Morgan Stanley
May 27, 2026 06:47 PM GMT

MORGAN STANLEY RESEARCH
North America

May 27, 2026

AI and the Economic Transition

May 27, 2026

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All information as of May 14, 2026, unless otherwise stated.
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AI matters for our outlook on investment spending, labor markets and productivity growth

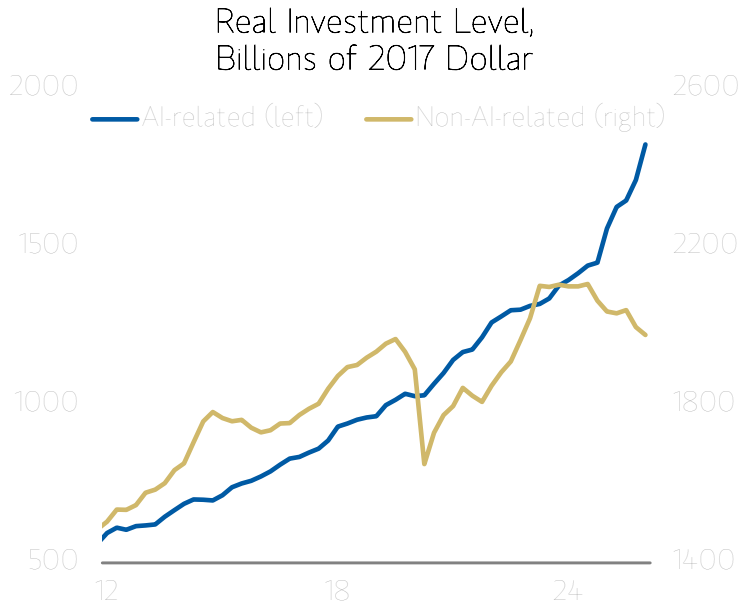
- **AI-related capex should continue to drive overall growth, supported by sustained hyperscaler spending – which should exceed $1tn in 2027 – and the ongoing buildout of compute and power capacity. AI-related spending will remain the dominant driver within business spending.**
- **Productivity gains are likely. AI, like prior general-purpose technologies, should raise output per worker, particularly with organizational change.**
- **AI-exposed industries are seeing a clearer acceleration in productivity, with output per employee rising faster in 2025 than in less exposed sectors. This reflects stronger output growth rather than widespread labor substitution.**
- **Our AI disruption tracker points to early, narrowly concentrated displacement, more evident among younger workers, while aggregate effects remain modest (at most ~10bp on the unemployment rate), alongside signs of broader task reallocation.**
- **Slow to moderate diffusion of AI produces manageable labor displacement in the presence of task creation and indirect wealth effects in our framework. If feedback effects are strong, even fast diffusion produces a more manageable economic transition**

Source: Morgan Stanley Research

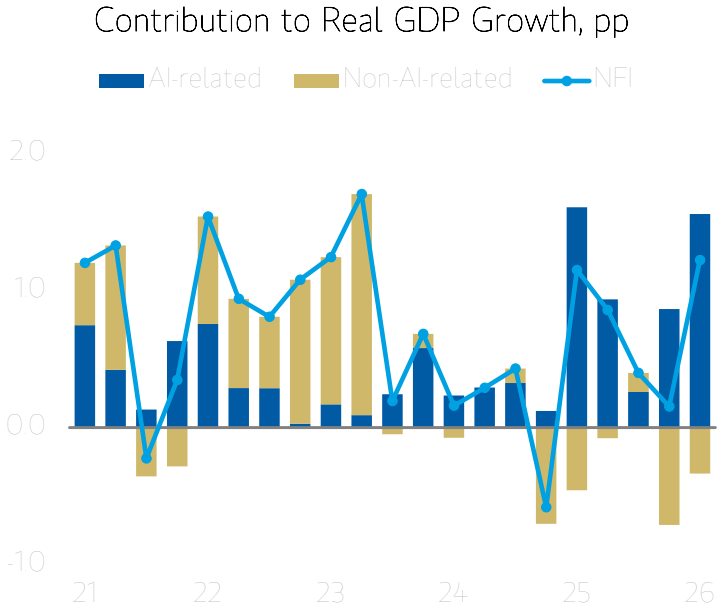
AI spending to remain robust despite the energy price shock

We expect business spending, measured by nonresidential fixed investment, to grow by 7.0% 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



Source: BEA, Morgan Stanley Research

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

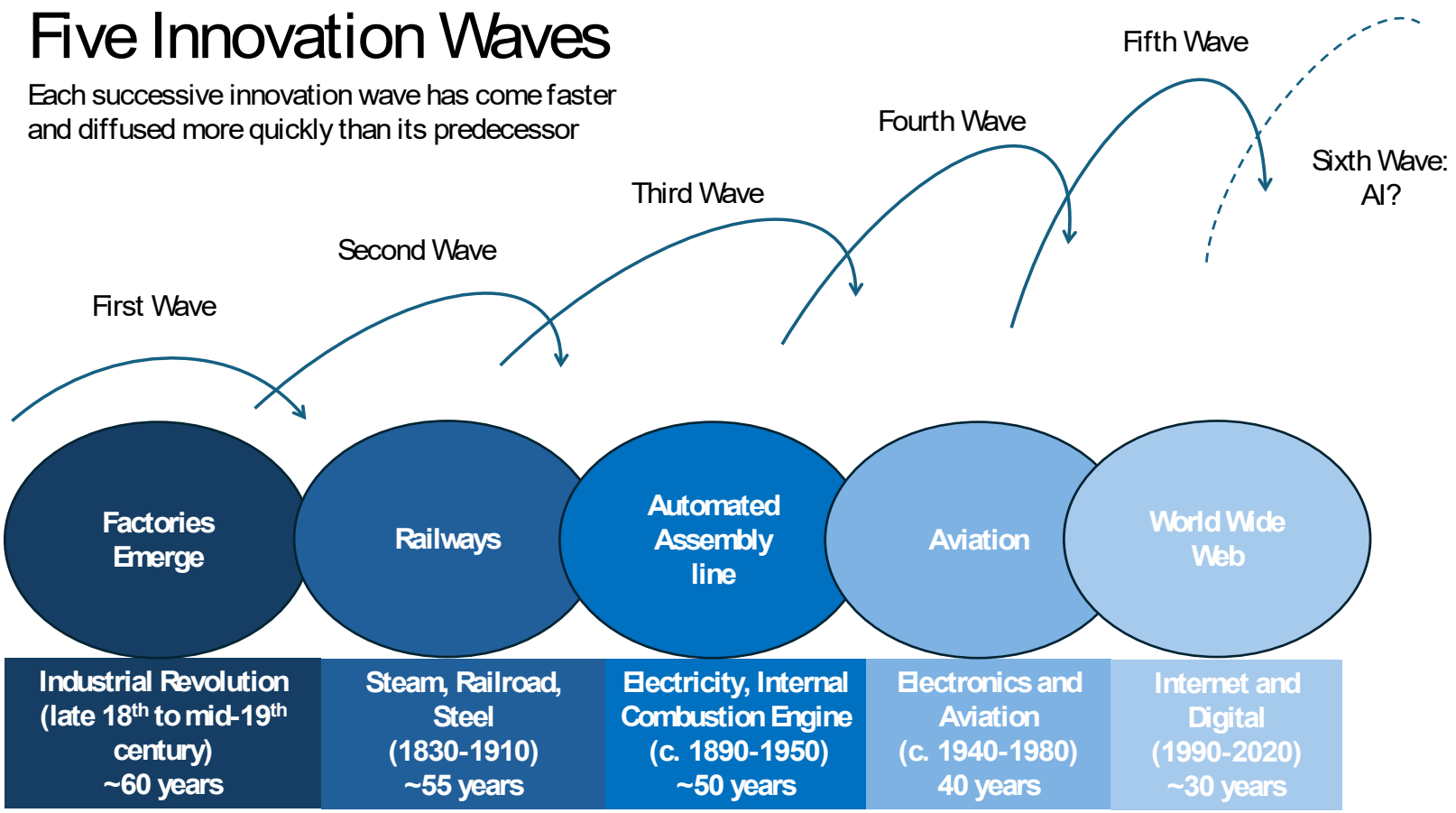
We expect AI capex to be the dominant driver of growth in NFI in 2026 and 2027. It has become a structurally driven macro force that is less sensitive to geopolitical uncertainty and traditional business cycle dynamics, supported by the buildout of foundational capacity rather than near-term demand conditions. Even after adjusting for imports, we estimate that AI-related investment and its associated productivity improvements will contribute 0.4-0.5pp 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	0.99	1.18
AI-related	0.31	0.26	0.83	1.03	0.86
Non-AI-related	0.59	-0.12	-0.08	-0.04	0.31
Imports, computers & peripherals	-0.03	-0.20	-0.68	-0.88	-0.69
Domestic AI-related investment	0.28	0.05	0.15	0.15	0.18
Productivity	0.00	0.00	0.10	0.20	0.25
AI total	0.28	0.05	0.25	0.35	0.43

Note: AI-related investment includes spending on information processing equipment, software, data centers, and power centers. Remaining categories are defined as non-AI-related spending. AI-related imports are computers and peripherals. 2026 and 2027 numbers are Morgan Stanley Research estimates. Source: BEA, Haver Analytics, Morgan Stanley Research

Lessons From the Five Innovation Waves that Preceded AI



Source: Morgan Stanley Research

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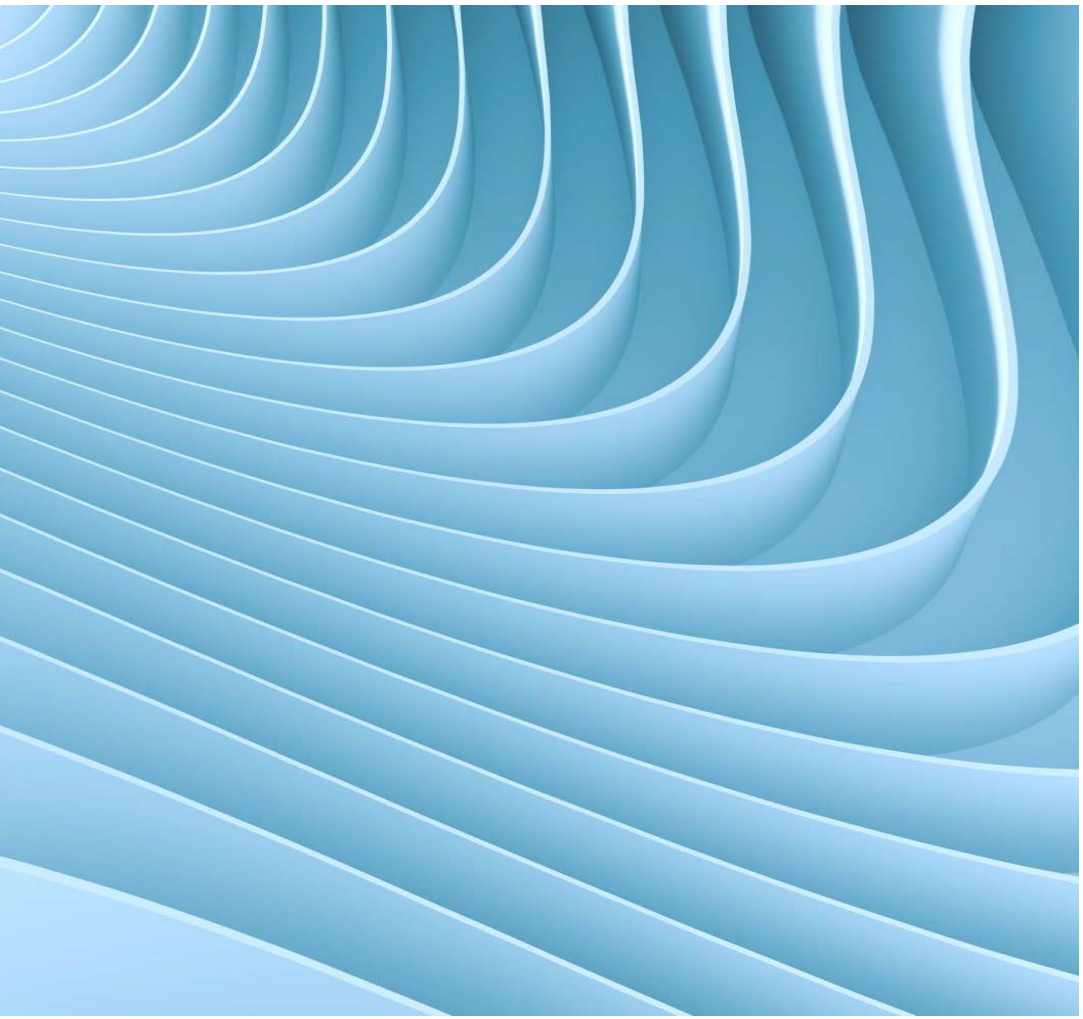


AI Labor Disruption: More Micro than Macro So Far

How is AI affecting the labor market today?

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.

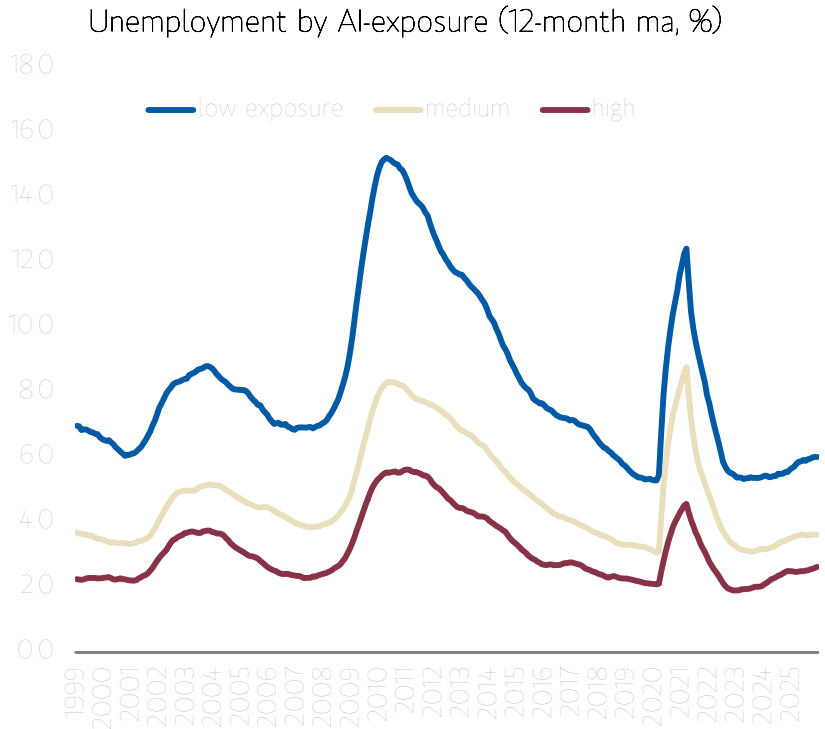
Characteristics of AI-exposure groups

	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

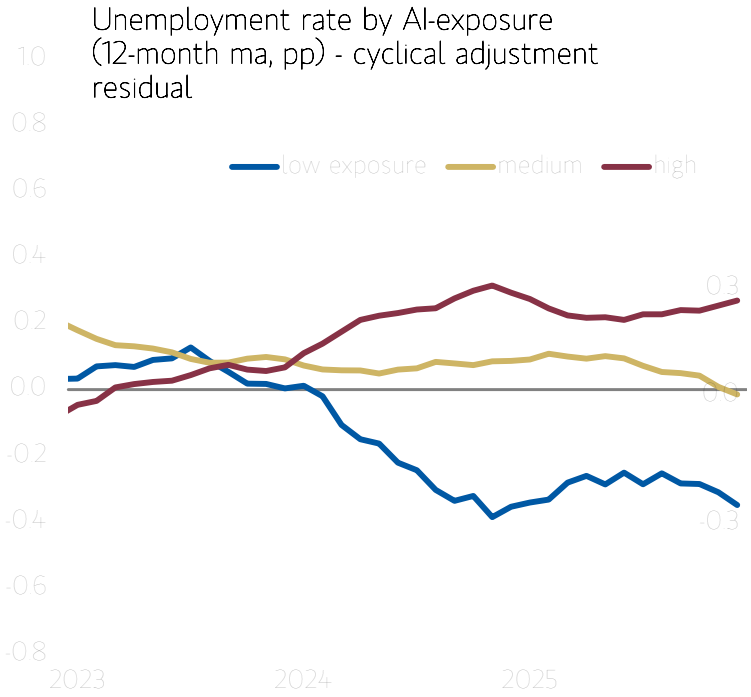
Source: IPUMS, Felten et al (2021), Morgan Stanley Research

Modest signs of disruption so far

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



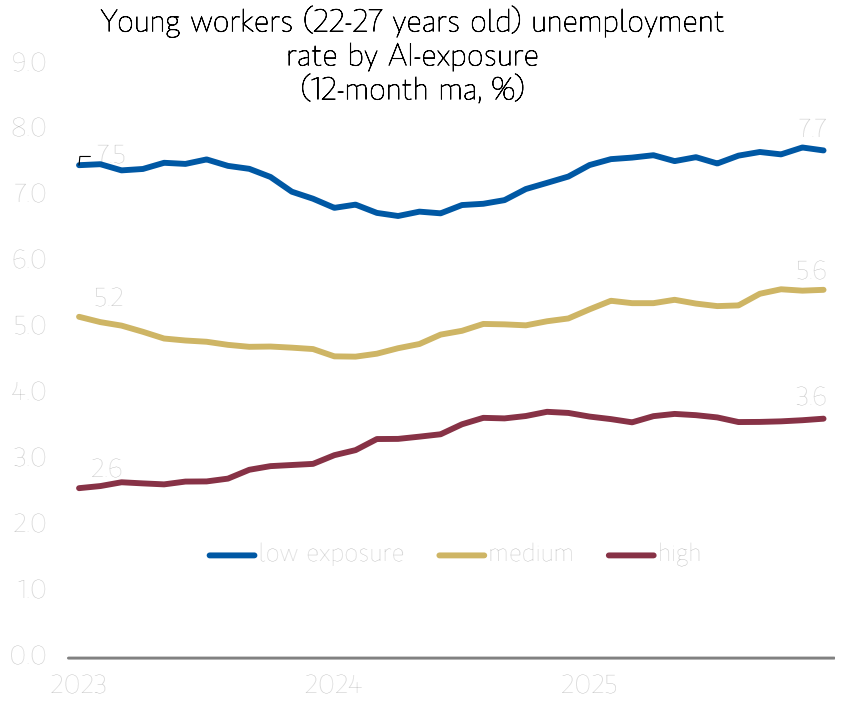
… adjusting for cyclicality, high-exposure unemployment rate runs ~0.3pp higher than normal.



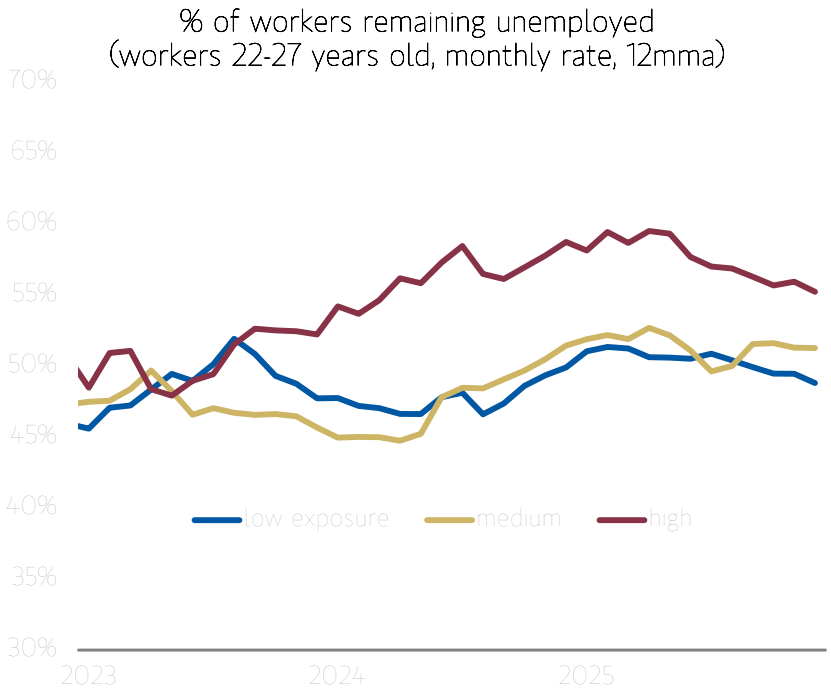
Source: IPUMS, Felten et al (2021), Morgan Stanley Research

Young workers look like the leading edge

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



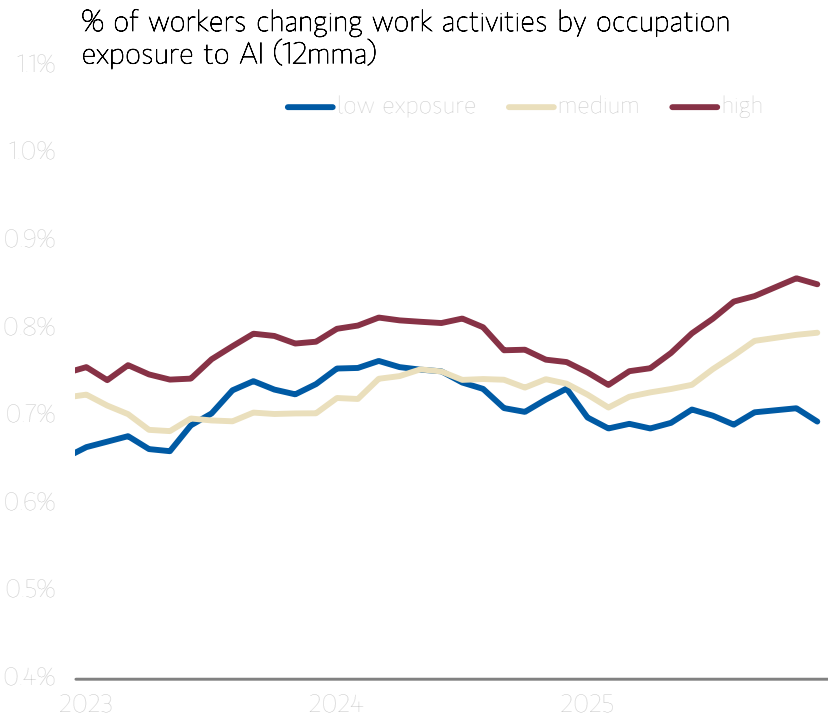
It's taking longer for young workers to find jobs that are more exposed to AI



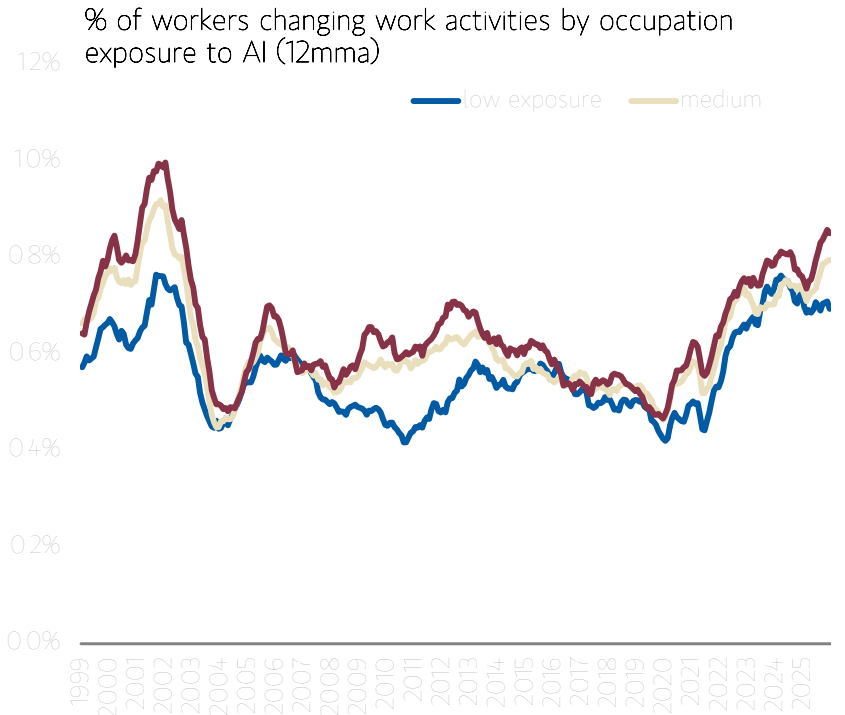
Source: IPUMS, Felten et al (2021), Morgan Stanley Research

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)



Source: IPUMS, Felten et al (2021), Morgan Stanley Research

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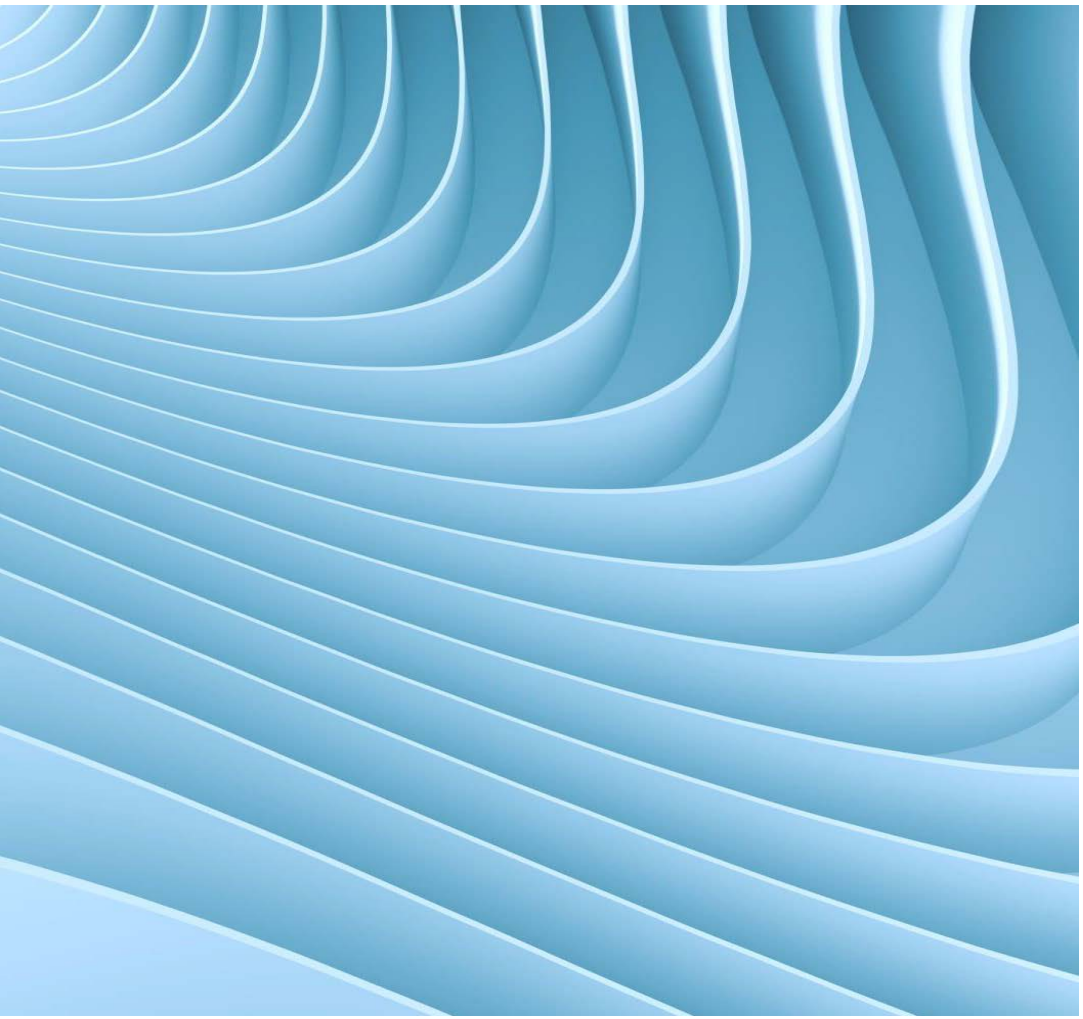


Noticeably positive output effects despite the minimal employment effects

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.

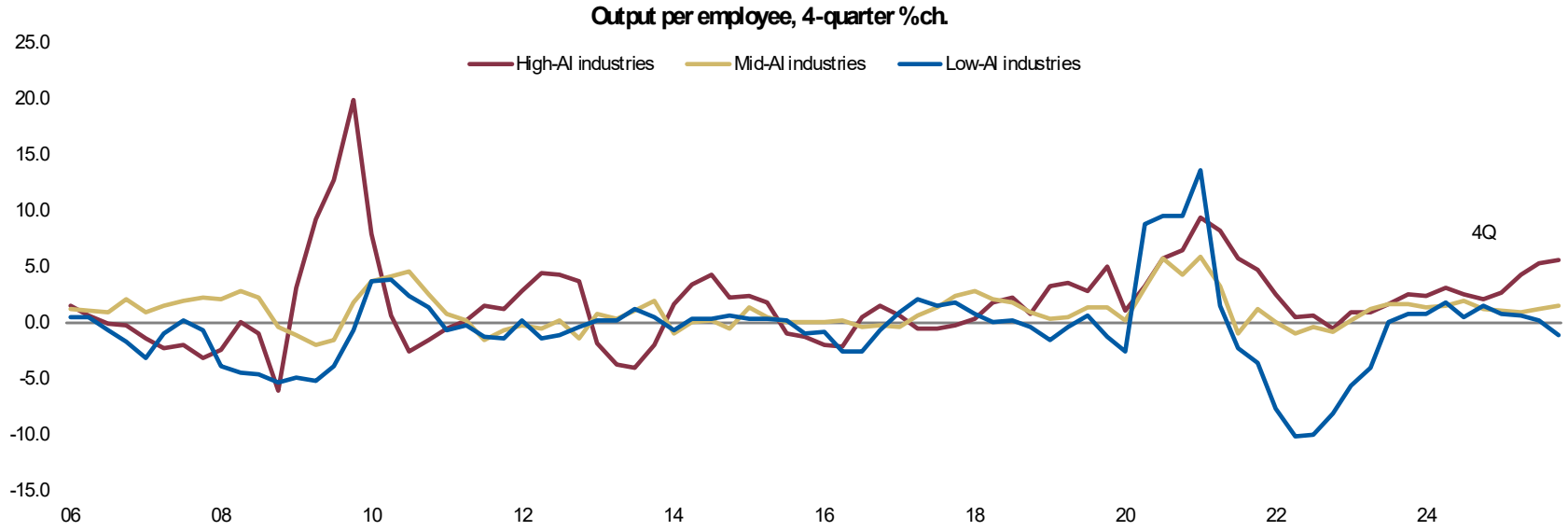
Output gains were especially clear among AI-related industries, likely reflecting capital deepening. Other industries also showed some gains.

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

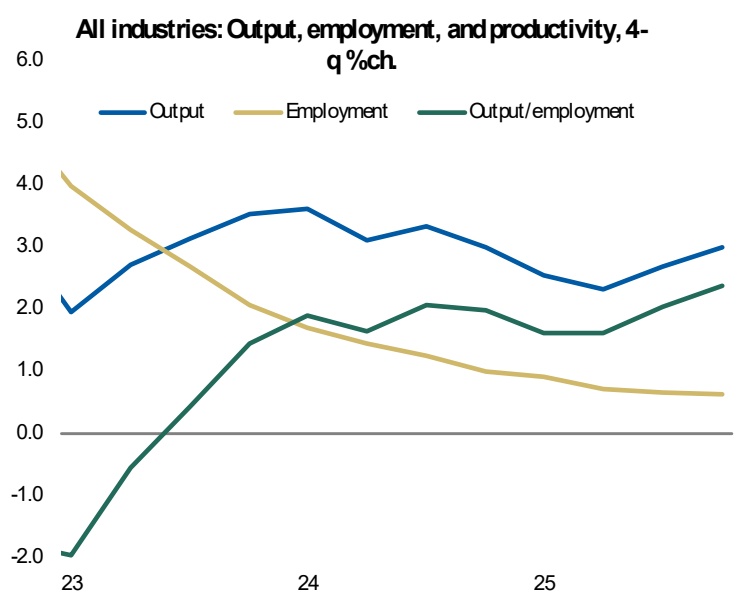


Source: BEA, BLS, Morgan Stanley Research

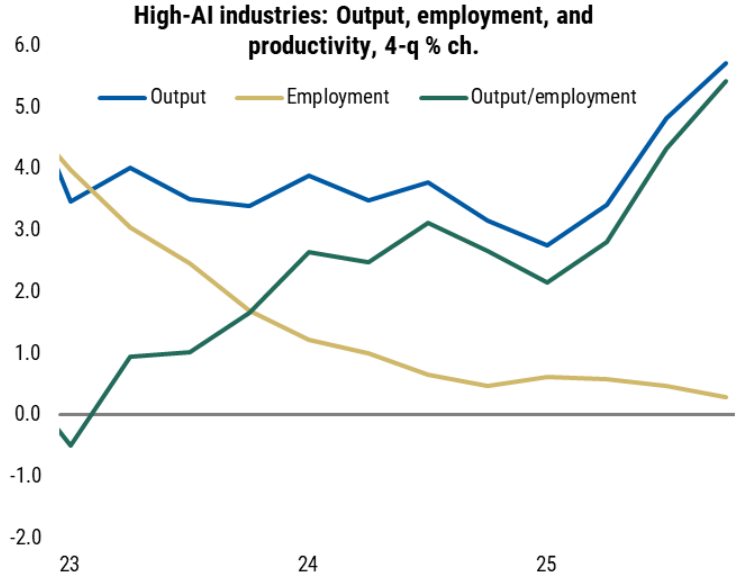
The main driver of productivity is faster output growth, not labor displacement

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.

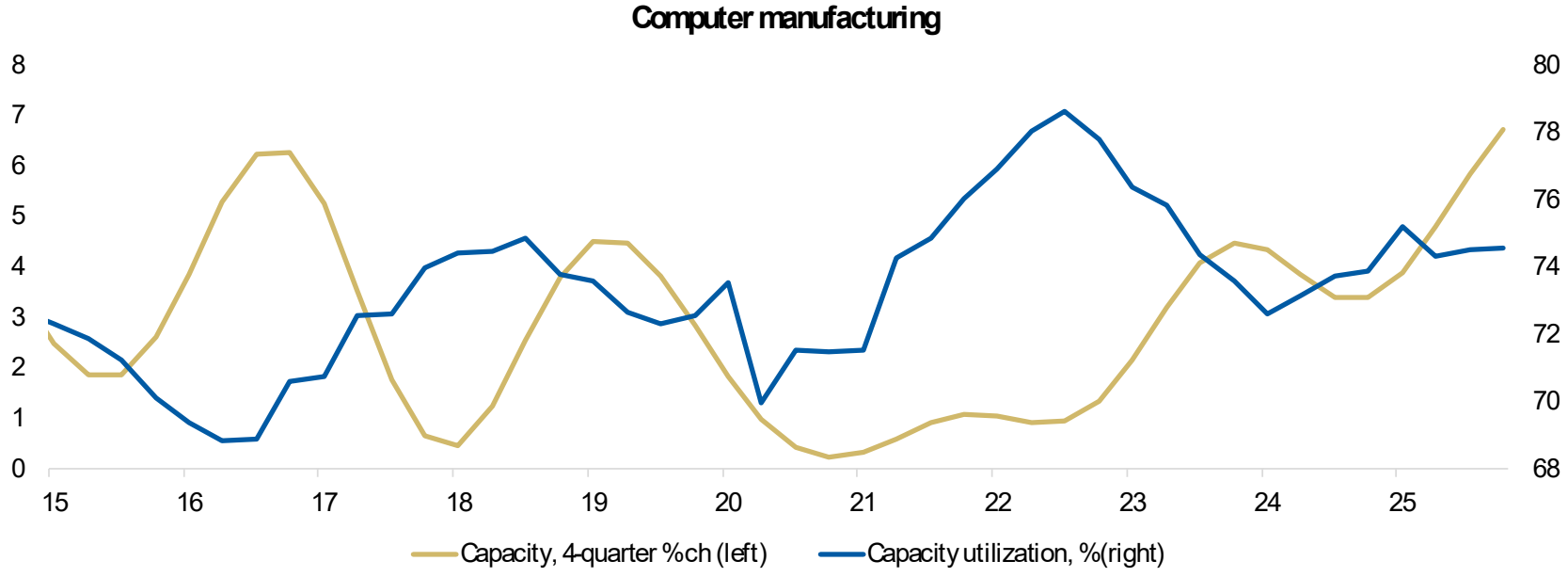


Source: BEA, BLS, Morgan Stanley Research

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



Source: Federal Reserve, Morgan Stanley Research

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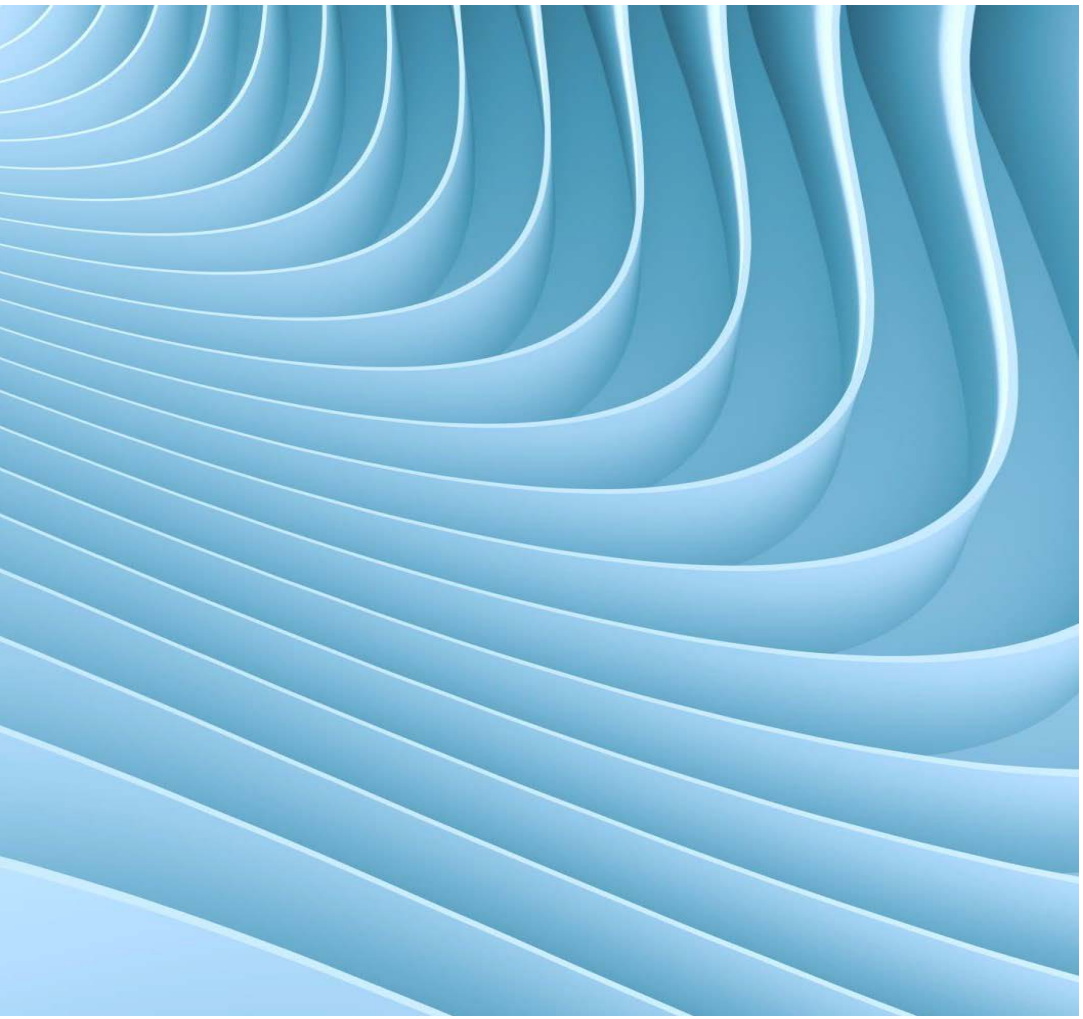
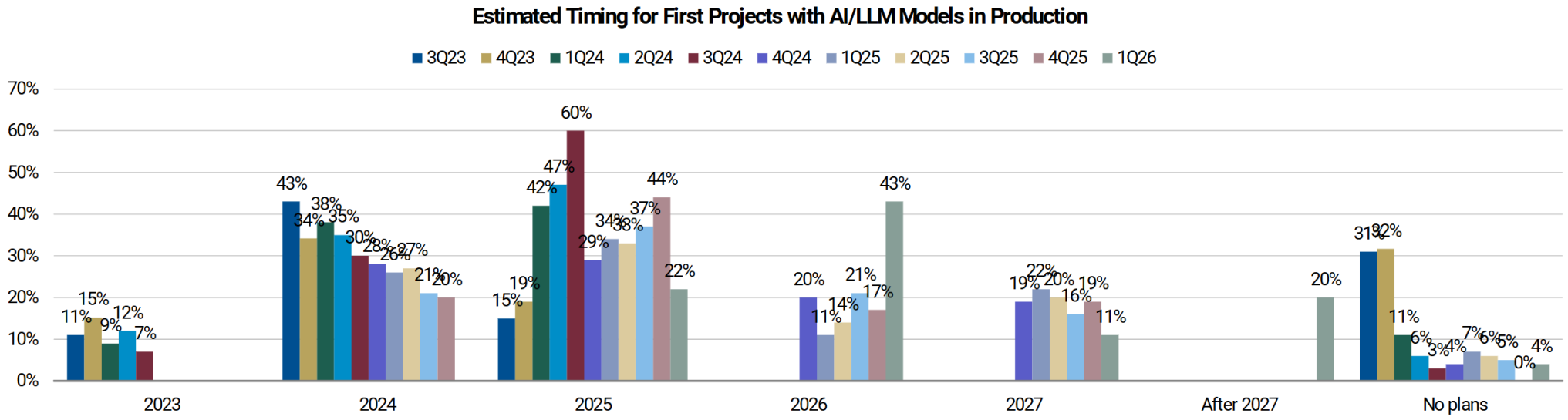


Micro evidence on usage

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



Source: Alphawise, Morgan Stanley Research. N=100.

How Are Companies in Different Sectors Adopting AI?

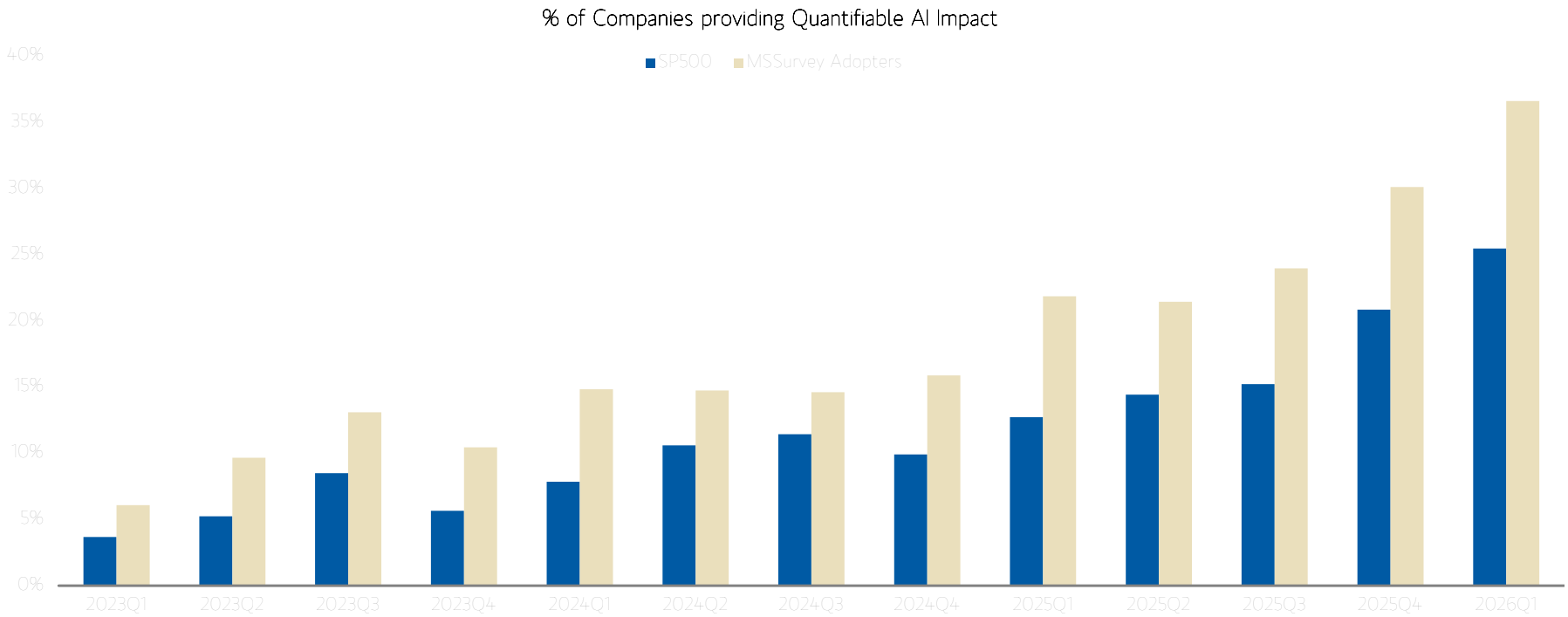
Consumer	Energy & Materials	Financials & REITs	Health Care	Industrials	Tech, Media, & Telecom
Visual Search	Predictive Maintenance	Fraud Detection & Prevention	Medical Imaging	Autonomous Trucks	Ad/Content Generation
Smart Kitchens	Smart Grids	Alternative Credit Scoring	Drug Discovery	AI Enabled Factory 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.

Source: Morgan Stanley Research

How is AI usage progressing?

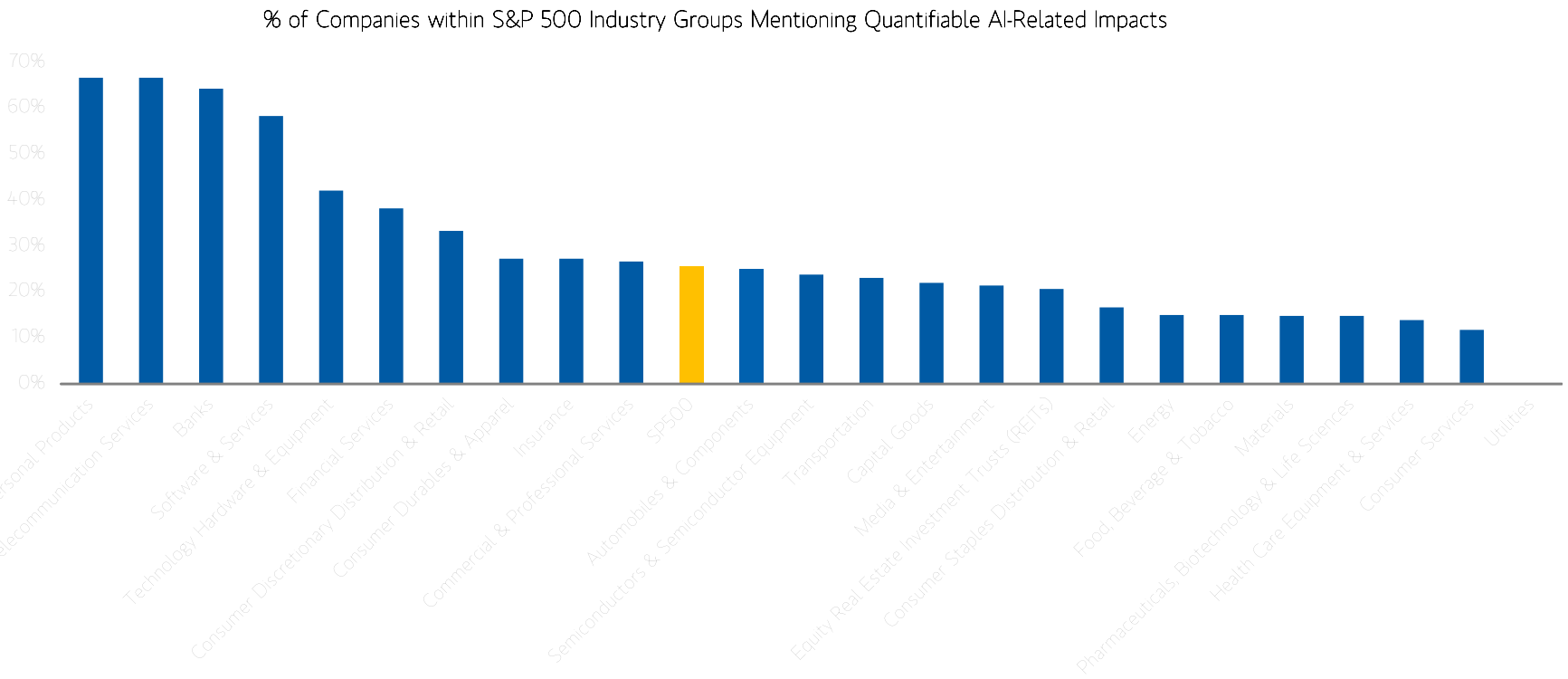
Discussions of Quantifiable Benefits from AI Are Rising



Source: Morgan Stanley Research. Note: companies mentioning multiple quantifiable benefits from AI are only counted once in this chart.

How is AI usage progressing?

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



Source: Morgan Stanley Research

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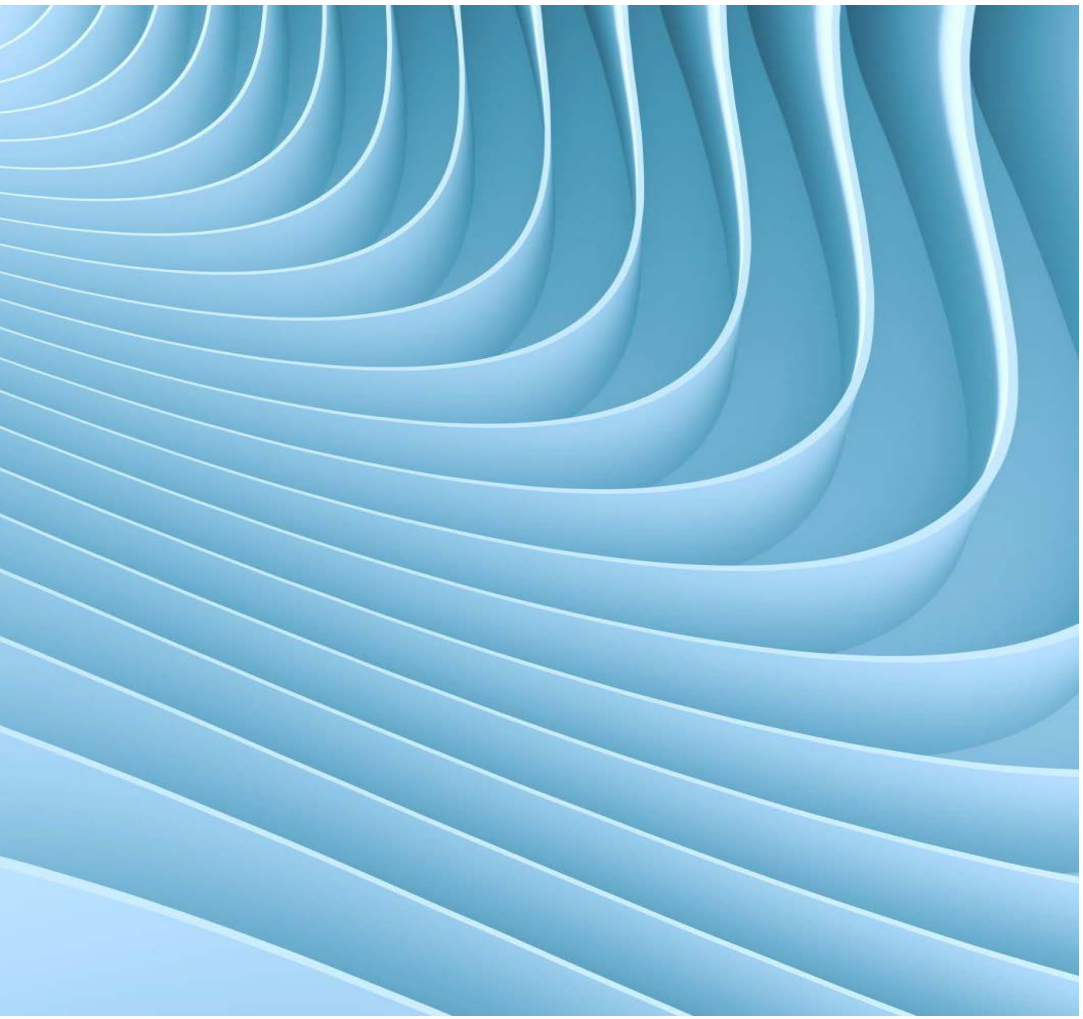


Labor displacement risks from AI

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.

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

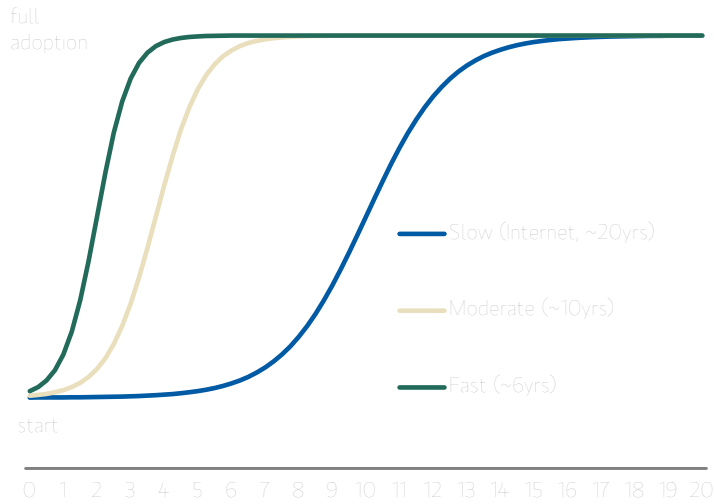
a) Outcomes depend on buffers: labor income losses vs policy support, wealth effects, and new task creation determine whether AI triggers demand shortfalls or a stable transition.

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

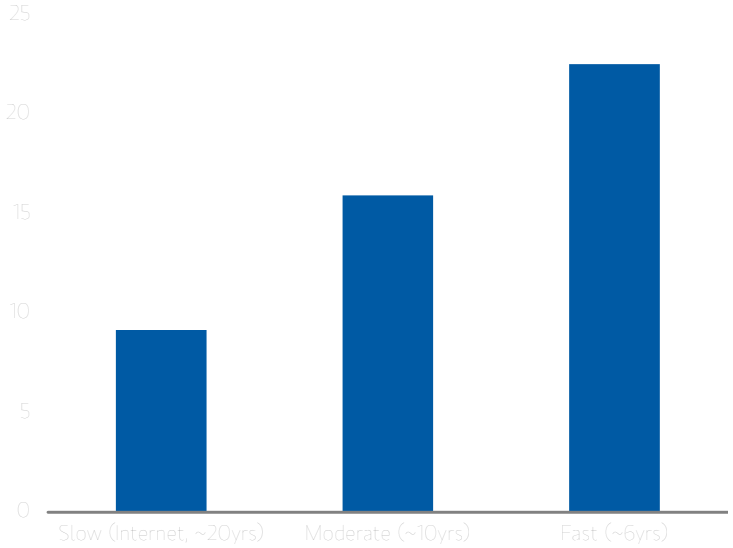
What does AI diffusion look like?

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 way.

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



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

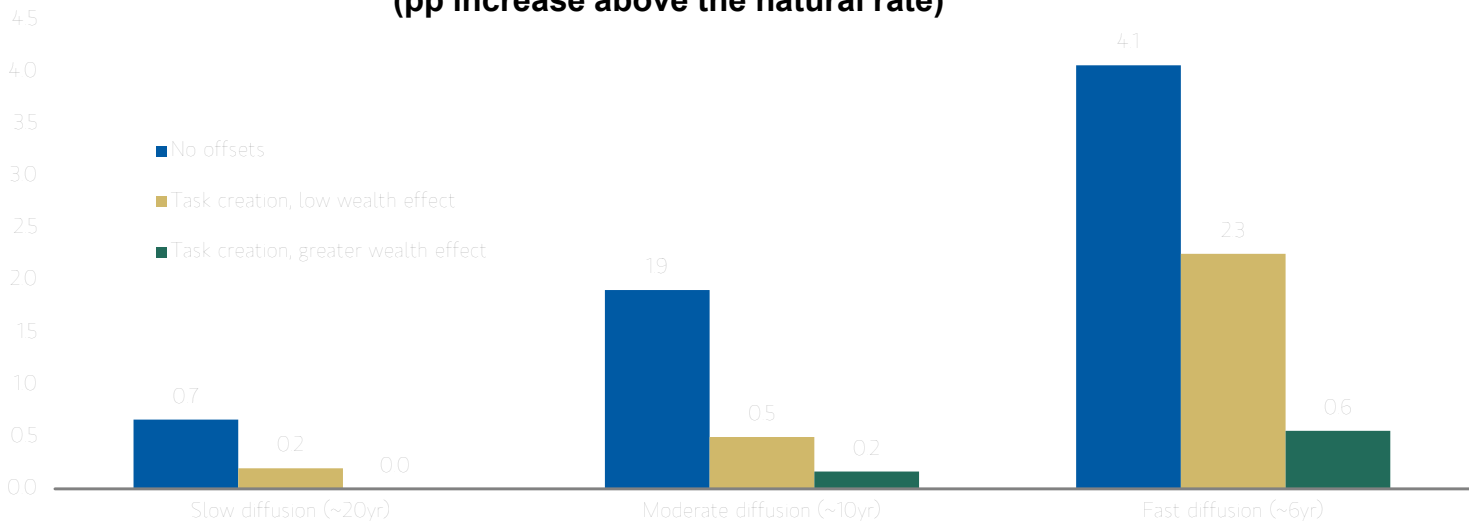


Note: For the left graph, the x-axis represents years and the y-axis is percent of the economy that is ultimately subject to AI diffusion and integration. In the right graph, we show the share of the economy that sees AI diffusion in a given year during peak transition, where the diffusion curve is at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

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

Peak increase in the unemployment rate under different diffusion speeds and indirect feedback effects (pp increase above the natural rate)



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 moderate wealth effect. All scenarios assume no active fiscal policy support, but monetary policy responds using a Taylor rule. Source: Morgan Stanley Research

Related Research

US Economics Mid-Year Outlook: Capex Over Consumption

AI and Economic Transition: Lessons from the Five Innovation Waves That Preceded AI

AI and Economic Transition: AI Labor Disruption: More Micro Than Macro So Far

AI and Economic Transition: Industries with high AI exposure are seeing labor productivity from faster output growth, not labor replacement

AI and Economic Transition: Expect Rhyme, Not Rupture: The Pace of AI Adoption, Productivity Gains, and Labor Displacement Risks

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