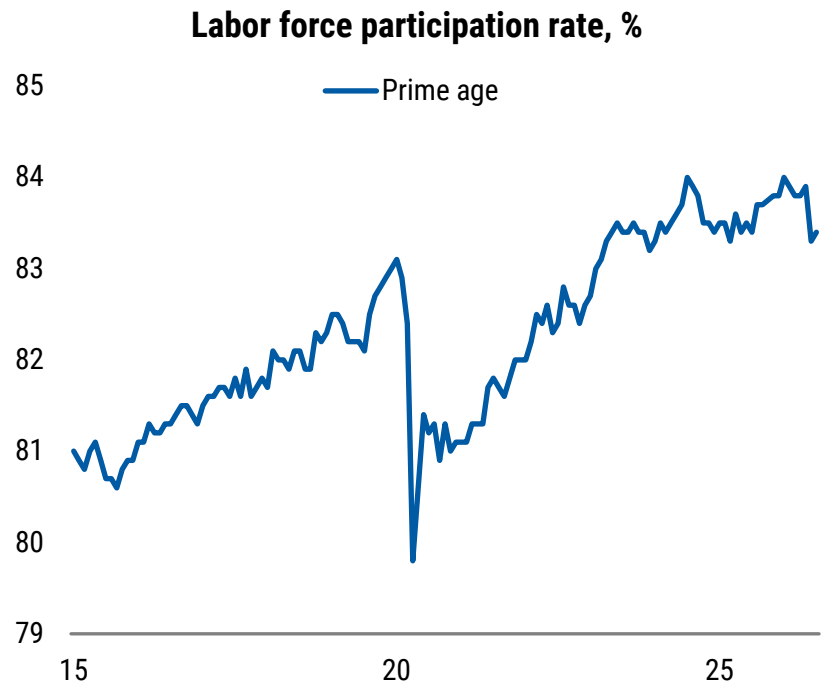


Note: This right chart reflects the four quarter change in price-, cost-, and profit-per unit of real gross value added by the nonfinancial corporate business sector (sa, US$), for the four quarters ending in 4Q

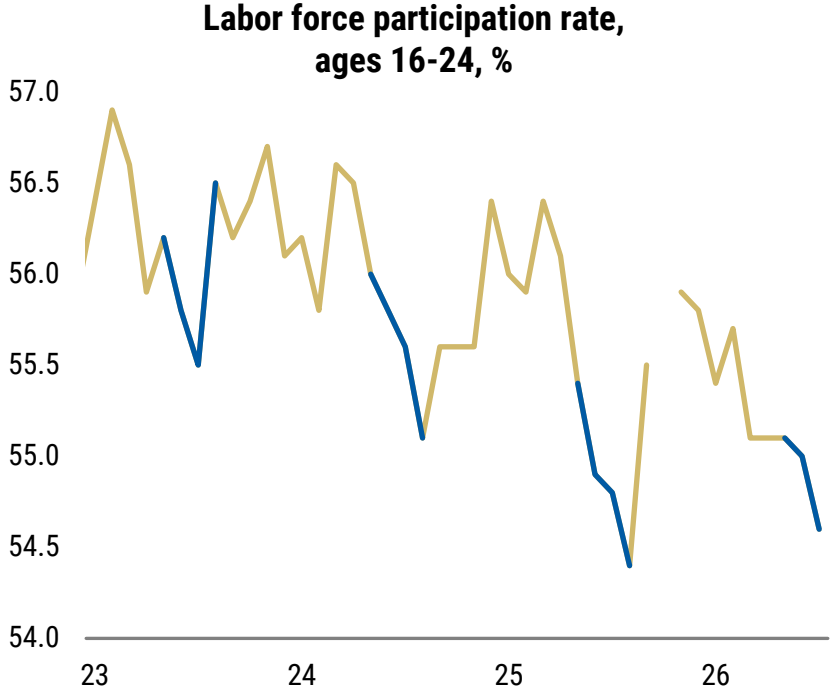
The recent declines in LFPR have raised concerns about labor supply

LFPR moved sideways through May but fell a cumulative 0.4pp in June and July. Most of the decline occurred in June and reflected a decline among prime-age workers, with only a very limited rebound in July. We expect a further rebound. The additional decline in LFPR in July reflected declines among those younger than and older than prime age.

The breakeven pace for payrolls has fallen.



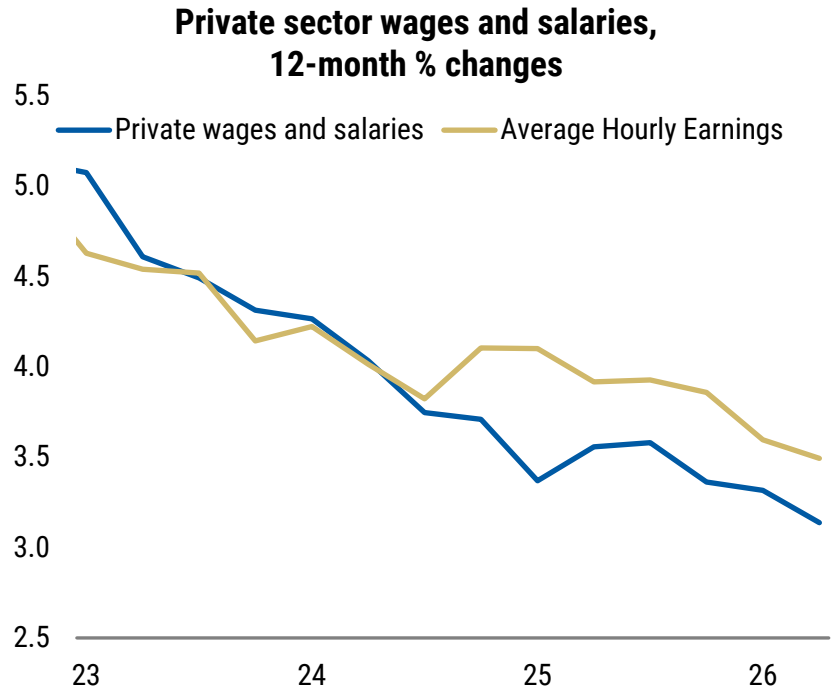
In recent years, youth LFPR has dipped in summertime, reversed in fall



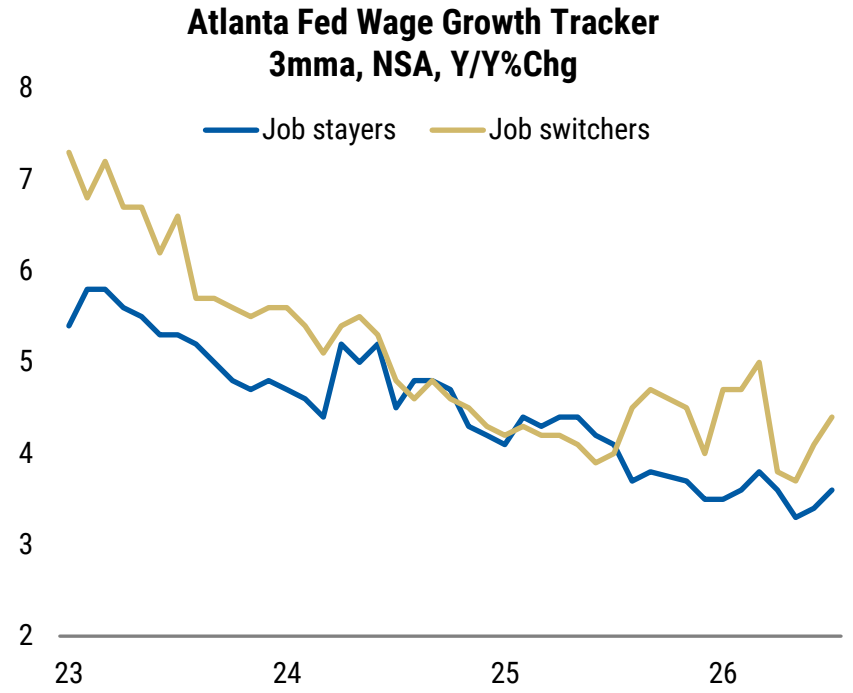
Wage growth has continued to slow

Wage growth has been slowing, consistently across different measures. Average hourly earnings and the ECI measure of private wages and salaries have trended down. The faster recent pace of AHE reflects shifts in employment toward higher-paying jobs rather than faster wage and salary growth.

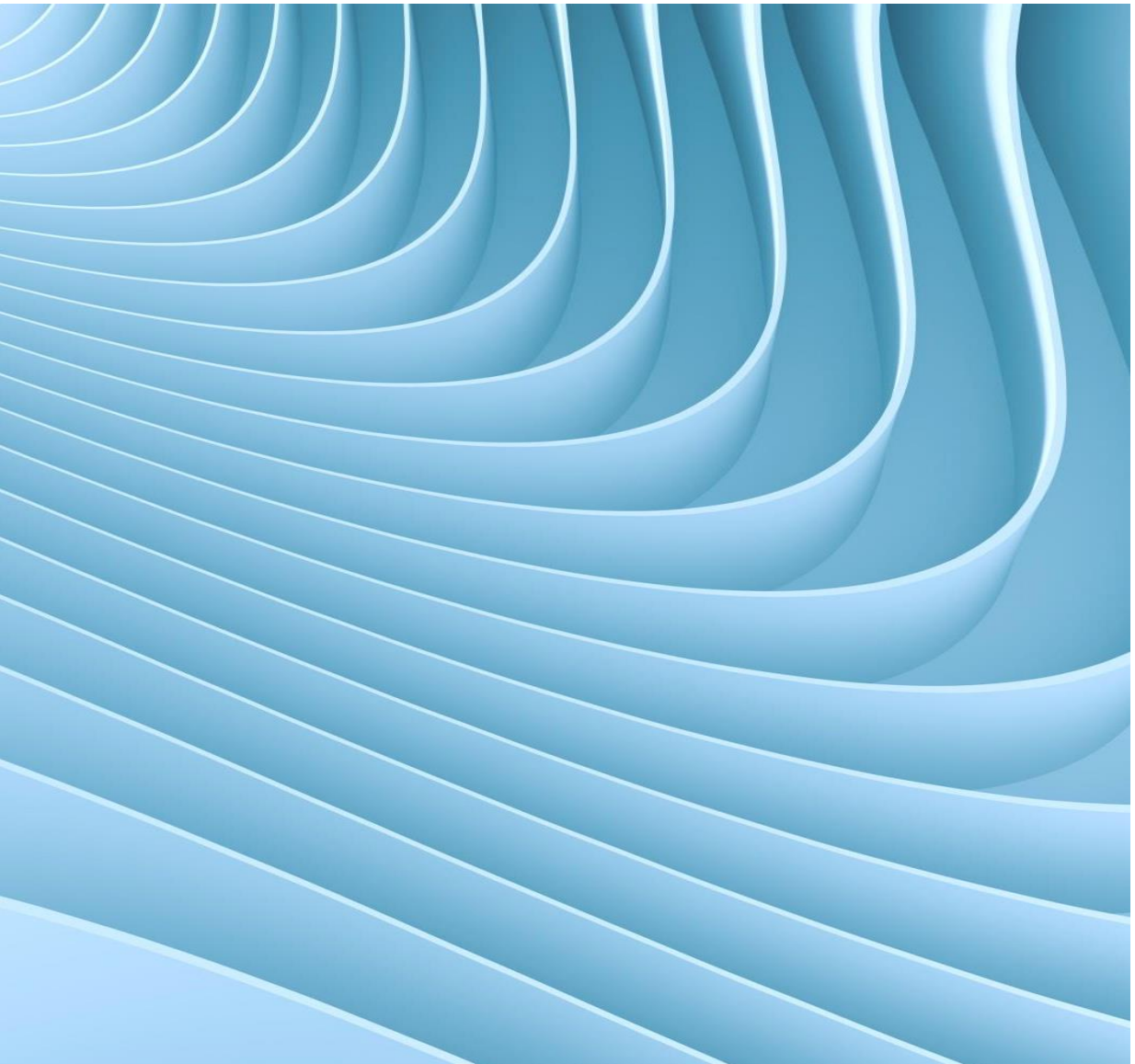
Average hourly earnings and wages continue to moderate



Wage growth for job stayers and job switchers also suggests a stable labor market.



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Monetary policy: Inflation in the spotlight

We expect evidence of disinflation to keep the Fed on hold in 2026. Our forecast has inflation falling enough to justify 50bp of cuts in 2027.

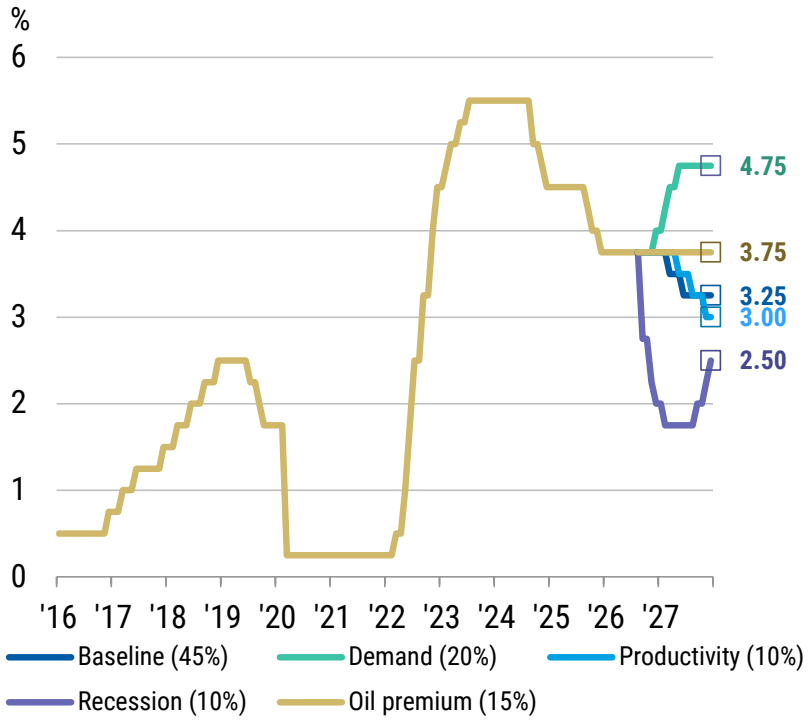
How far disinflation goes remains an open question. The Middle East conflict and AI demand-side price pressures could mean less inflation that we expect (or firming in inflation), leading the Fed to hike rates.

An "oil risk premium" alternative scenario seems like the most pressing risk, but markets see greater risk of an "animal spirits" outcome.

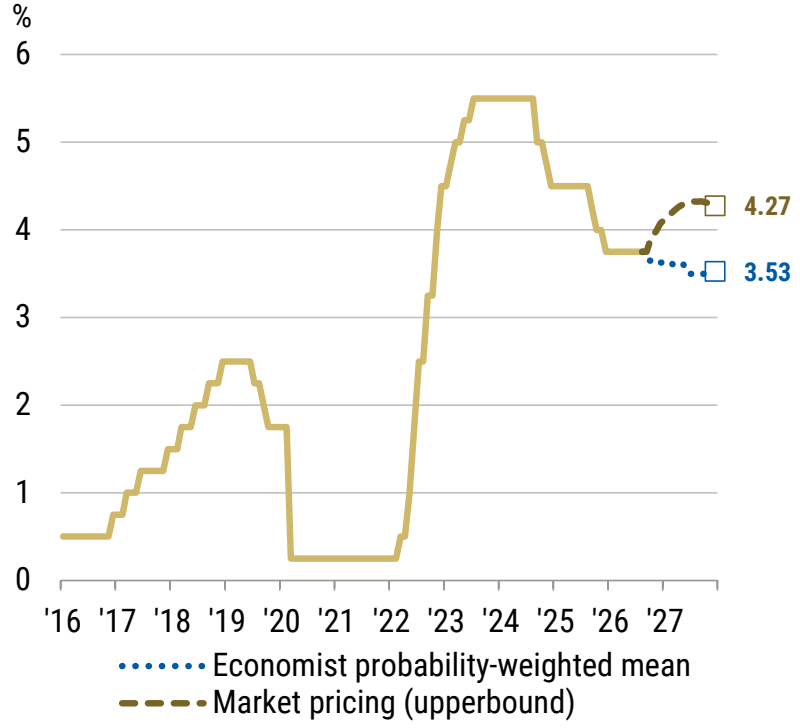
Risks skew toward lower fed funds than markets price currently

probabilities to them. We compare the weighted average to market prices

Target fed funds range upper bound and forecast and 4 alternative scenarios



Target fed funds range upper bound and economist-assigned probability-weighted mean vs. market pricing



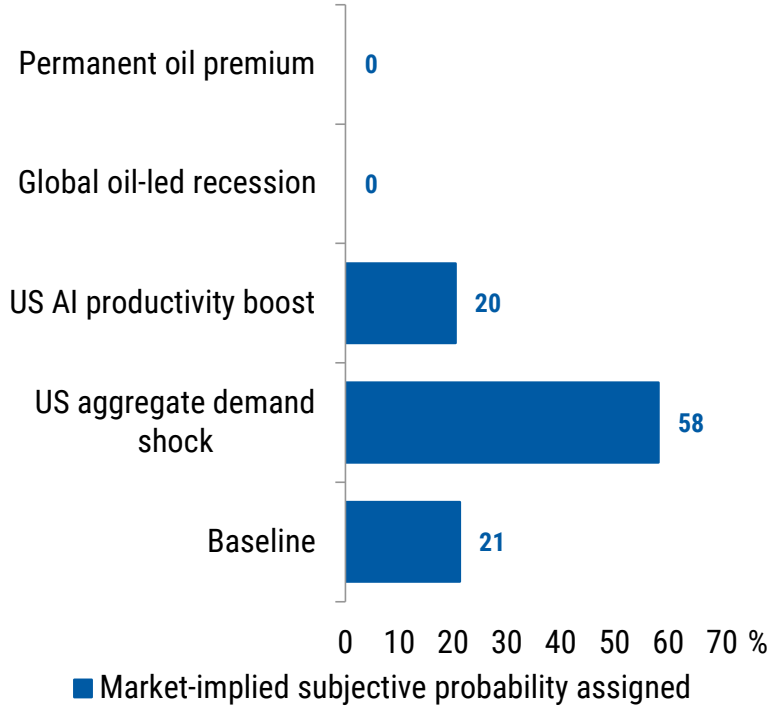
August 28, 2026

Bloomberg tickers: FDTR Index, FF1 Comdty, ... , FF24 Comdty

What assigned probabilities align best to current market prices?

What might current market prices imply about the probabilities investors assign to our economist's baseline and three alternative scenarios?

Subjective probabilities that produce a market path most closely aligns to the current market-implied path



Target fed funds range upper bound and market-price-aligned probability-weighted mean vs. market pricing



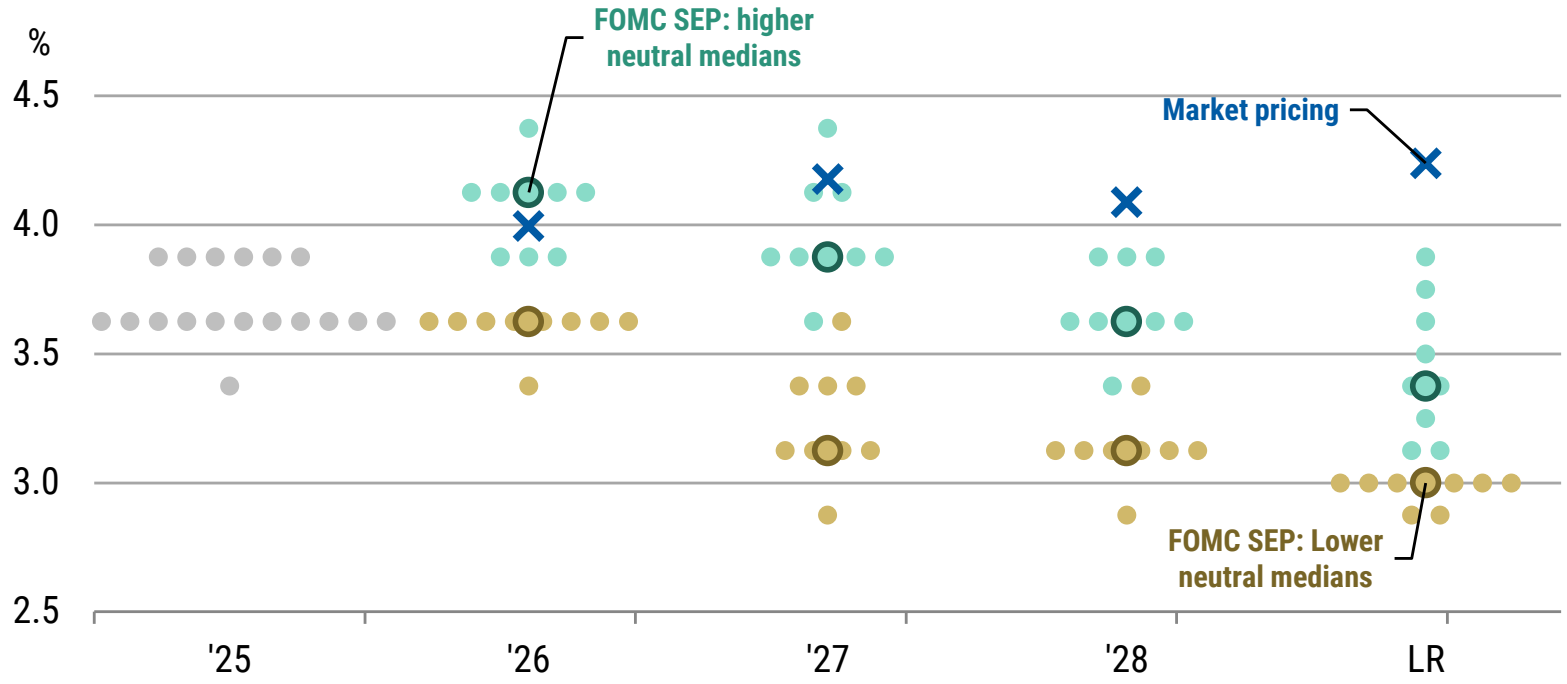
August 28, 2026

* Microsoft Excel solver used *without* constraints
Bloomberg tickers: FDTR Index, FF1 Comdty, … , FF24 Comdty

Two camps on the FOMC disagree on how quickly to return to r*

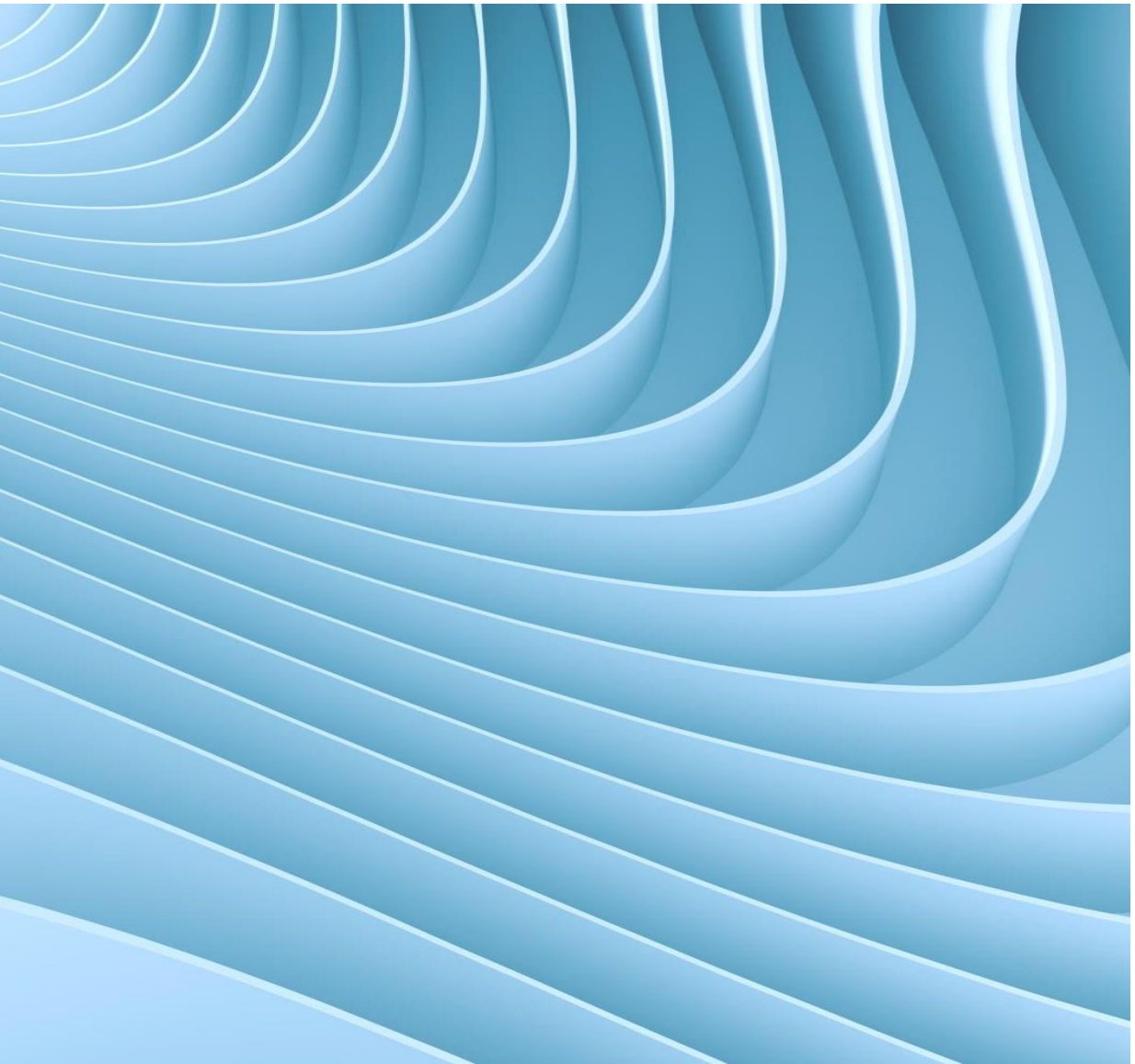
Both camps appear to share the view that returning to a neutral policy setting – r* – should occur, but when exactly remains in debate. The first camp wants to wait until 2028, while the second camp wants to start this year

(1) FOMC participants' assessments of appropriate monetary policy: midpoint of target range or target level for the federal funds rate: June 2026, (2) medians of those with a higher long run neutral dot vs. those with a lower long run neutral dot, and (3) market pricing



June 2026 (SEP dot-plot), **April 2026** (SME), and **August 31, 2026** (market prices)
Bloomberg tickers: FFF6 Comdty, FFF7 Comdty, FFF8 Comdty, FFF9 Comdty, FFU0 Comdty

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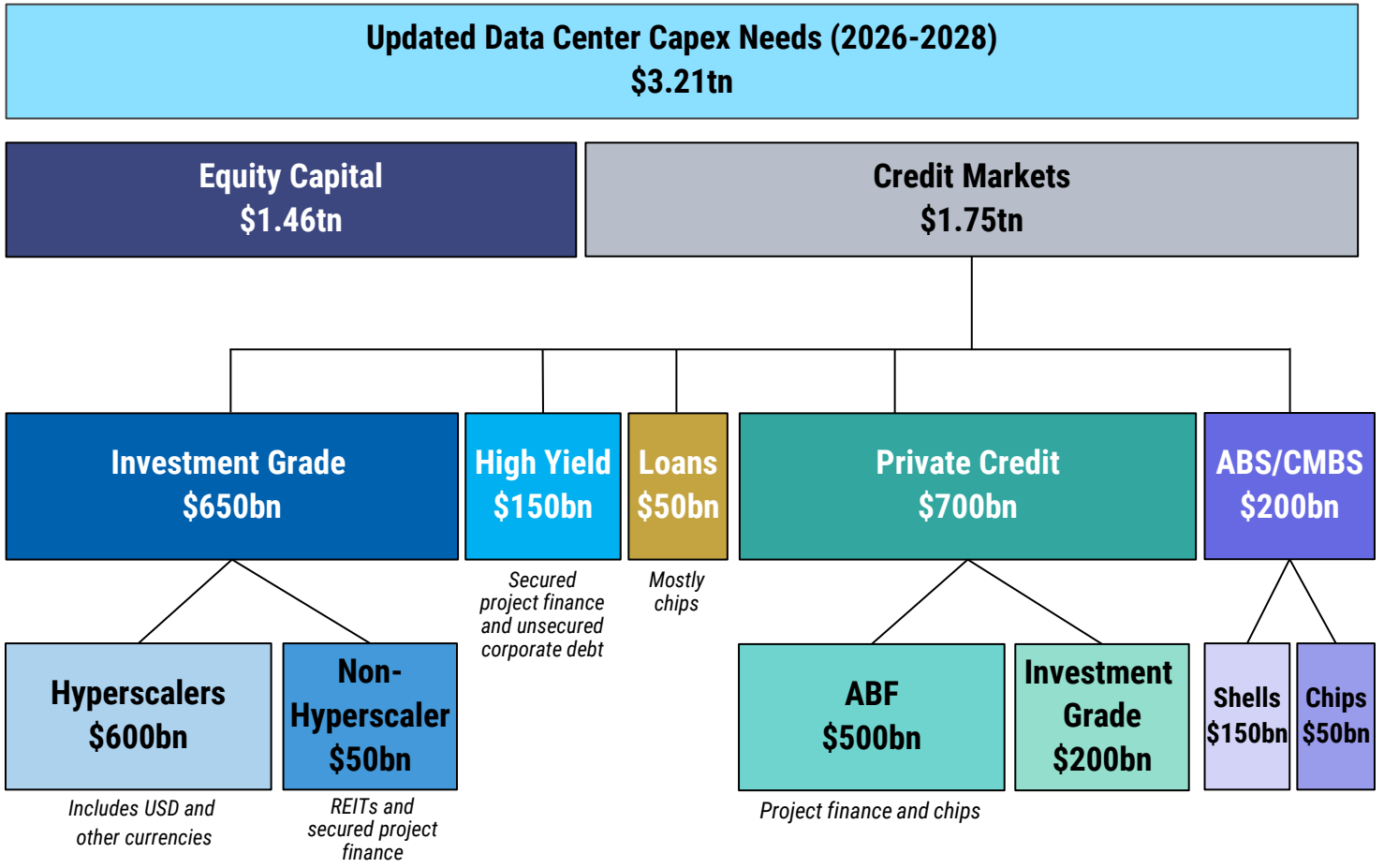


Financing the AI expansion: Credit market exposure to AI is increasing rapidly

We expect 3.2tn in issuance to support data center spending through 2028. $1.8tn will come from credit markets, $700bn of which will come from private credit.

Hyperscaler credit quality remains strong, suggesting capacity for additional debt issuance. Rather than constraining issuance, the market adjustment is likely to come through wider spreads.

Updated Data Center Capex – Growing Role Of Credit Markets

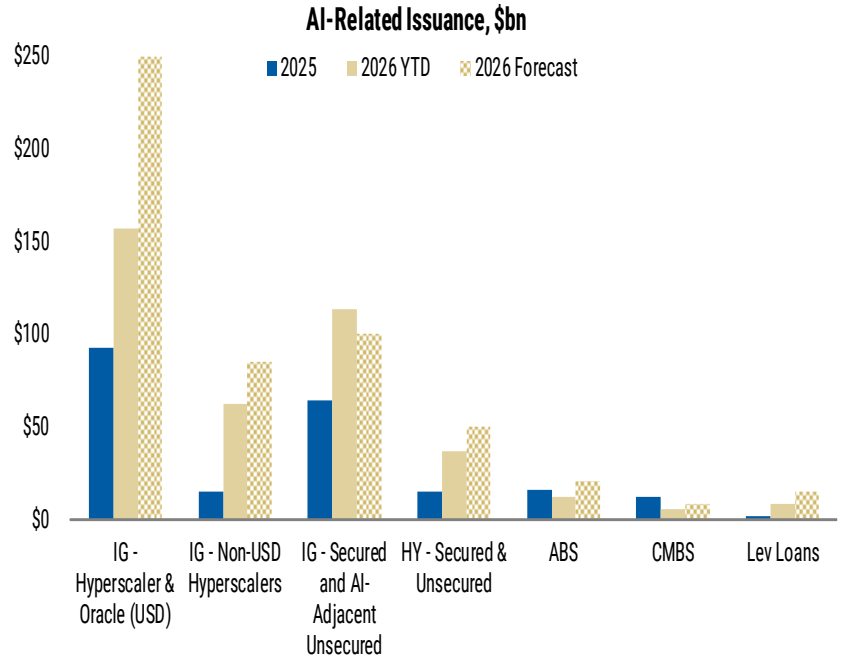


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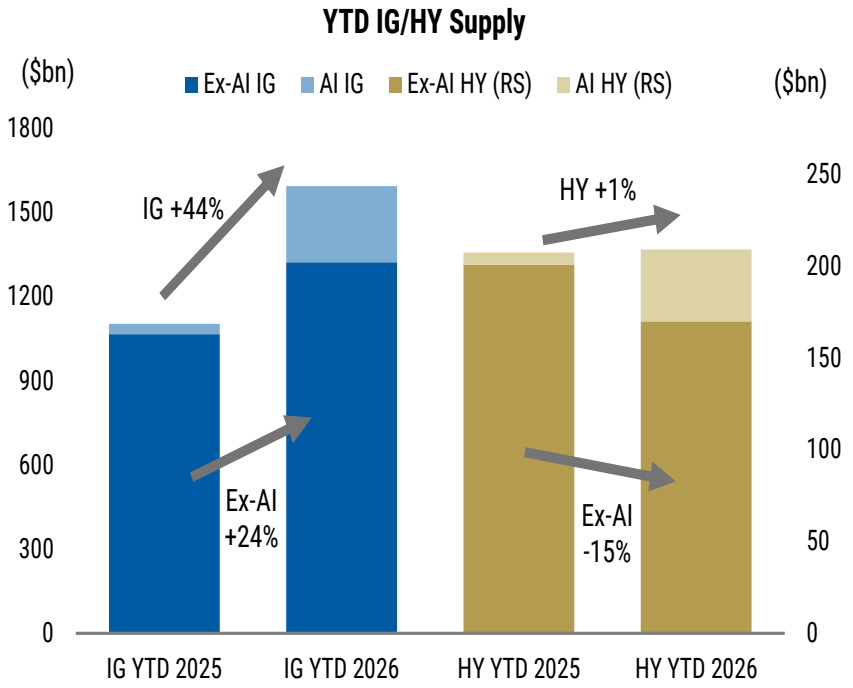
Corporate Supply Surging And Broadening Within The AI Ecosystem

IG corporate supply is tracking 44%+ higher than in 2025, with AI-driven financing driving the bulk of the 'delta'. Issuance has broadened beyond hyperscalers to other megacaps and project-financing deals for DC construction.

AI-related issuance has surged; supporting our above-consensus call for overall credit supply



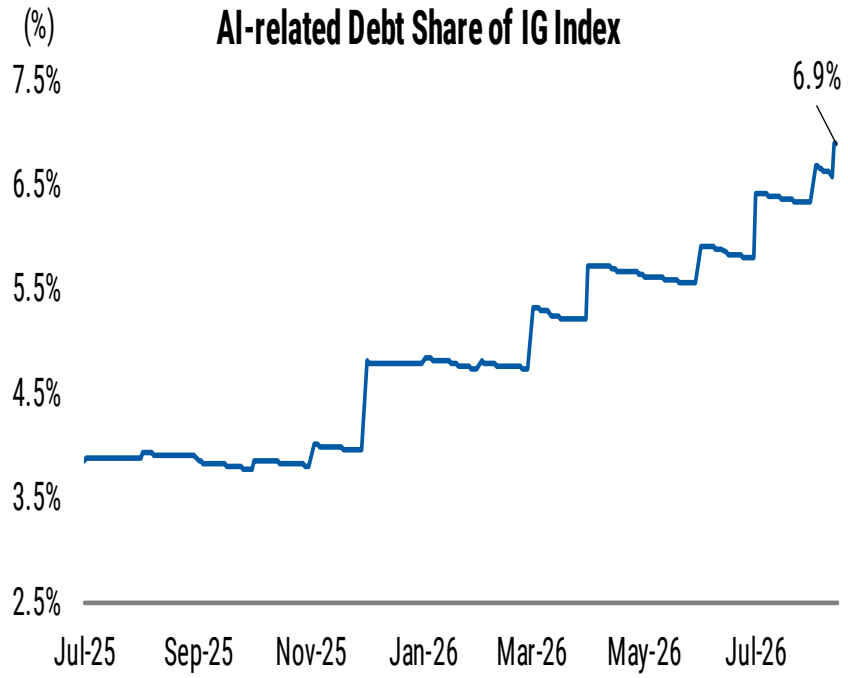
The uptick in corporate supply YTD largely driven by AI-related financing



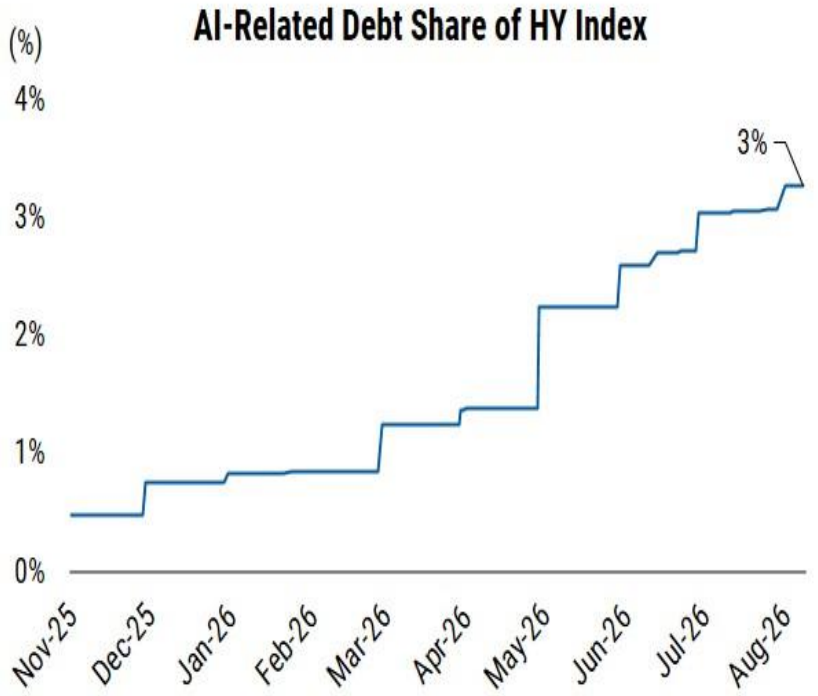
Credit Market Exposure To AI Is Increasing Rapidly

Hyperscaler, data center construction, and other AI-related debt account for a growing share of the IG and HY markets. AI exposure in credit markets while rising is much lower than it is in equities

The AI-related debt share of the IG index has risen rapidly on the back of heavy issuance



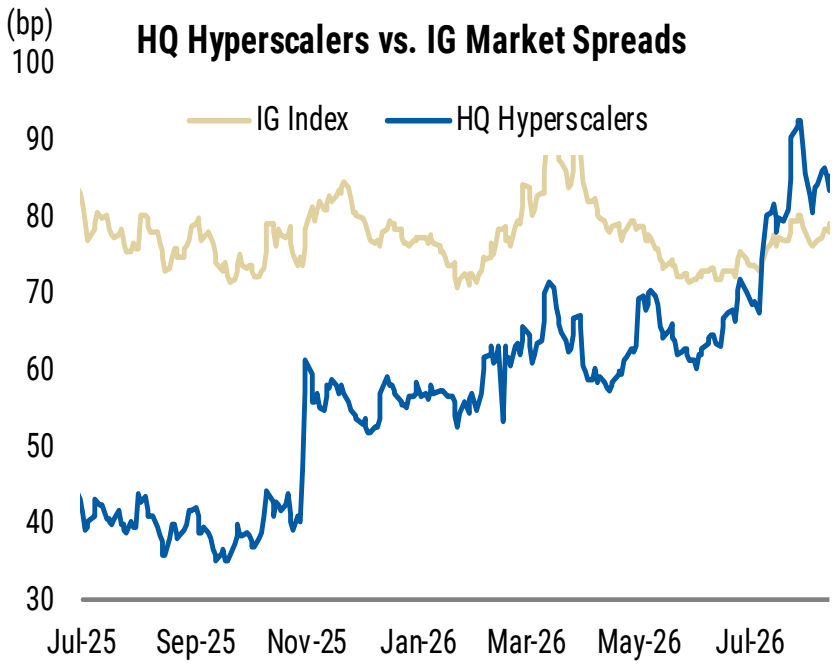
Data-center debt accounts for ~3% of the HY index, up from less than 1% last year



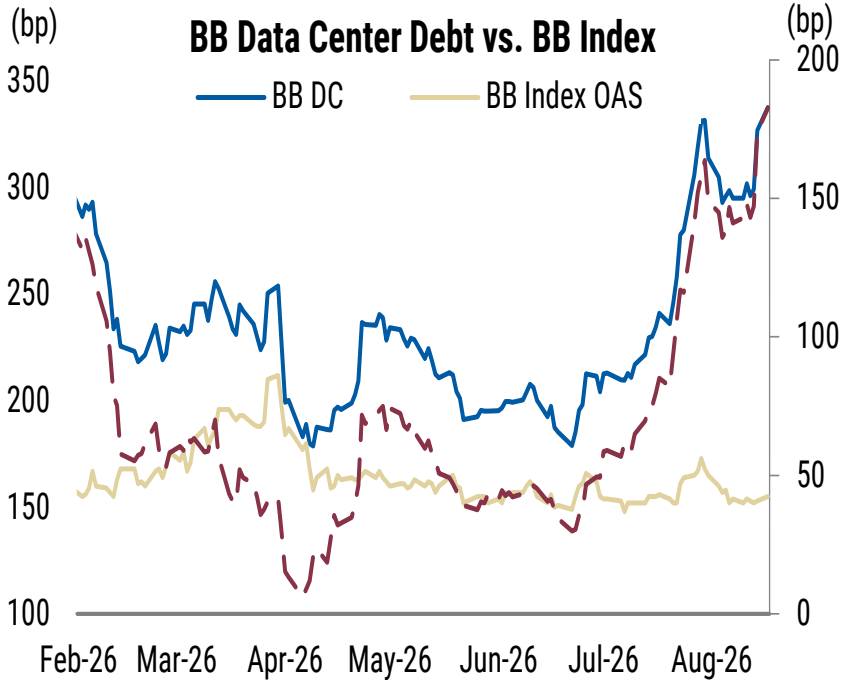
Capacity to Absorb More Issuance - But Spreads Should be Wider

Hyperscaler credit quality remains strong, suggesting capacity for additional debt issuance. Rather than constraining issuance, the market adjustment is likely to come through wider spreads

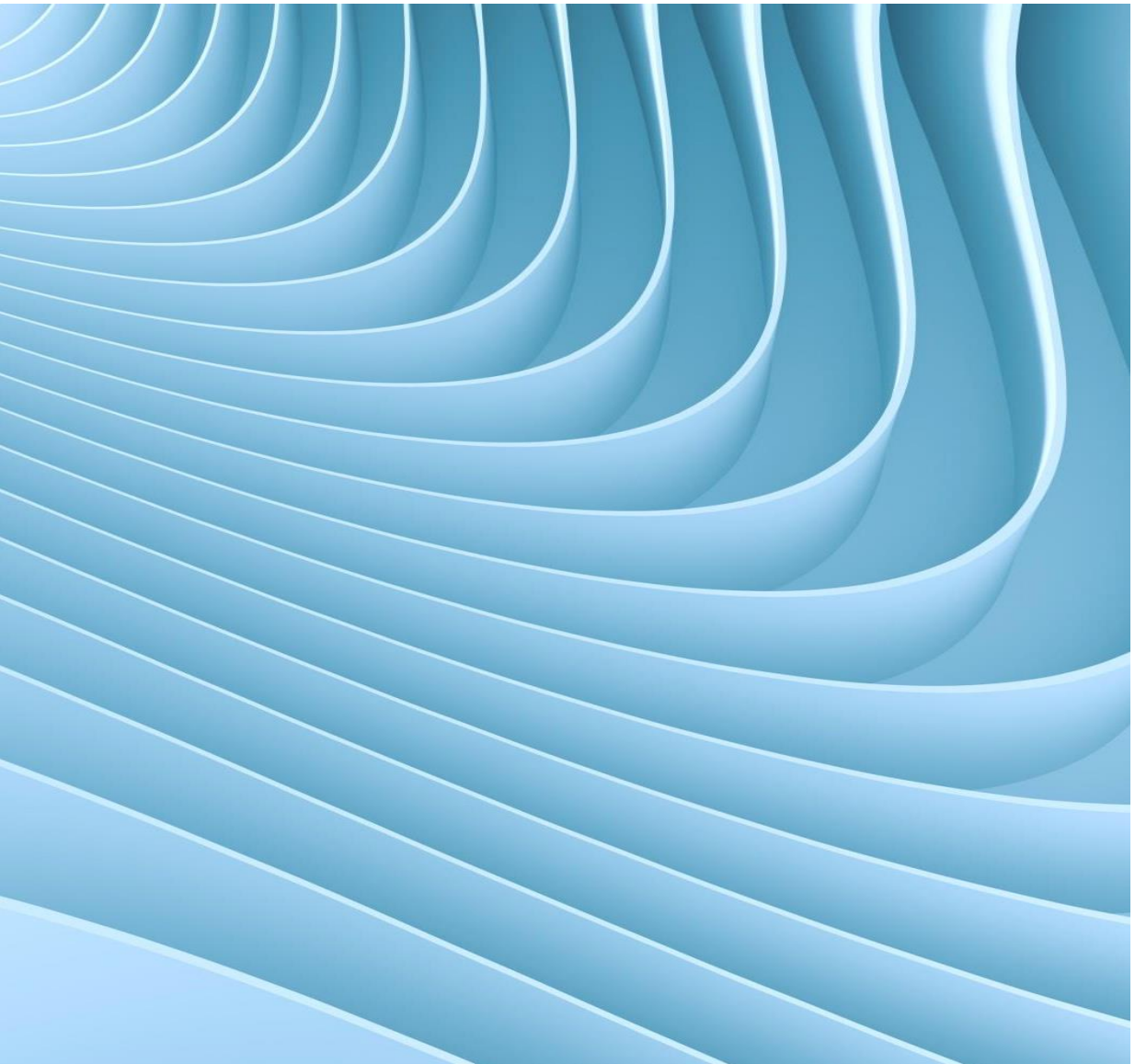
Hyperscaler spreads have widened but remain low in absolute levels; limited spillover to rest of the market



In HY, risk-reward in DC construction risk looks better with shorter duration exposure



Morgan Stanley



AI Labor Disruption: More Micro than Macro, but increasingly visible

How is AI affecting the labor market today? High AI-exposed occupations are seeing residual excess unemployment and longer unemployment spells.

Calibrating AI Exposure

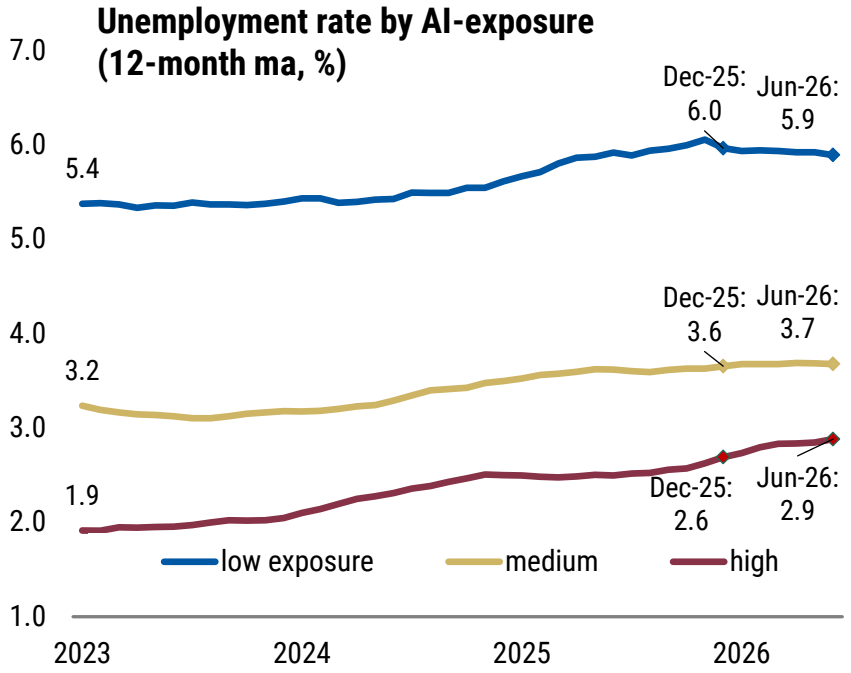
To analyze potential labor market disruptions, we classify occupations by their exposure to AI using the framework developed by Felten et al. (2021). Felten and co-authors construct an AI exposure index by assessing how tasks within each occupation align with current and anticipated AI capabilities.

Characteristics of AI-exposure groups

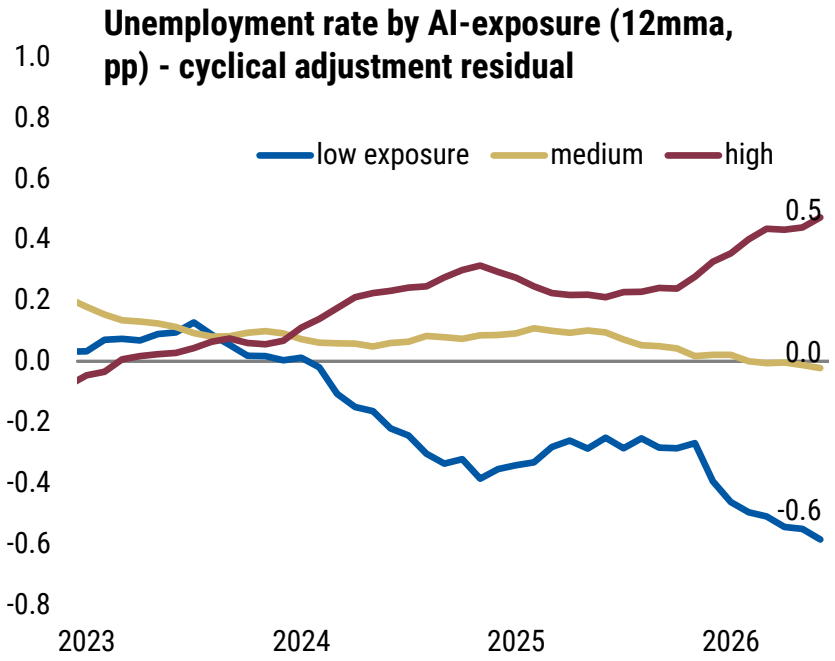
	Low Exposure	Medium Exposure	High Exposure
Number of occupations in CPS	119	237	118
Median Annual Income (by Occupation Exposure, as of 2024)	$46,390	$56,270	$96,690
Percent of Employees With at least a Bachelor's Degree (Within Occupations)	11%	37%	67%
Most exposed occupations within group	Heating/AC installers, elevator installers/repairers, textile bleaching, locksmiths, telecommunications equipment installer/repairer	Architects, emergency management directors, first-line supervisors of administrative support workers, materials engineers, librarians	Financial examiners, actuaries, purchasing agents, budget analysts, accountants and auditors, judicial law clerks
Most exposed industries within group	Food manufacturing, apparel manufacturing, building contractors, waste treatment and disposal, motor vehicle manufacturing	Writers, electronic shopping, specialty hospitals, electric lighting equipment manufacturing, real estate	Accounting/tax preparation, legal services, securities and commodities contracts, insurance agencies/brokerage, credit intermediation

Modest signs of disruption so far

The unemployment rate has been rising similarly across all occupations, but different occupations have different cyclicality

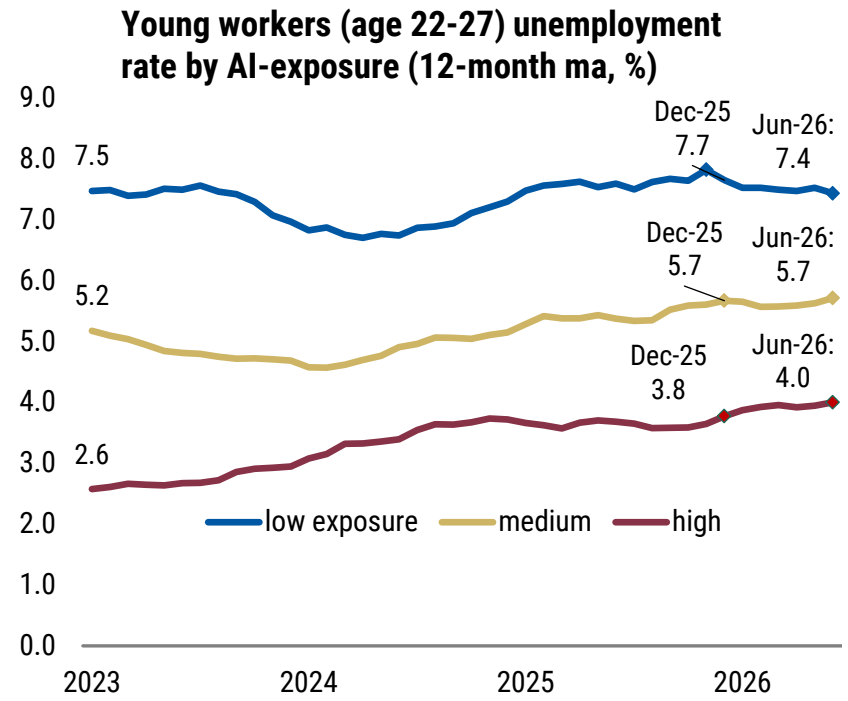


… adjusting for cyclicality, high-exposure unemployment rate runs ~0.5pp higher than normal.

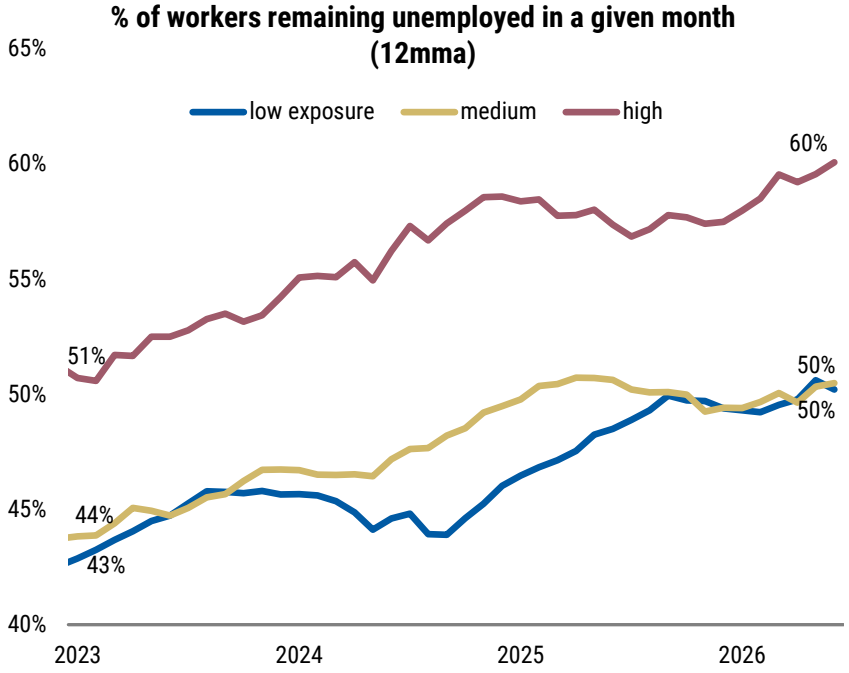


Young workers look like the leading edge

Slightly more evidence of disruptions among young workers, but magnitudes are still small.

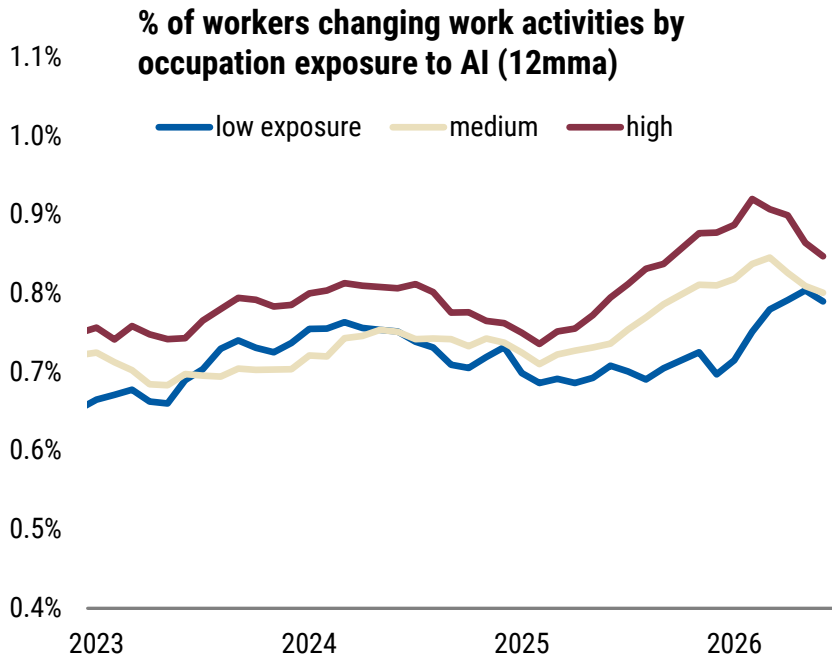


It's taking longer for young workers to find jobs that are more exposed to AI

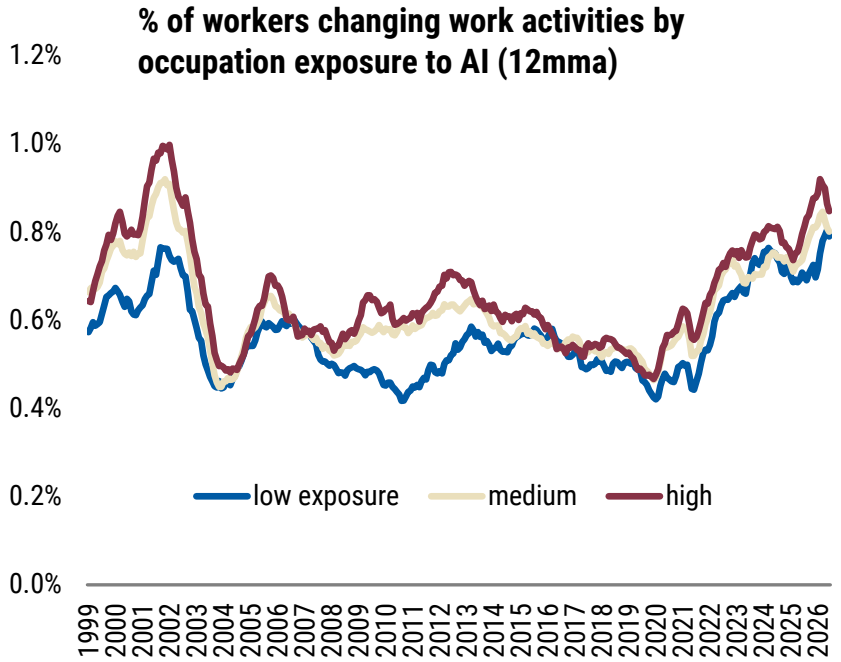


Tasks are changing

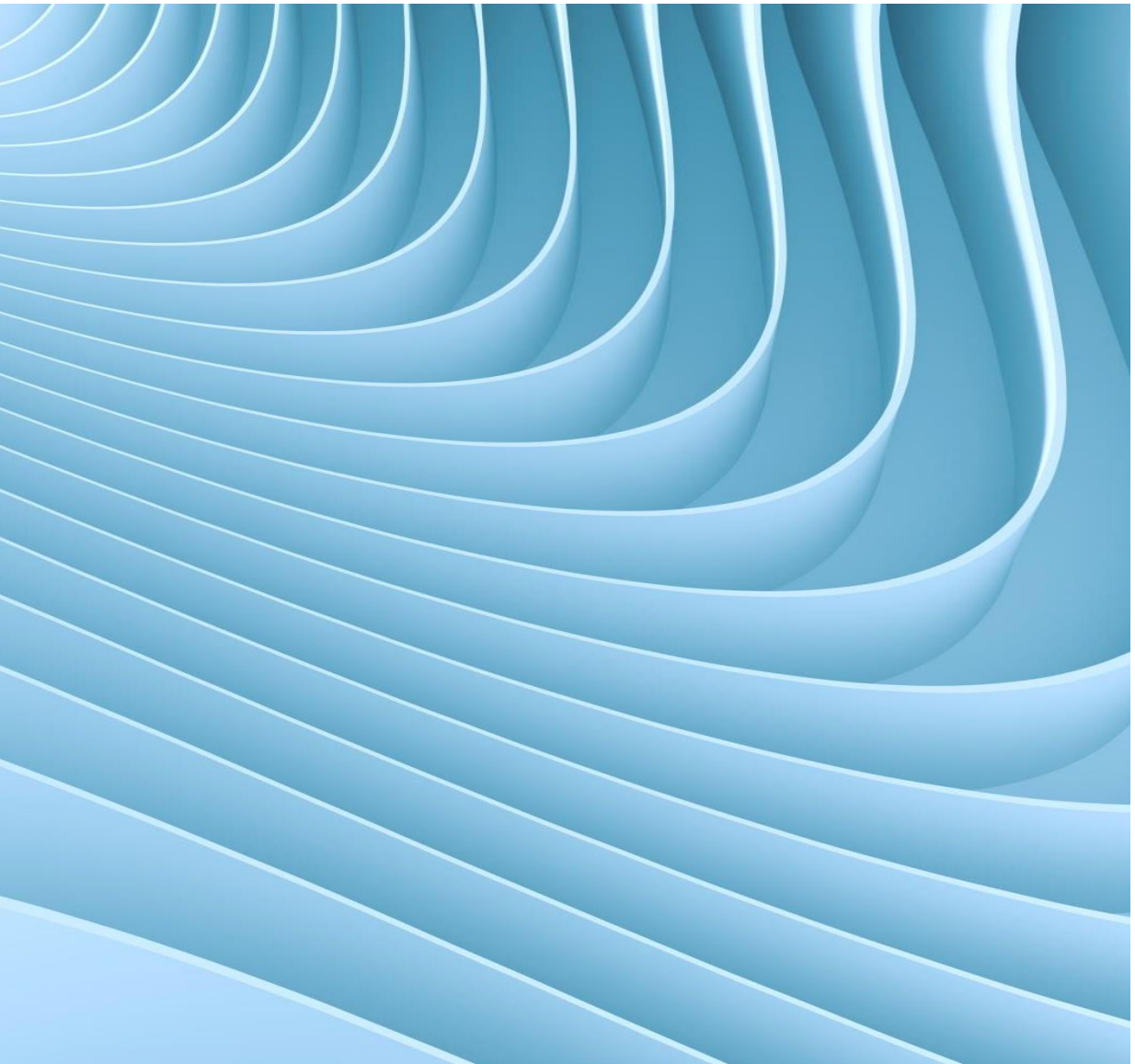
Tasks are changing more in AI-exposed occupations…



… Zooming out we can see that the ratio is approaching levels close to the ICT revolution (late 90s, early 2000s)



Morgan Stanley



Noticeably positive output effects despite the minimal employment effects

We examined industry output/employee. Industries that are more exposed to AI have led an acceleration in productivity. In 2025, output/employee was faster and accelerated more in high-AI industries than in other industries.

The pickup reflects faster output growth rather than labor displacement.

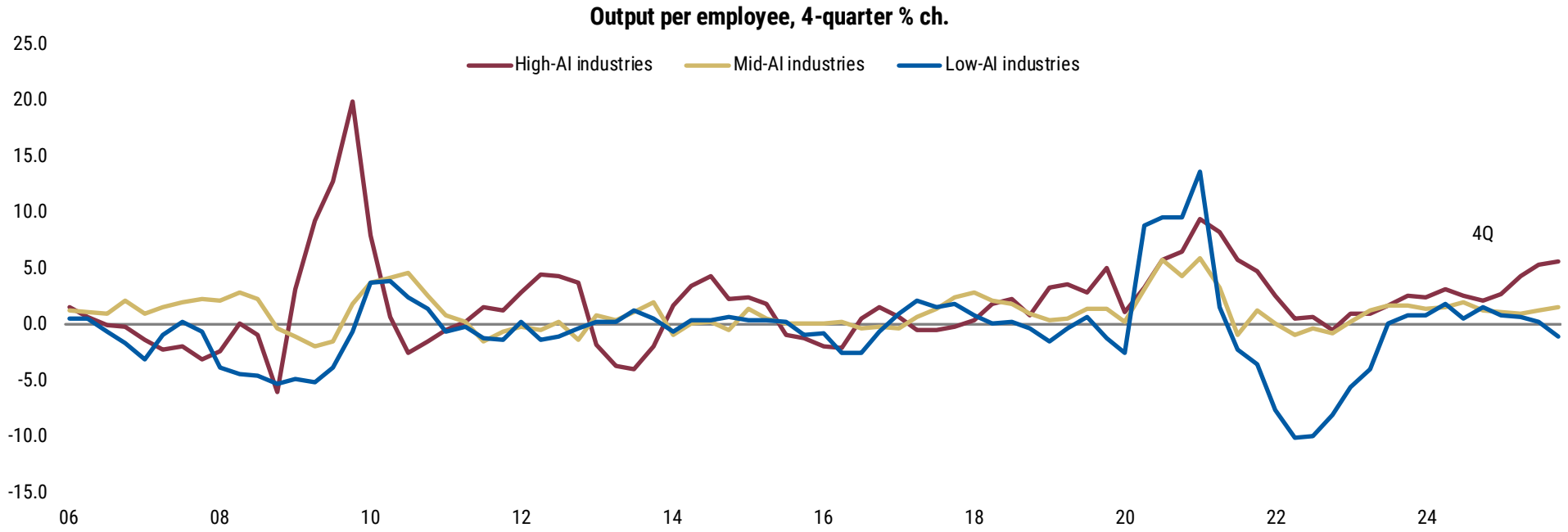
Output gains were especially clear among AI-related industries, likely reflecting capital deepening. Other industries also showed some gains.

High hyperscaler capex will continue the capital deepening.

Labor productivity accelerated in industries with high AI exposure

We find positive correlation between industry-level AI exposure and faster labor productivity growth. We estimate that industries with high AI exposure contributed 1.7pp of the 2.4pp growth in output per employee in the four quarters through 4Q 2025. Furthermore, its contribution accelerated: it contributed only 0.7pp in 2024.

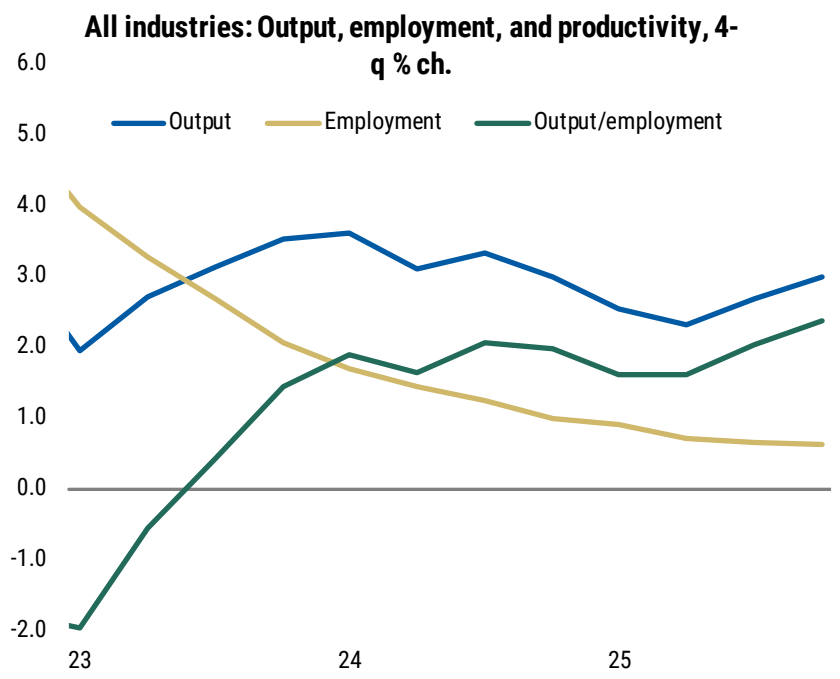
In industries with high AI exposure, output per employee rose faster in 2025, and accelerated more, than in other industries



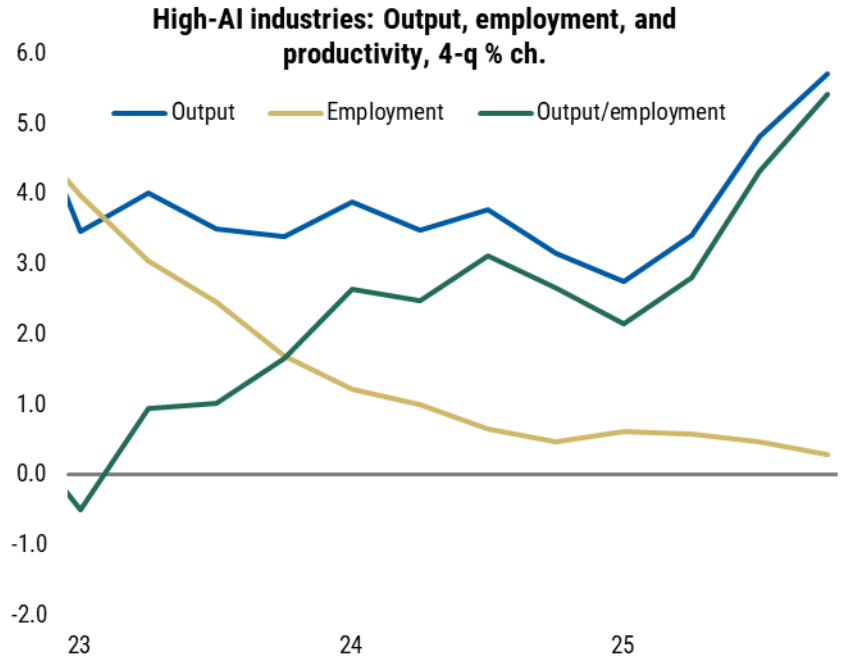
The main driver of productivity is faster output growth, not labor displacement

We find that its faster growth reflected faster output growth rather than slower employment growth. And the acceleration in output growth was because of the industries with high-AI exposure; output growth slowed in the mid- and low-AI aggregates.

Overall industry output per employment accelerated in 2025 because of faster output growth



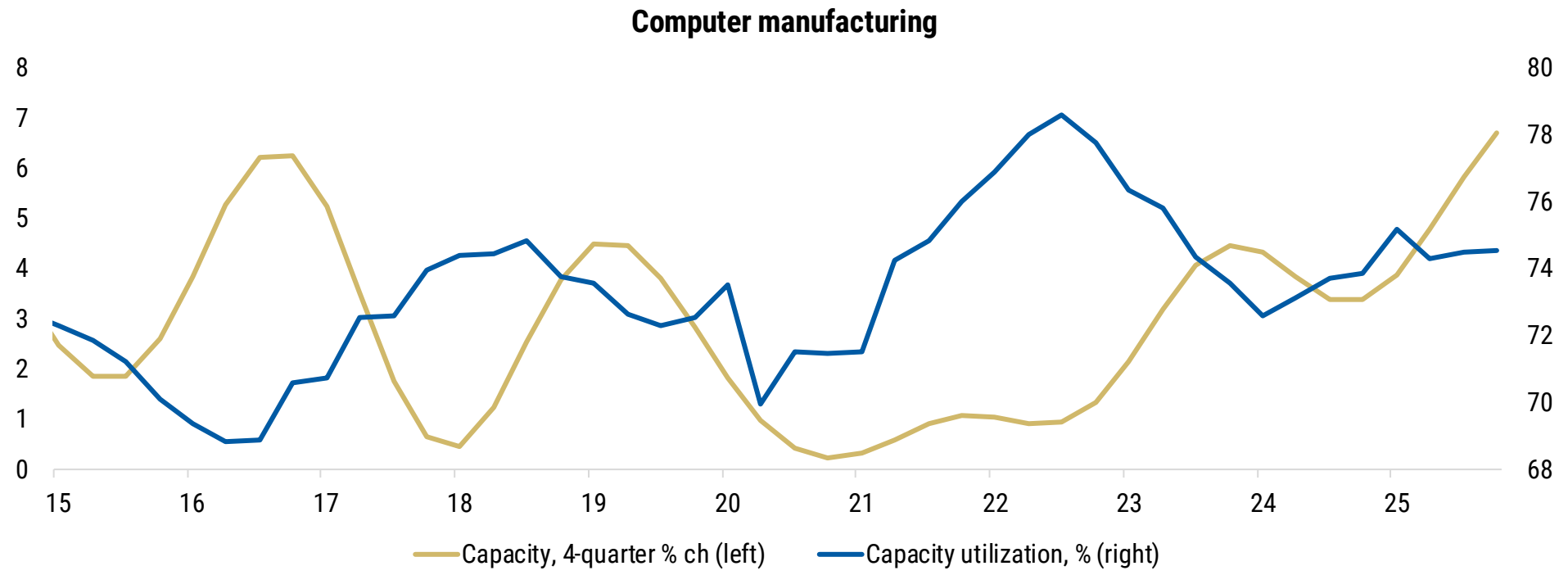
High-AI industry output and productivity surged, while employment growth stagnated.



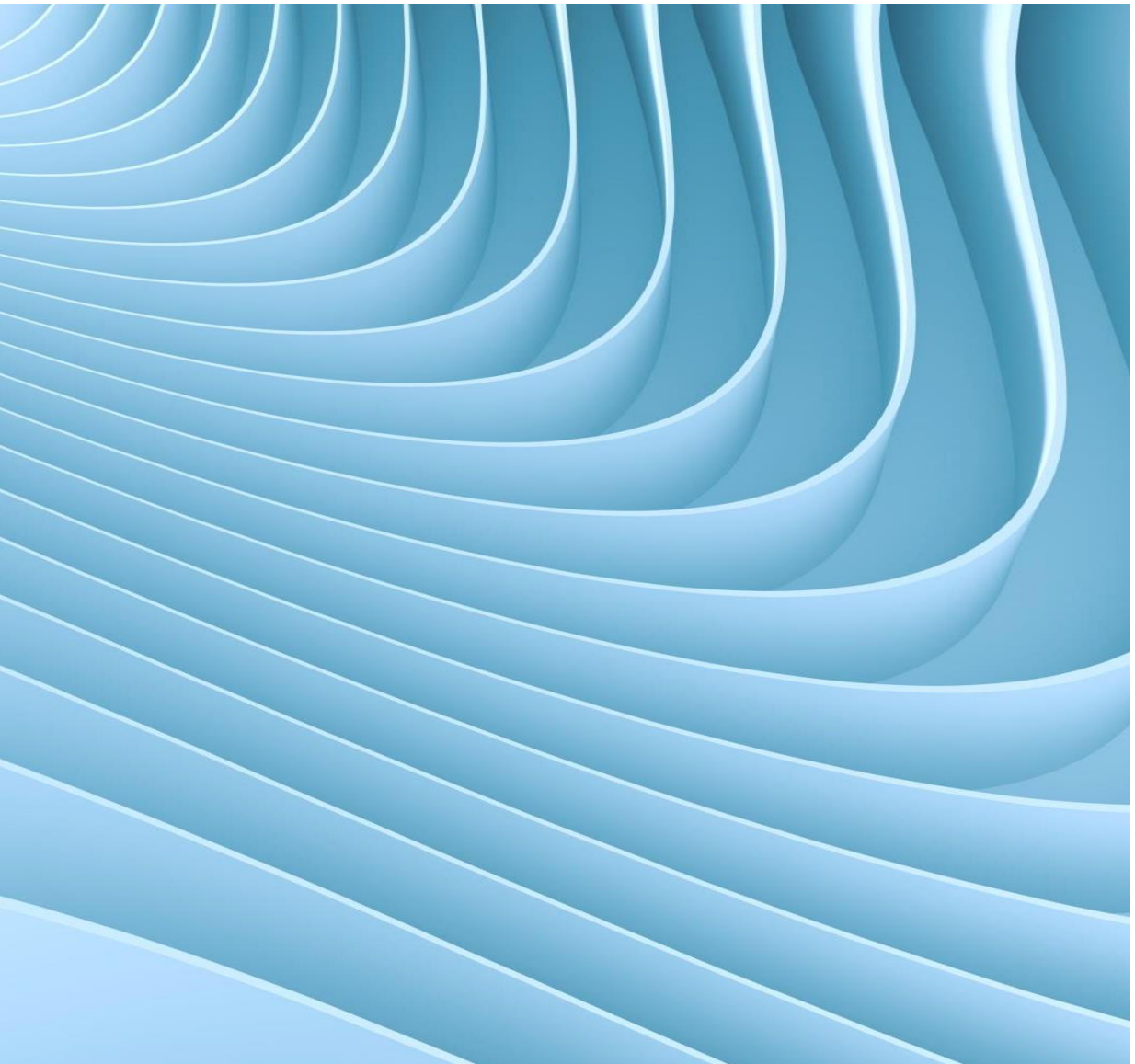
Computer manufacturing capacity has risen sharply

Capacity growth has accelerated from 3.7% y/y in 2024 to 7% y/y in January-February 2026. Despite the surge in computer output over the past year, capacity utilization has barely risen, and is fairly low, suggesting further room to run for productivity growth.

Modest increase in computer manufacturing capacity utilization in 2025, amid rapid growth in capacity



Morgan Stanley



Consumer Effects of AI: Why Affluent Consumers May be Safer than Advertised

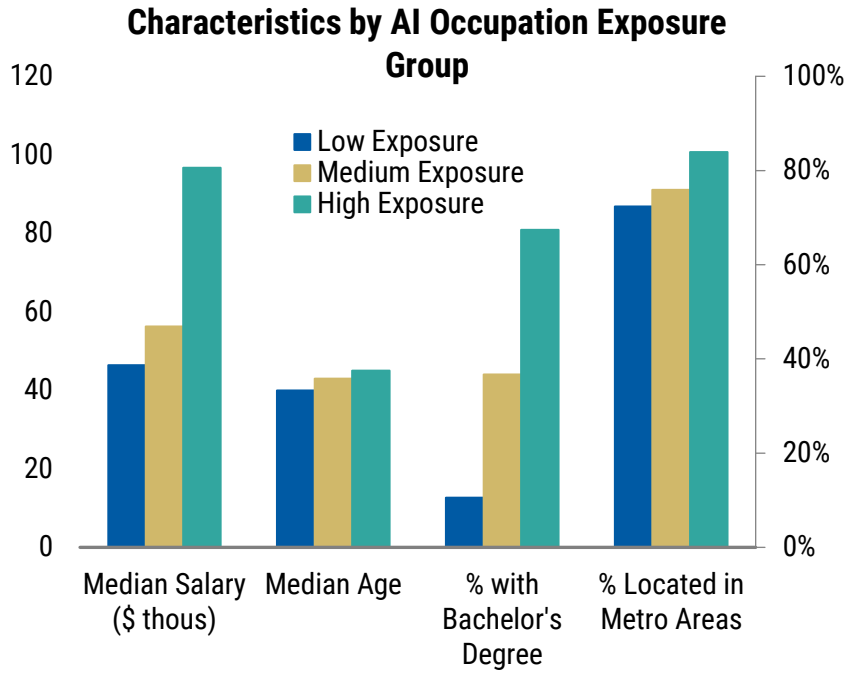
While college-educated, high-income, city-dwelling ("CHIC") households are more exposed to labor displacement risk, they are also more exposed to AI upside from wealth effects, job creation, and disinflation. On net, these households benefit most in the base case, though career stage will still be an important distinction.

In a bear scenario of rapid diffusion, CHIC households are first affected by displacement, but the resulting aggregate demand shock spreads the weakness across cohorts, and monetary and fiscal policy responses will be key.

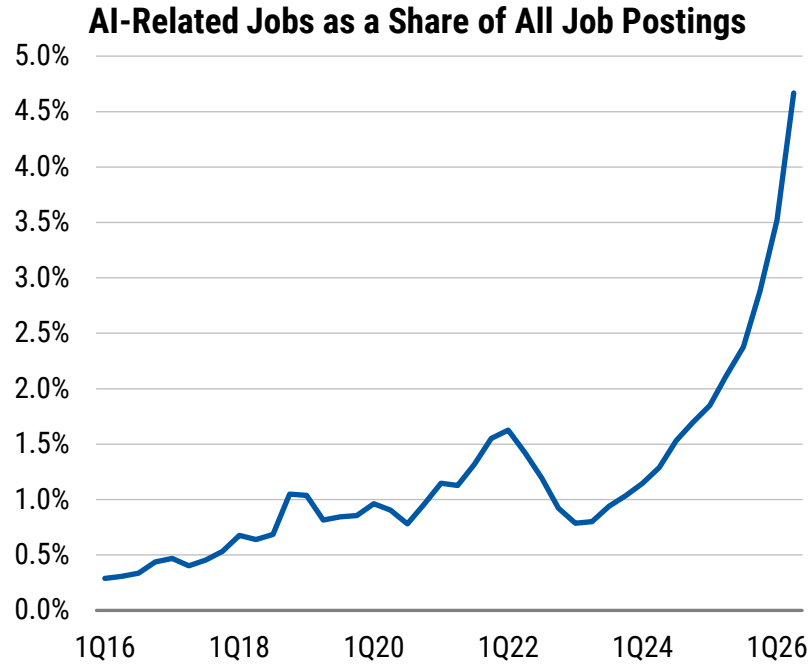
CHIC households are most exposed to job loss … and job gains

High AI exposure occupations tend to be concentrated amongst CHIC households. Within this group, younger workers are so far more affected by displacement, while for more experienced workers, exposure could mean augmentation. It is still early to see job creation, but so far new AI-related occupations have been aimed at these same higher-income consumers in similar "highly-exposed" industries.

High exposure AI occupations tend to be higher-income, more educated, and concentrated in cities



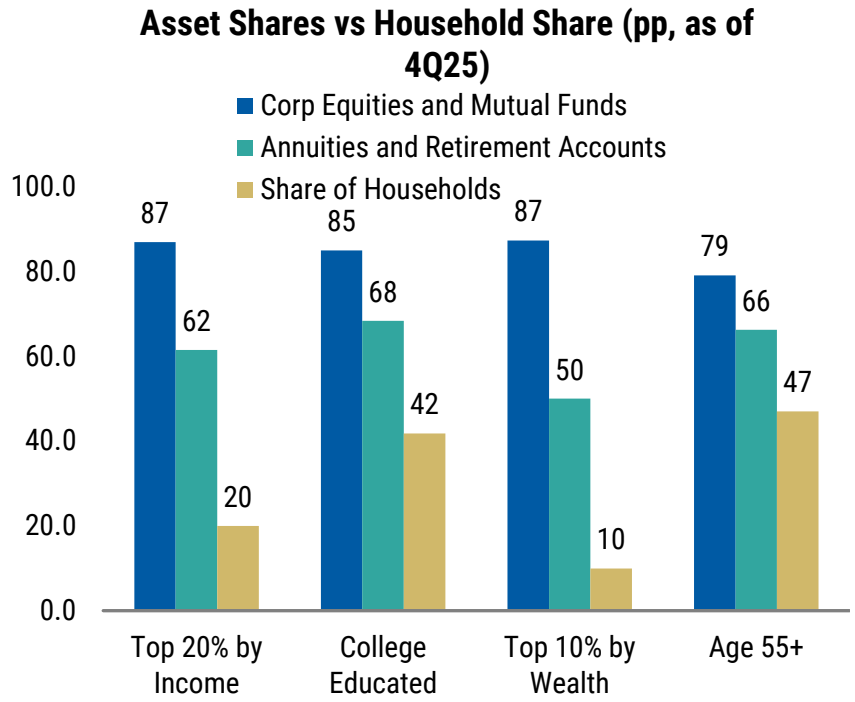
AI-related jobs postings, aimed at these same consumers, are growing as a share of postings



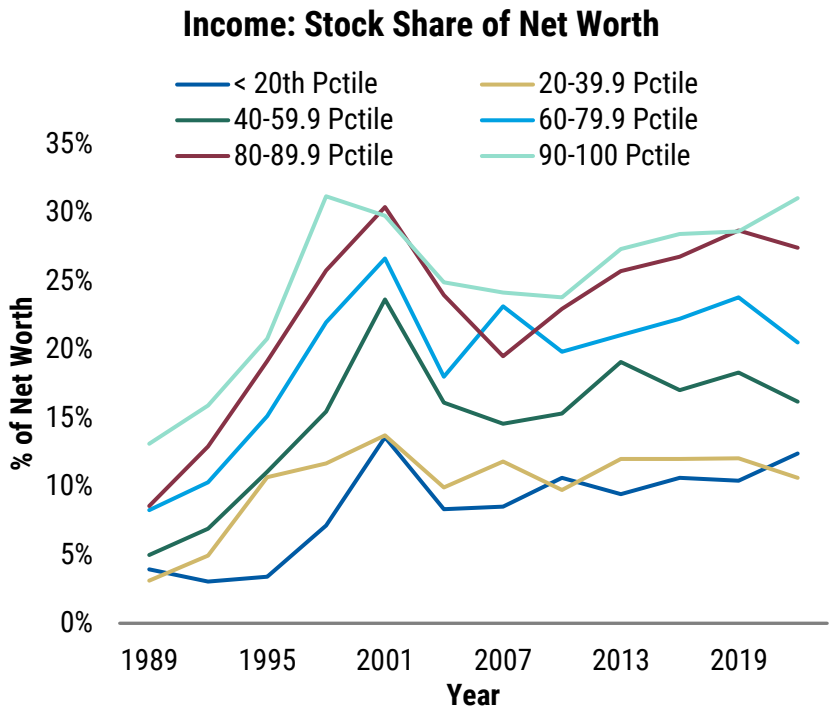
CHIC households are more exposed to potential gains in capital returns

CHIC households, and especially older CHIC households, have more equity exposure, both in absolute terms and as a share of their own net worth. Among lower-income and less-educated households, a smaller share have any equity exposure at all.

High-income, older, college-educated consumers hold a vast majority of household equity wealth



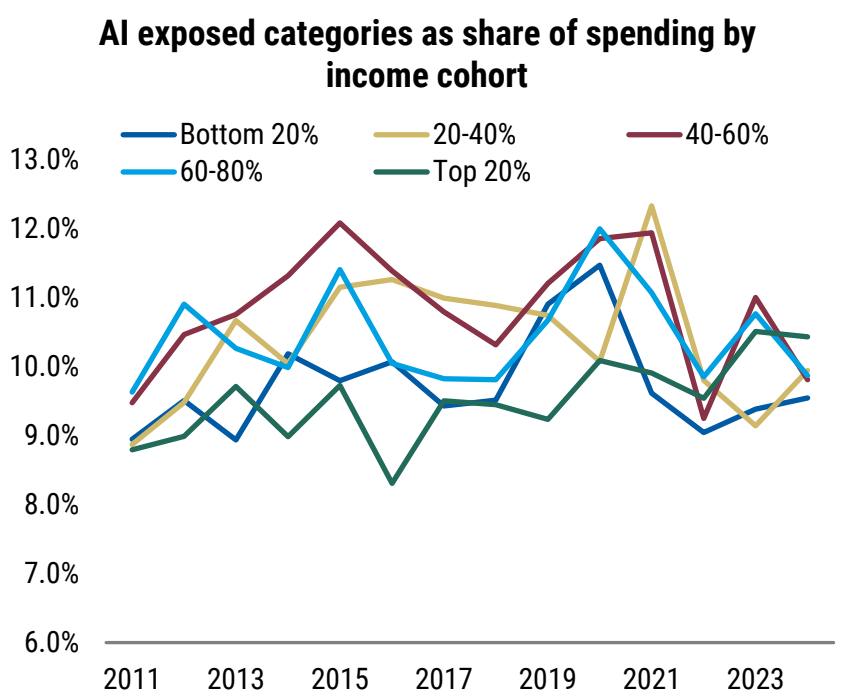
Equities also make up a larger share of net worth for these consumers



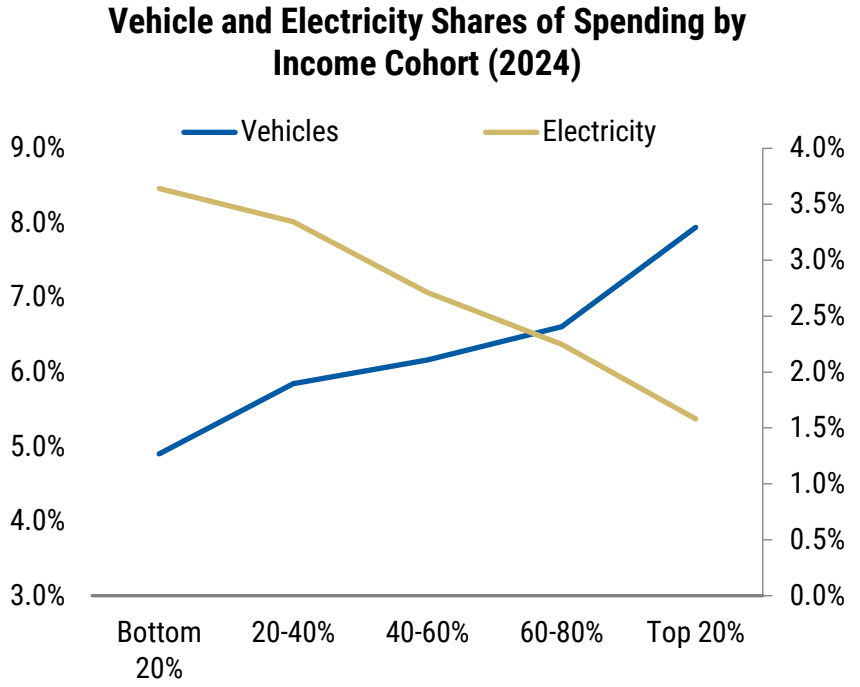
We expect CHIC households are less exposed to near-term AI price pressures

While overall exposure to near-term AI price pressures is similar across income cohorts, low-income consumers are more exposed to electricity, where we have already seen some evidence of higher inflation. We also expect high-income, older households to benefit first from productivity-driven disinflation in services.

We expect near-term AI price pressures could come from electricity, software, and chip-related goods



Lower-income households have more exposure to electricity while higher-income are more exposed to vehicles



Note: In left chart "AI exposed categories" include electricity, vehicles, computers, telephones, computer software, video game hardware and accessories, and major appliances. Source: BLS, Haver

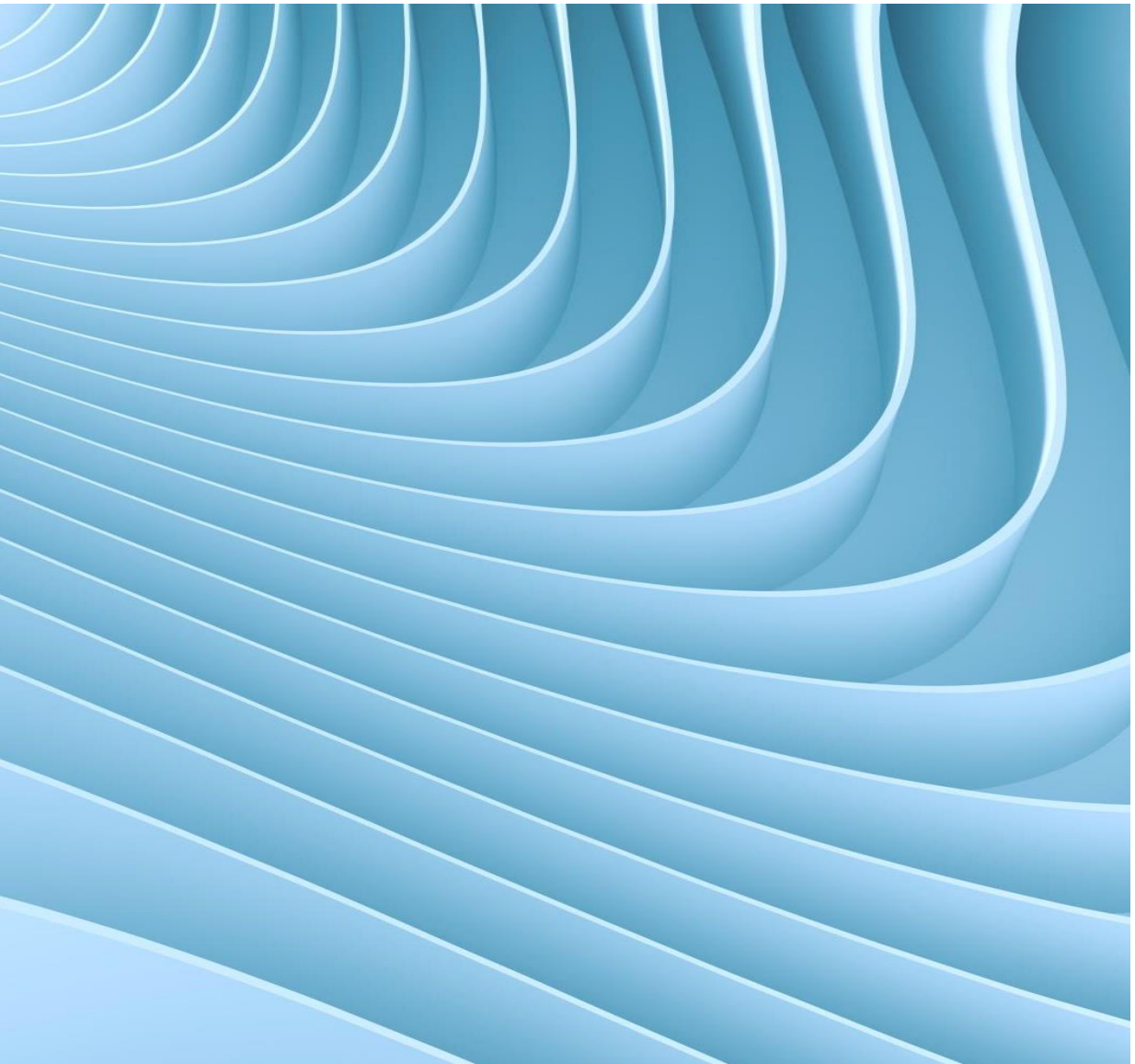
CHIC households benefit most in base case, with risks from rapid diffusion

Elevated equity wealth relative to labor income makes asset markets an important driver of spending for high-income and older consumers. For this cohort as a whole, relatively modest increases in asset markets can offset the spending effects of temporary declines in labor income. In our base case, these consumers benefit most, and income and wealth inequality widen. In a scenario of rapid diffusion or asset market declines, these consumers could be first affected by displacement, with weakness eventually spreading to other cohorts as well.

Top 20% Income Cohort: Percentage increase in permanent equity wealth needed to offset a 1% decline in labor income

		Marginal propensity to consume out of labor income							
		50%	60%	70%	80%	85%	90%	95%	100%
Marginal propensity to consume out of financial wealth	1%	8%	10%	12%	13%	14%	15%	16%	17%
	2%	4%	5%	6%	7%	7%	7%	8%	8%
	3%	3%	3%	4%	4%	5%	5%	5%	6%
	4%	2%	2%	3%	3%	4%	4%	4%	4%
	5%	2%	2%	2%	3%	3%	3%	3%	3%
	6%	1%	2%	2%	2%	2%	2%	3%	3%
	7%	1%	1%	2%	2%	2%	2%	2%	2%
	8%	1%	1%	1%	2%	2%	2%	2%	2%

Morgan Stanley

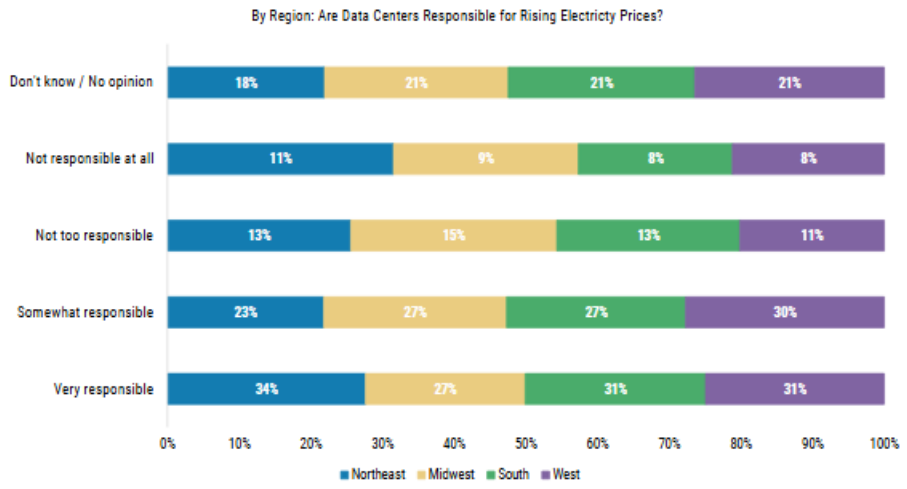


Are Data Centers Really Driving Consumer Electricity Bills Higher?

Are data centers responsible for higher utility prices? The public says yes.

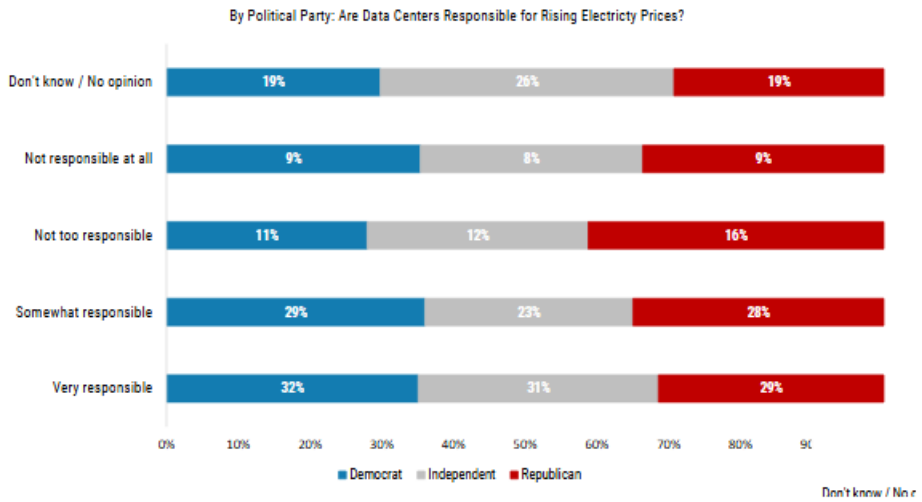
Across regions, with 55–60% saying data centers are at least somewhat responsible for higher electricity prices, regardless of whether consumers live in states with regulated or deregulated electricity markets. A similar pattern emerges across political affiliations: 54–61% attribute at least some responsibility to data centers, with Democrats at the upper end of the range and Independents at the lower end. Notably, roughly 30% of respondents in every region and political group view data centers as very responsible for rising electricity costs.

By Region: Are Data Centers Responsible for Rising Electricity Prices?



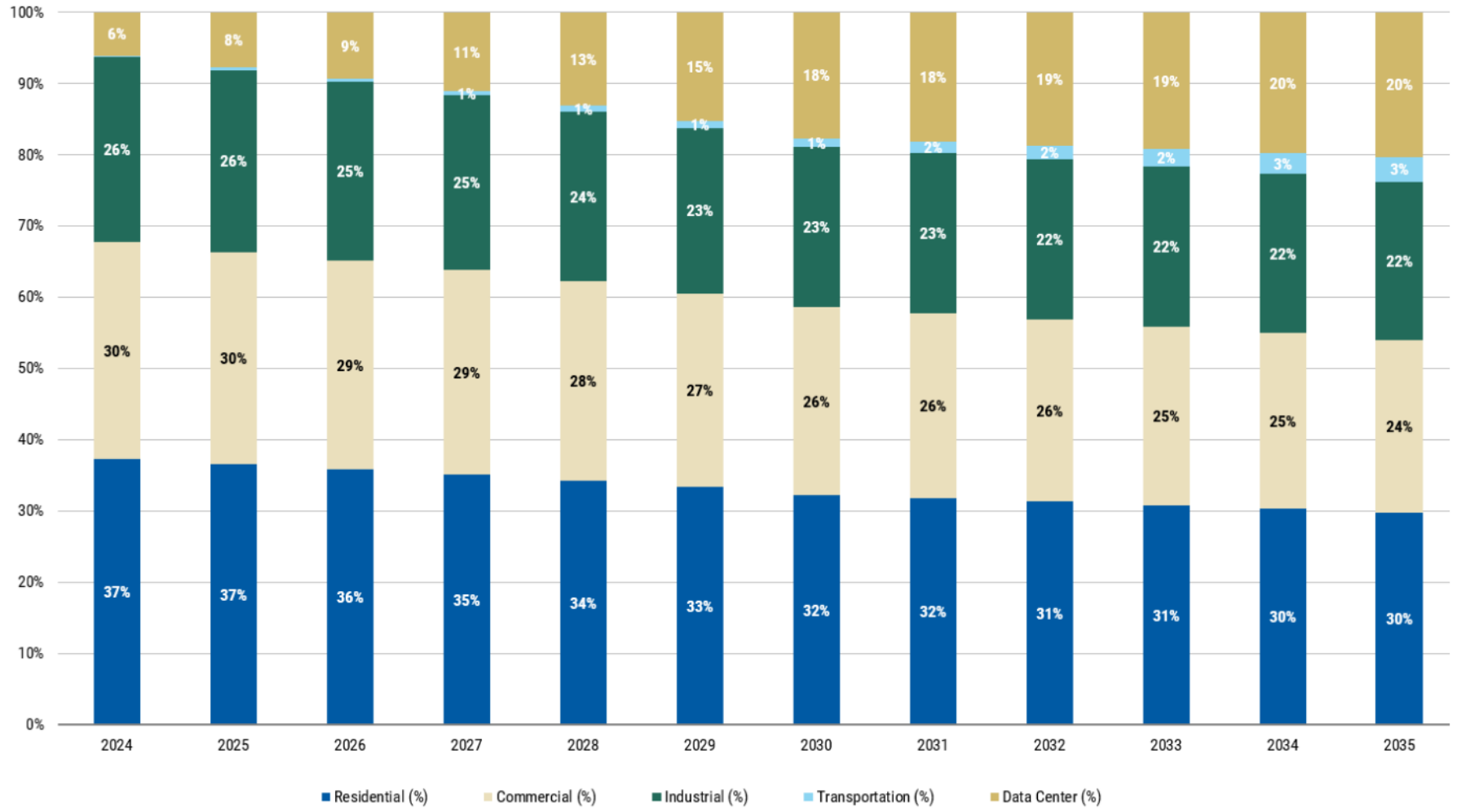
Source: Morning Consult, AlphaWise Web Intelligence

By Political Party: Are Data Centers Responsible for Rising Electricity Prices?



Source: Morning Consult, AlphaWise Web Intelligence

Data centers will take share of US electricity demand



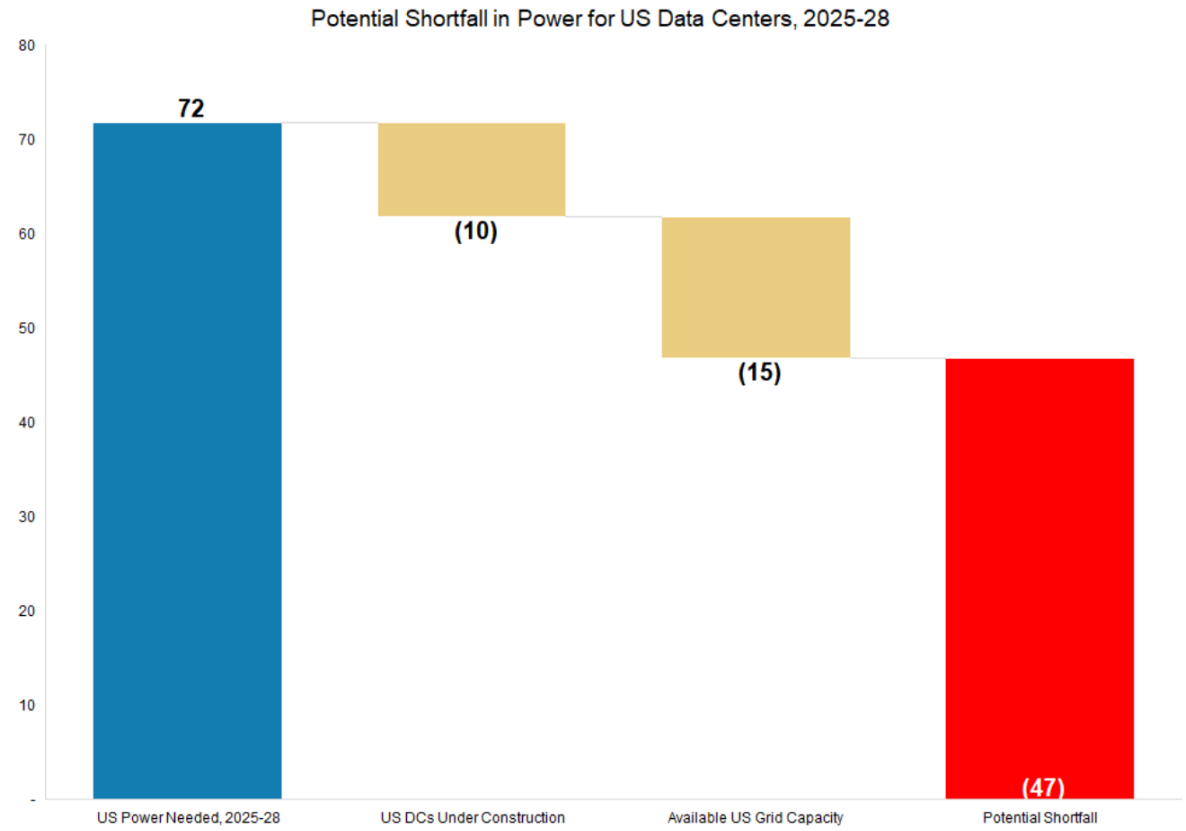
Source: EIA, Morgan Stanley Research estimates

Data centers will take share of US electricity demand

Our projected U.S. power shortfall facing developers through 2028 now totals 47 gigawatts (GW), up from 44 GW previously.

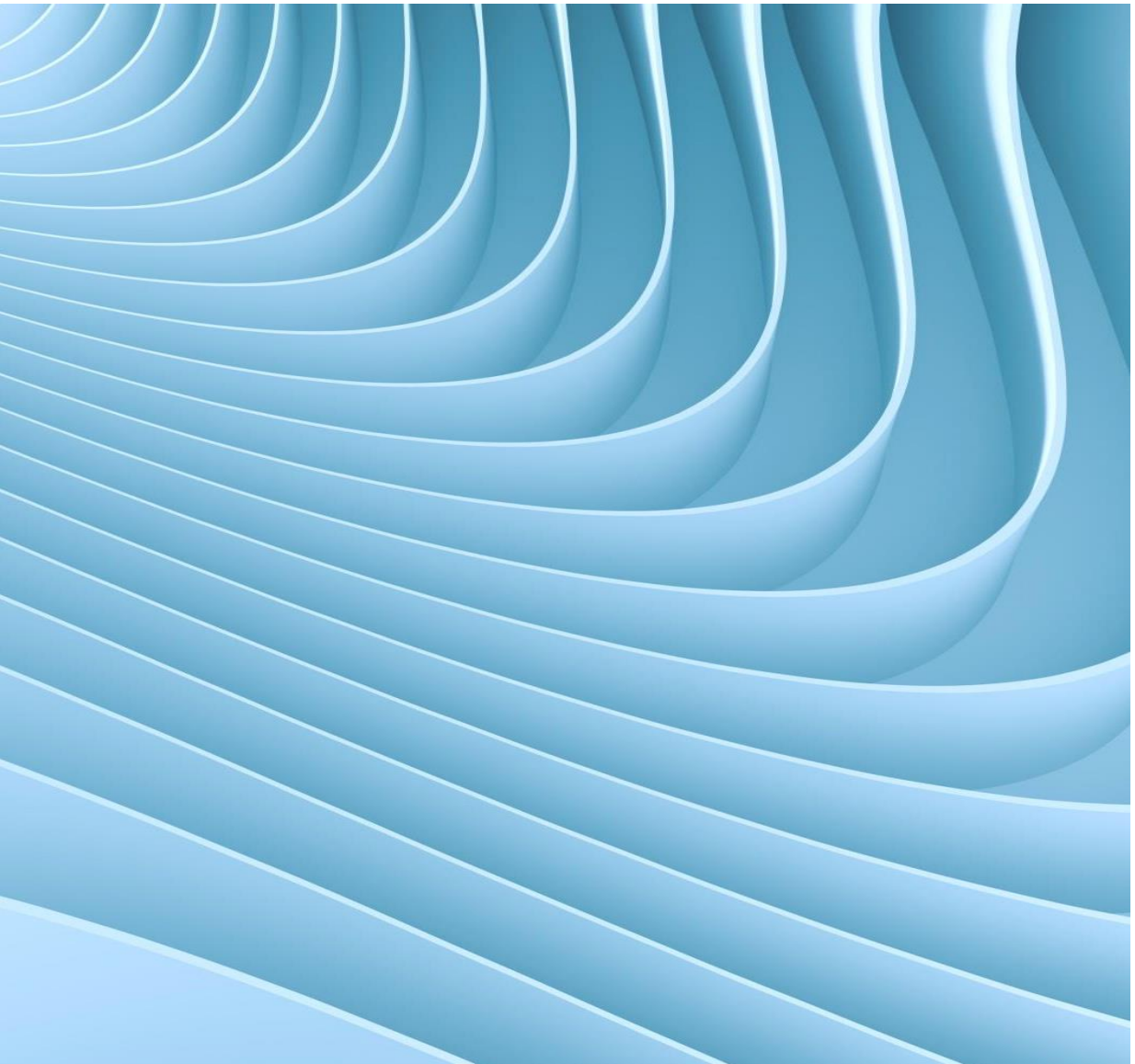
For reference, Miami-Dade uses ~5 GW of power, and the greater Philadelphia area uses ~3 GW.

Some of this gap can come from other sources, but a shortfall will remain.



Source: Morgan Stanley Research

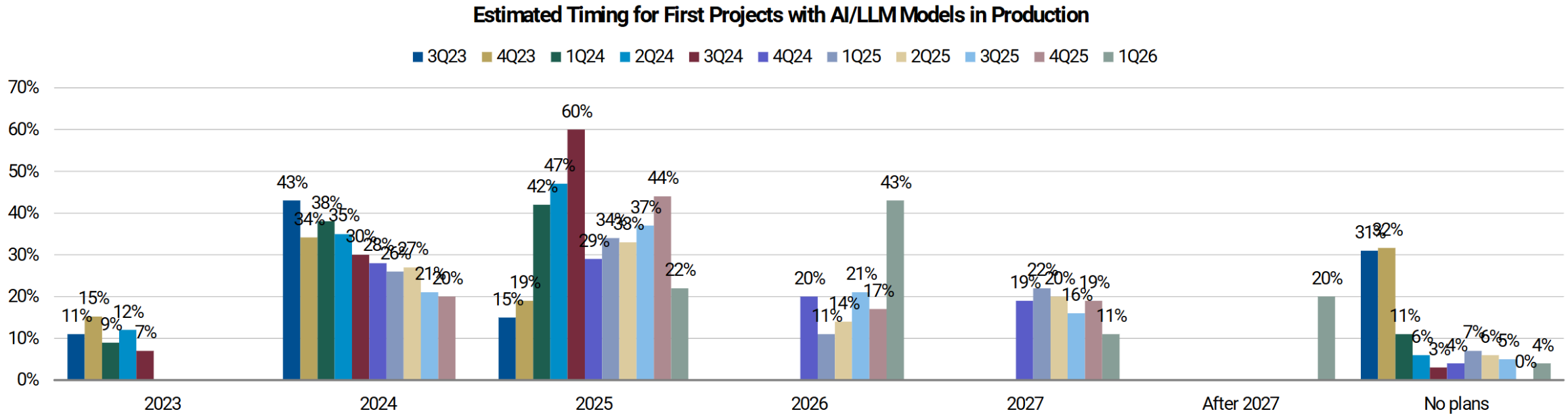
Morgan Stanley



Micro evidence on usage

About 25% of S&P500 firms are identifying some financial or productivity benefit from AI usage.

The Majority of CIOs Expect to Have AI Projects in Production by the End of 2026



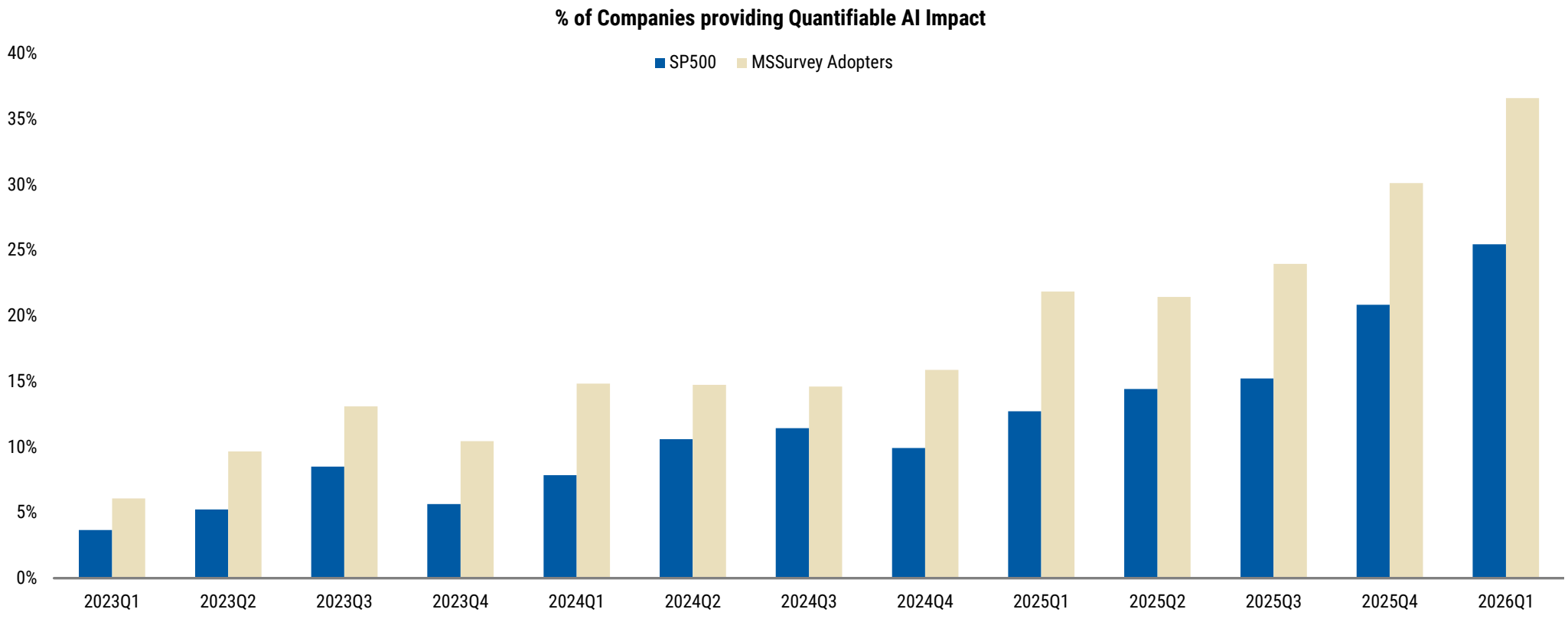
How Are Companies in Different Sectors Adopting AI?

Consumer	Energy & Materials	Financials & REITs	Health Care	Industrials	Tech, Media, & Telecom
Visual Search	Predictive Maintenance	Fraud Detection & Prevention	Medical Imaging	Autonomous Trucks	Ad/Content Generation
Smart Kitchens	Smart Grids	Alternative Credit Scoring	Drug Discovery	AI Enabled Factory Robots	Coder Assistance Tools
Autonomous Delivery	Carbon Tracking	Automated Back Office Tasks	Clinical Decision Support	Predictive Quality Control	Real Time Translation
Customer Service Automation	Exploration & Drilling	Robo-Advisors	Predicting Drug Trial Success	Supply Chain Resilience	Churn Prediction
Demand Forecasting		Customer Onboarding/KYC	Production Efficiency		Personalized Travel Planning

Boxes without an outline are examples of digital AI applications while boxes with an outline are examples of physical AI applications.

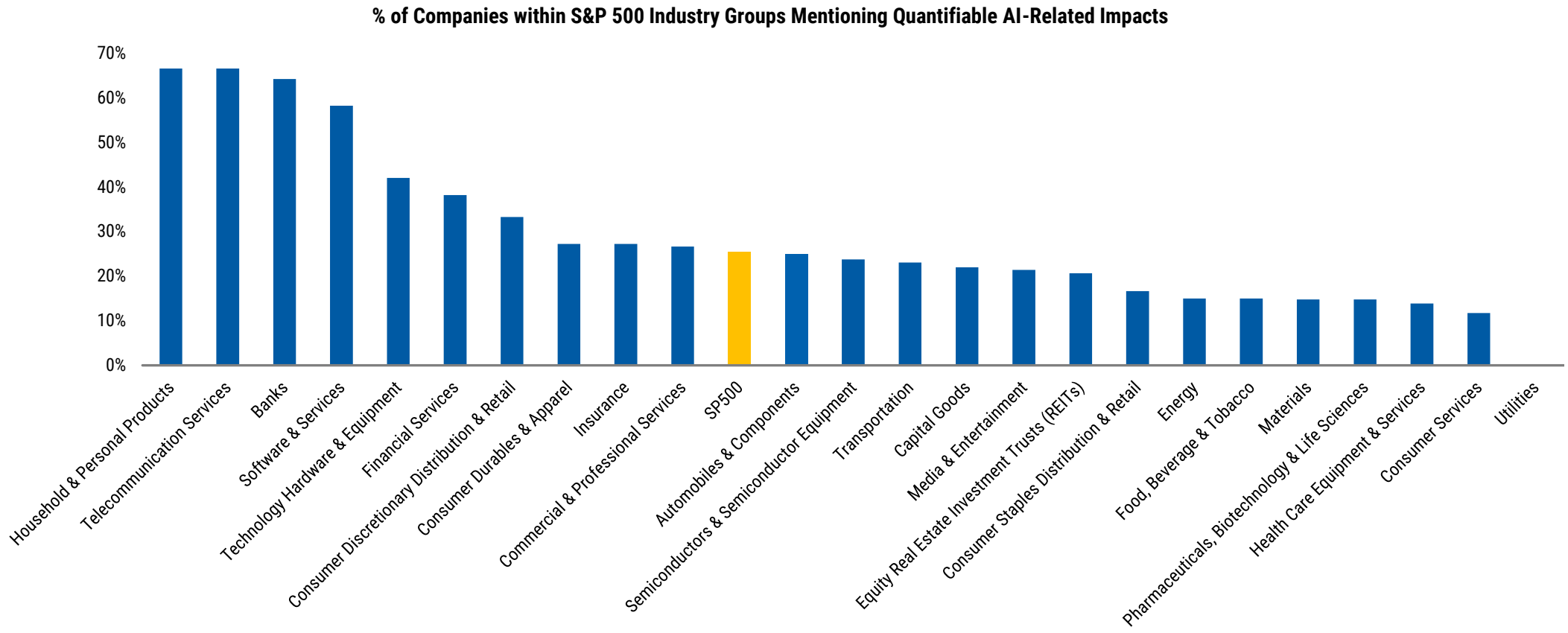
How is AI usage progressing?

Discussions of Quantifiable Benefits from AI Are Rising

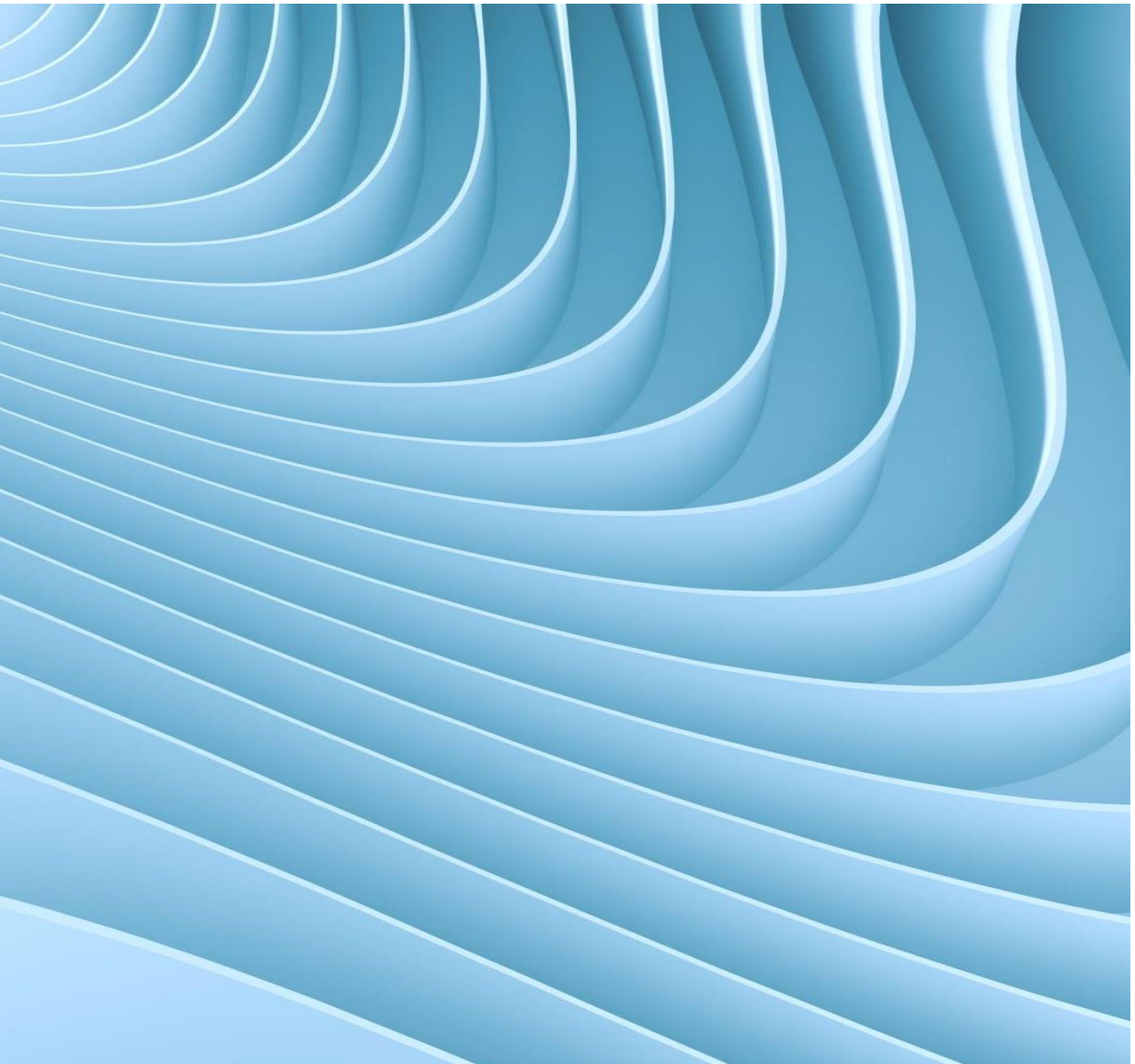


How is AI usage progressing?

Percent of Companies within S&P 500 Sectors Mentioning Quantifiable AI-Related Impacts



Morgan Stanley



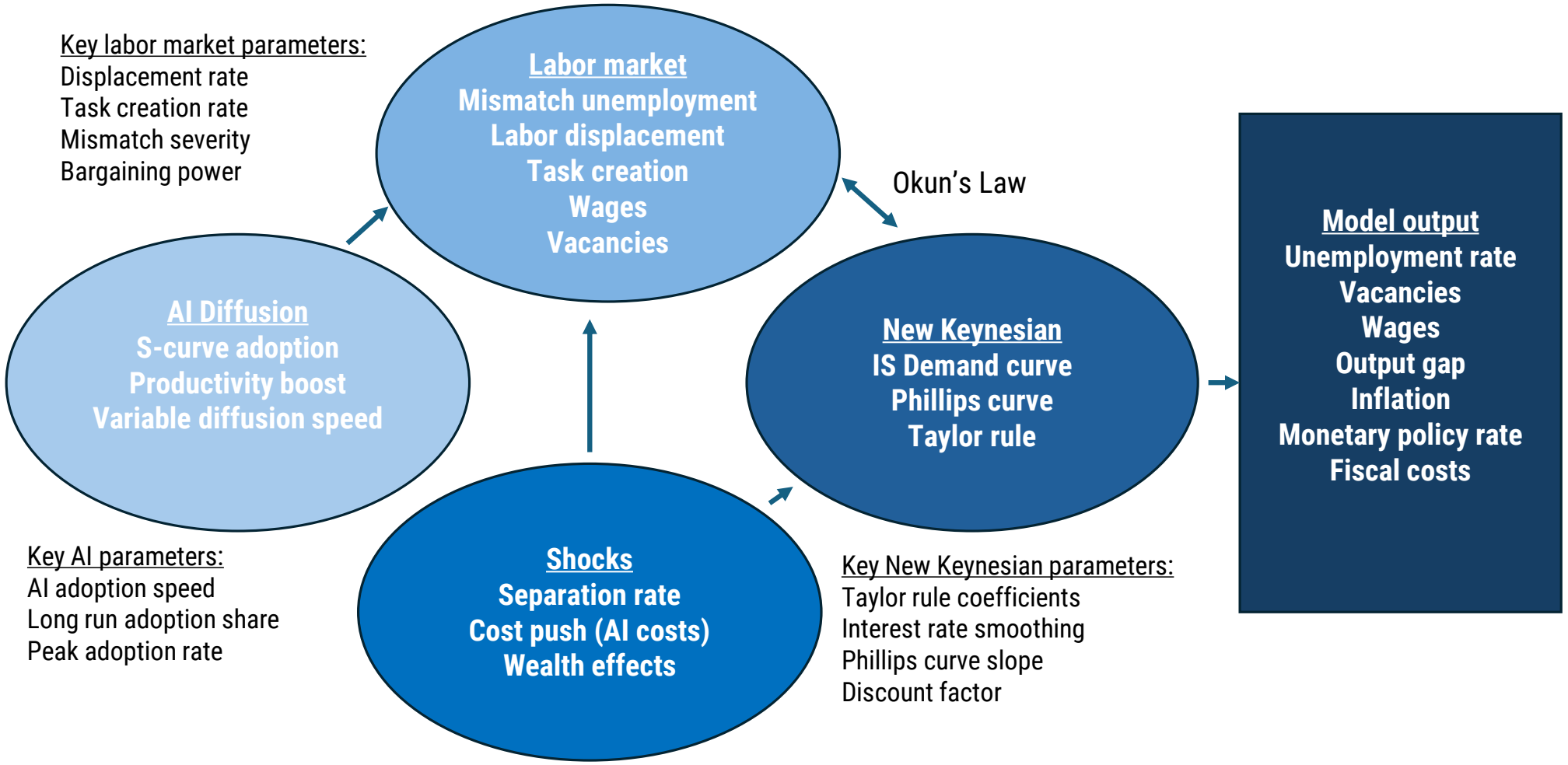
Labor displacement risks from AI

What might less favorable labor market outcomes look like if AI adoption proves disruptive?

Our baseline assumes AI diffuses at roughly twice the pace of the internet era, boosting productivity without a meaningful rise in unemployment or triggering a downturn.

Risks are highly sensitive to diffusion speed: much faster "overnight" adoption (3–4x internet pace) generates significant displacement, while new tasks, job creation, and policy feedbacks meaningfully dampen transition costs.

A unified framework



Three races that define our macro framework

1. Speed of adoption vs. labor-market adjustment:

a) Transition hinges on speed mismatch: outcomes depend on whether AI diffusion outpaces the labor market's ability to retrain and rematch workers.

b) Fast adoption = transition shock: front-loaded displacement and skill mismatch drive unemployment, disinflation risk, and recession-like dynamics despite similar long-run gains

2. Labor displacement vs. new task creation

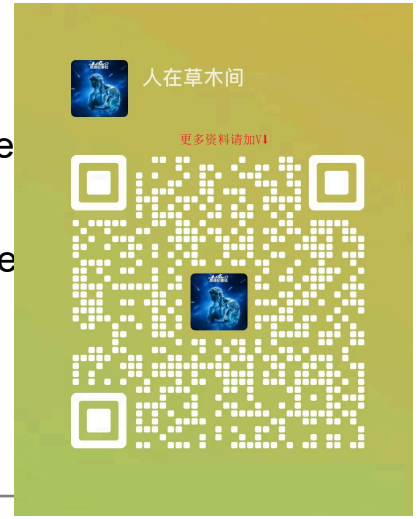
a) Job impact depends on the balance: AI displaces some tasks but also creates new AI-complementary roles that drive vacancies and labor demand.

b) If creation lags displacement: unemployment stays elevated and demand leaks; if it keeps pace, absorption is faster and the transition is smoother.

3. Income loss vs. policy support and indirect feedback effects

a) Outcomes depend on buffers: labor income losses vs policy support, wealth effects, and new task creation dete
triggers demand shortfalls or a stable transition.

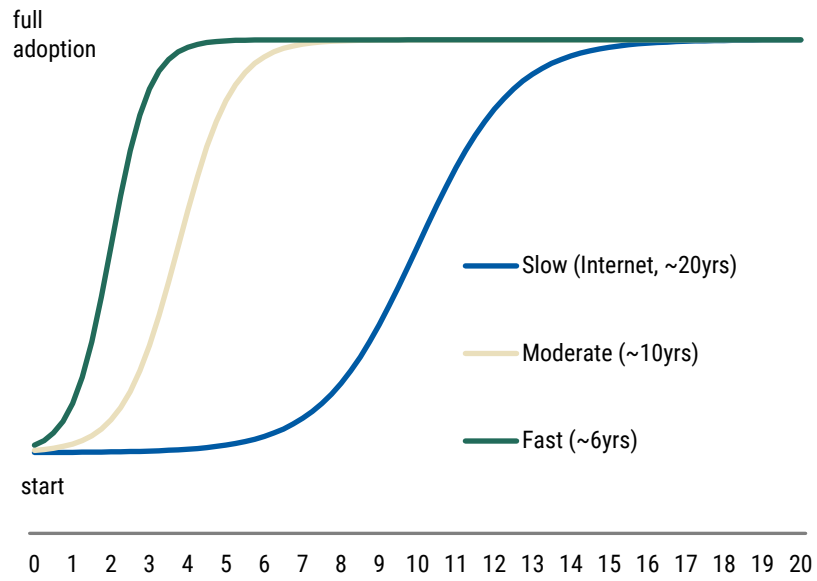
b) With full feedback loops: policy, income gains, and task creation absorb shocks—making unemployment smalle
more manageable.



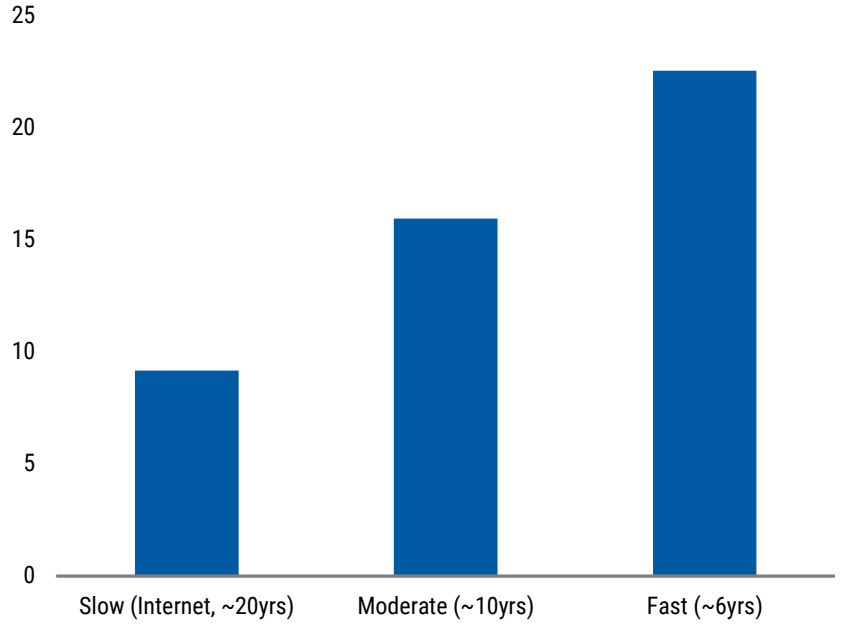
What does AI diffusion look like?

The shape of technology diffusion: As the speed diffusion increases, time to full adoption shrinks, and the peak annual rate of adoption increases in the speed of diffusion in a non-linear.

Examples of diffusion speeds - from initial to full economic integration in:



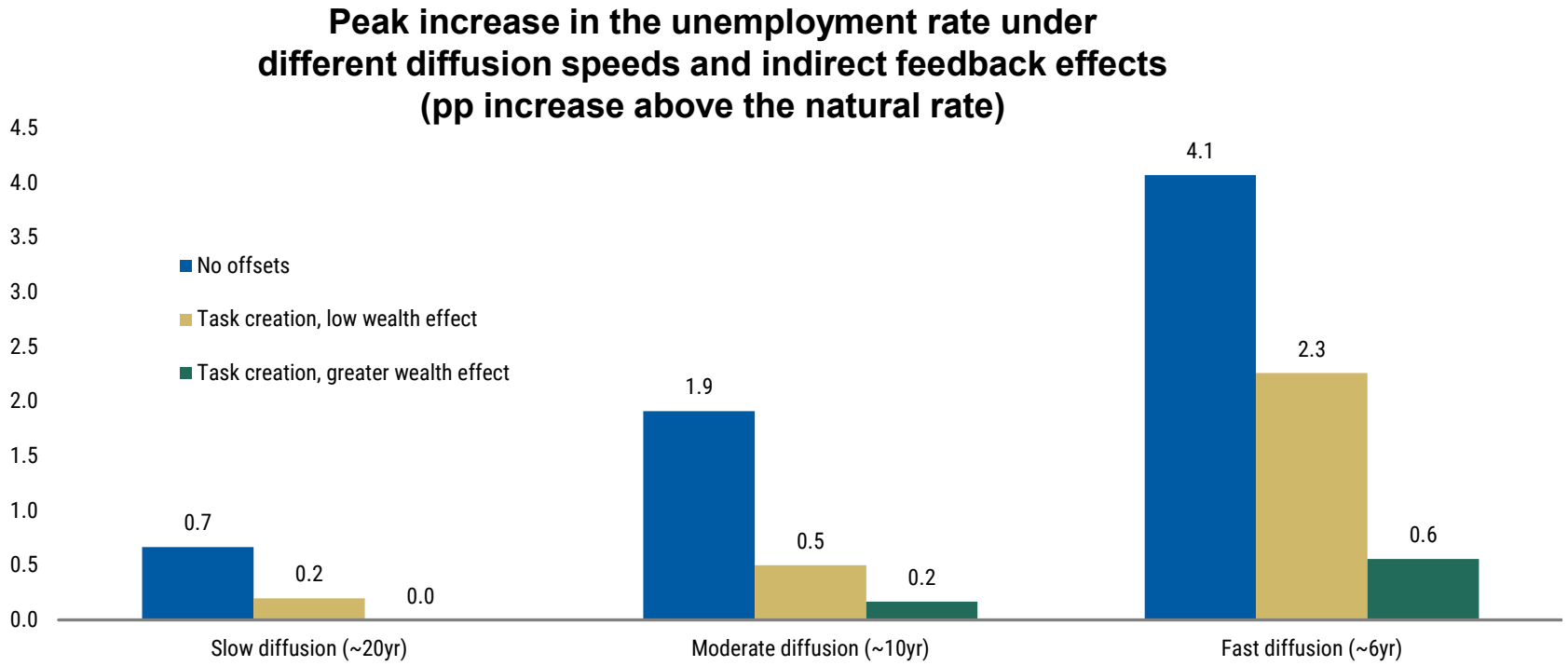
Peak diffusion rate (% of the economy that sees adoption in a year)



Note: For the left graph, the x-axis represents years and the y-axis is percent of the economy that is ultimately subject to AI diffusion and integration. In the right graph, we show the share of the economy that sees AI diffusion in a given year during peak transition, where the diffusion curve is at its steepest. Initial adoption can be similar across diffusion speeds, but the peak diffusion rate matters

Potential labor market displacement from AI adoption depends on diffusion speed and strength of feedback effects

Slow to moderate diffusion rates produce manageable labor displacement in the presence of task creation and indirect wealth effects. If feedback effects are strong, even fast diffusion produces a more manageable economic transition



Note: Different diffusion speeds are shown on the X-axis. Y-axis is pp increase in the unemployment rate above the natural rate at peak diffusion. Simulated unemployment rate paths under three different diffusion speeds – cumulative diffusion in 20 years, 10 years, and 6 years – assuming 1) low task creation with no wealth effect, 2) low task creation and low wealth effect, and 3) low task creation and

Full forecast table

	Cal. average % ch.			4Q/4Q % change			Quarterly % change, annual rate (unless otherwise noted)									
	2025E	2026E	2027E	2025A	2026E	2027E	3Q25A	4Q25A	1Q26A	2Q26E	3Q26E	4Q26E	1Q27E	2Q27E	3Q27E	4Q27E
Real GDP	**2.1**	**2.2**	**2.5**	**2.0**	**2.3**	**2.6**	**4.4**	**0.5**	**2.0**	**2.3**	**2.3**	**2.5**	**2.4**	**2.6**	**2.6**	**2.6**
Final Sales [1]	2.2	2.3	2.3	2.2	2.1	2.3	4.5	0.3	1.6	2.3	2.2	2.4	2.1	2.4	2.4	2.4
Final Domestic Demand [2]	**2.4**	**2.2**	**2.6**	**1.8**	**2.4**	**2.8**	**2.8**	**0.6**	**2.8**	**2.2**	**2.3**	**2.3**	**2.6**	**2.8**	**2.8**	**2.9**
Final Private Domestic Demand [3]	2.6	2.4	2.8	2.4	2.5	3.1	2.9	1.8	2.5	2.4	2.5	2.5	2.8	3.1	3.2	3.2
Personal Consumption Expenditures	2.6	2.0	2.0	2.1	1.8	2.1	3.5	1.9	1.6	1.7	1.9	1.9	1.8	2.2	2.2	2.2
— Goods	3.2	0.8	1.3	1.4	0.6	1.6	3.0	0.3	-0.1	0.5	1.0	1.0	1.2	1.7	1.7	1.7
— Services	2.3	2.6	2.3	2.4	2.3	2.3	3.6	2.7	2.4	2.3	2.3	2.3	2.1	2.4	2.4	2.4
Nonresidential Fixed Investment	4.1	6.1	7.2	5.6	7.0	8.0	3.2	2.4	10.4	5.9	5.9	5.9	7.9	8.0	8.0	8.0
— Structures	-5.3	-5.1	0.1	-5.5	-3.9	2.0	-5.0	-6.5	-6.7	-3.0	-3.0	-3.0	2.0	2.0	2.0	2.0
— Equipment	8.3	9.2	9.6	9.6	10.2	10.5	5.2	4.3	17.2	8.0	8.0	8.0	10.5	10.5	10.5	10.5
— IPP	5.6	8.8	8.0	8.0	9.2	8.0	5.6	5.4	13.0	8.0	8.0	8.0	8.0	8.0	8.0	8.0
Residential Investment	-2.2	-3.2	1.3	-3.8	-1.3	1.5	-7.1	-1.7	-8.0	1.0	1.0	1.0	1.5	1.5	1.5	1.5
Exports	1.6	3.8	1.7	1.1	4.0	1.8	9.6	-3.2	12.9	0.0	1.0	2.5	1.8	1.8	1.8	1.8
Imports	2.7	2.2	3.7	-1.9	6.0	5.0	-4.4	-1.0	21.4	-0.1	2.0	2.0	5.0	5.0	5.0	5.0
Government	1.1	0.8	1.3	-1.2	2.1	1.3	2.2	-5.6	4.4	1.4	1.4	1.4	1.3	1.3	1.3	1.3
Inventory contribution (pct pts, a.r.)	-0.1	-0.1	0.2	-0.2	0.1	0.2	-0.1	0.1	0.4	0.0	0.0	0.0	0.2	0.2	0.2	0.2
Trade contribution (pct pts, a.r.)	-0.2	0.1	-0.3	0.4	-0.4	-0.4	1.6	-0.2	-1.3	0.0	-0.2	0.0	-0.5	-0.5	-0.5	0.0
Nominal GDP (Current $)	5.0	5.8	4.7	5.4	5.4	4.7	8.3	4.2	5.6	7.5	4.3	4.1	4.7	4.5	4.6	4.9
Nominal Consumption	5.3	5.3	5.5	5.0	5.0	4.1	6.3	4.9	6.1	7.0	3.8	3.3	4.1	3.9	4.0	4.5
Employment & Personal Income																
Civilian Unemployment Rate (%)	**4.3**	**4.3**	**4.2**	**4.5**	**4.3**	**4.1**	**4.3**	**4.5**	**4.3**	**4.3**	**4.3**	**4.3**	**4.2**	**4.2**	**4.1**	**4.1**
Civilian Labor Force Participation Rate (%)	62.4	61.9	61.7	62.5	61.8	61.7	62.3	62.5	62.0	61.9	61.8	61.8	61.8	61.7	61.7	61.7
Employment to Population Ratio (%)	59.8	59.2	59.1	59.7	59.2	59.1	59.6	59.7	59.3	59.2	59.2	59.2	59.1	59.1	59.1	59.1
Average Monthly Change in Nonfarm Payrolls (Thous.)				10	43	60	23	-39	68	43	30	30	60	60	60	60
Real DPI	1.1	1.2	1.7	1.3	1.2	1.7	1.0	0.0	1.5	-0.8	1.9	2.4	1.3	1.4	2.2	2.0
Saving rate (%)	4.7	3.6	3.3	4.0	3.5	3.2	4.4	4.0	4.0	3.4	3.4	3.5	3.4	3.2	3.2	3.2
Business Indicators																
Industrial Production	1.2	2.2	1.9	1.6	2.4	2.5	2.1	-1.7	7.4	0.3	0.9	1.1	2.4	2.5	2.5	2.5
Productivity	2.3	2.3	2.0	2.6	1.8	2.1	5.2	1.8	1.6	1.9	1.7	1.9	1.9	2.2	2.2	2.2
Inflation (quarterly % change, a.r.)																
Consumer Price Index							3.1	2.5	3.6	6.9	2.0	1.3	2.1	1.5	1.8	2.6
CPI ex Food & Energy							3.2	2.0	2.8	3.2	2.5	2.3	3.0	1.9	2.3	2.8
PCE Price Index							2.8	2.9	4.5	5.1	1.8	1.4	2.3	1.7	1.8	2.2
PCE ex Food & Energy							2.9	2.7	4.3	3.0	2.1	1.9	2.9	1.9	2.1	2.4
Inflation (4-quarter % change)																
Consumer Price Index	2.7	3.5	2.1	2.7	3.4	2.0	2.9	2.7	2.7	4.0	3.7	3.4	3.0	1.7	1.7	2.0
CPI ex Food & Energy	2.9	2.7	2.5	2.7	2.7	2.5	3.1	2.7	2.5	2.8	2.6	2.7	2.7	2.4	2.4	2.5
PCE Price Index	2.6	3.4	2.0	2.8	3.2	2.0	2.7	2.8	3.1	3.8	3.6	3.2	2.6	1.8	1.8	2.0
PCE ex Food & Energy	**2.8**	**3.0**	**2.3**	**2.9**	**2.8**	**2.3**	**2.9**	**2.9**	**3.1**	**3.2**	**3.0**	**2.8**	**2.5**	**2.2**	**2.2**	**2.3**
Monetary Policy																
Fed Funds Target (%, midpoint of target range)				**3.625**	**3.625**	**3.125**	**4.125**	**3.625**	**3.625**	**3.625**	**3.625**	**3.625**	**3.375**	**3.125**	**3.125**	**3.125**
Fiscal Policy																
Federal Budget balance (% of GDP)				-5.4	-6.3	-6.1										

1) GDP less contribution from inventory investment 2) GDP less contributions from inventory investment and trade 3) GDP less contributions from inventory investment, trade, and the government sector. (Private final consumption plus investment.) Source: Bureau of