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How AI Wound Up Driving Economy and Stock Market

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The U.S. economy keeps putting more eggs in the artificial- intelligence basket.

Tech companies are spending hundreds of billions of dollars to meet AI computing needs and issuing billions of dollars of debt to help make those purchases.

The rapid data-center buildout is powering construction spending, hiring and municipal revenues. Meanwhile, a stockmarket rally fueled by the rise in shares of chip makers and other companies benefiting from the AI boom has led to a massive increase in household wealth. That is helping to bolster consumer spending.

Combined, those factors are likely responsible for roughly one-third of the nation's recent economic growth, according to Michael Pearce, an economist at Oxford Economics.

But the strength that the economy is drawing from the AI boom is also a vulnerability: What would happen if the boom fizzled out?

"It is very much an AIdriven economy right now," said Barclays economist Jonathan Millar. "It's hard to imagine that we would be anywhere near as resilient without that impetus."

Mapping out exactly how much strength the economy is drawing from AI is less than straightforward and prone to error. Even so, it appears substantial.

Details of last week's gross

domestic product report, which measures economic growth based on what the country produces, showed that business investment in AI-related categories continues to swell.

Spending on software, datacenter construction and computer and communications equipment, were it to keep the same pace for 12 months, would come to about $1.5 trillion. Two years earlier, the annual rate was about $1 trillion.

On Monday, the Commerce Department reported that June construction outlays on data centers reached $68.3 billion, at an annual rate, up $21.5 billion from a year earlier. Outlays on all other private construction—everything from houses to shopping centers to hospitals—fell by $101.6 billion over the same period. Also Monday, comments included in the Institute for Supply Management's July manufacturing report pointed to robust, AI-related demand.

Not all of tech-related spending went toward AI— some of it was devoted to buying computers that sit on white-collar workers' desks, for example. On the other hand, the AI build-out is also pouring money into other capital- spending categories, such as cooling systems and backup generators.

A chunk of what is going into the build-out, such as memory chips, is imported, so some AI spending isn't directly boosting U.S. production, and therefore GDP.

In the first five months of this year, for example, the U.S. imported about $90 billion in computer equipment, semiconductors and other electronic components from Taiwan. That figure came to about $20 billion in the first five months of 2024.

Also, inflation is eating away at the value of AI spending. Surging chip prices mean buyers simply aren't getting as much bang for their buck as they used to.

Even so, Oxford's Pearce estimates that AI investment alone has been behind nearly a quarter of the growth in gross domestic product recently.

The AI-boosted stock market is the other big source of support.

In the first quarter, U.S. household net worth reached $174 trillion, according to the Federal Reserve, an increase of $13 trillion from a year earlier that was mostly because of stock gains. Since then, the broad S&P 1500 index has risen by about 15%, so net worth is likely trillions of dollars higher now. Those gains have been driven in large part by enthusiasm for AI.

When people's net worth increases, they spend more freely. Estimates of these wealth effects vary, but economists generally think that for every dollar in stock-market wealth gained, people spend a few cents more. The spending from higher-income consumers, who hold the bulk of stocks, benefits the most.

"Without this investment boom, I think it's pretty clear the economy would be running cooler," Pearce said.

To be sure, AI might be sucking up so many resources that it is actually crowding out other parts of the economy. For example, resources that are being taken up by data--center construction—land, materials, skilled labor—might otherwise be put to other use.

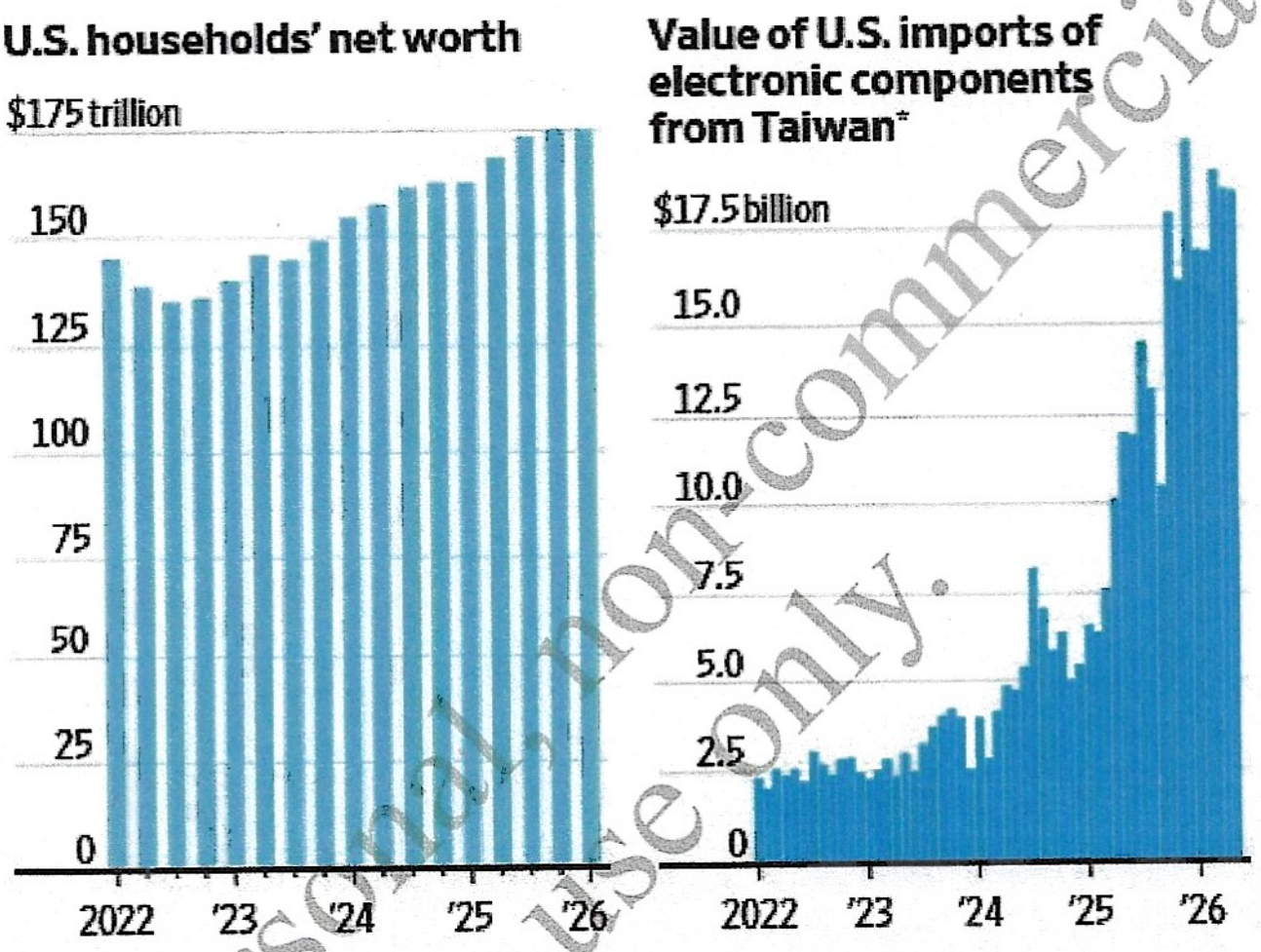
"You can't just take out AI and leave everything else unchanged," said JPMorgan Chase economist Michael Feroli. "The activity and the financial exuberance associated with AI might be squeezing out activity."

AI is also feeding into inflation, cutting into consumers' spending power. The iPhone 18 Pro coming out in September might cost less if it weren't for the jump in memory-chip prices.

For now, and despite recent selling in some AI-related stocks, the AI spending boom looks likely to continue. Analysts estimate that capital spending at five of the socalled hyperscalers—Alphabet, Amazon.com, Meta Platforms, Microsoft and Oracle—will come to nearly $4 trillion over the four years ending in 2029, according to FactSet. That is over $300 billion more than what they estimated about a month ago.

Real trouble in the stock market could disrupt that story. So, too, could problems in the debt markets that are helping fund the boom. Barclays estimates that bond issuance at the five big hyperscalers and AI entrant SpaceX will come to $285 billion this year, versus about $109 billion last year.

"AI is touching so many things," said Millar, from Barclays. "A lot of the economy is kind of banking on continued strength from the build-out."



*Including computer equipment and semiconductors †Seasonally adjusted, at an annual rate
Sources: Federal Reserve (net worth); Commerce Department (imports, AI-related investment)