



# 3 Tailwinds for 2026<sup>1</sup>

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Despite headline-grabbing news in 2025 — from tariffs to wars — economies around the world saw slower, but steady growth.

The outlook for 2026 is more of the same. Although the reasons why are evolving, with three tailwinds supporting a broadening recovery in corporate profitability:

1. **Lower interest rates:** Helped by slowing inflation and more balanced job markets.
2. **Broadening spending growth:** U.S. tax cuts support consumer spending and European governments are increasing fiscal support.
3. **Artificial Intelligence (AI):** The AI buildout drove revenues and construction in 2025 and that's expected to continue this year. At some point, AI should start to drive productivity improvements, which would grow GDP even as population growth globally stalls.

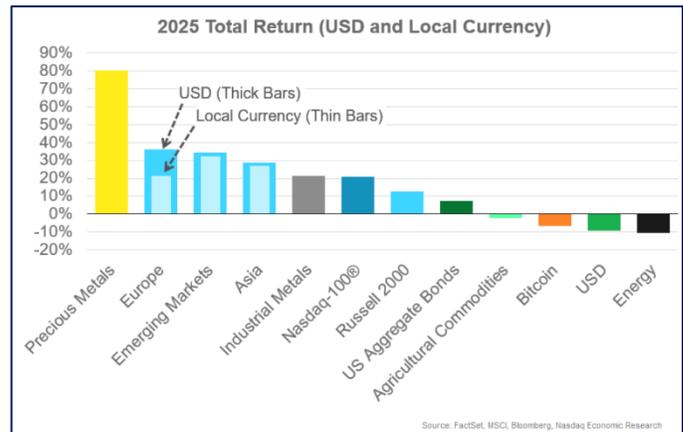
### 2025: A good year for global stocks

Looking first at returns last year highlights that stocks and metals dominated in 2025.

It *seemed* like 2025 was all about AI, which is mostly a U.S. market phenomenon. But many international stock markets outperformed U.S. stocks for the year. That was helped by the weakening U.S. dollar (USD), which boosts offshore returns in USD terms.

Despite the relatively weak economic growth and declining energy prices, stocks and metals rallied, with precious metals handily outperforming all other asset classes, boosted by major central banks cutting rates and fears about deficit sustainability.

Chart 1: Returns started to broaden out in 2025 in anticipation of earnings to come

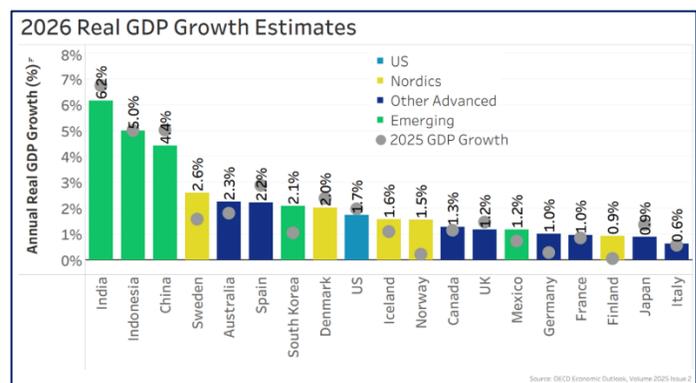


### 2026: Expecting a repeat of 2025's widespread but slow growth

Despite tariffs and geopolitical shocks, most economies in the world reported slow but steady growth in 2025, helped by resilient consumer demand. That's similar to levels of growth to last year, but the underlying drivers are different.

In 2026, we see three new tailwinds. But they will be somewhat offset by weaker jobs and wage growth. The net result should be widespread but slow growth.

Chart 2: Real GDP growth is expected to expand at a solid clip (again) in 2026



<sup>1</sup> <https://www.nasdaq.com/articles/3-tailwinds-2026>

**Tailwind 1: Lower interest rates support the labor market and help small caps**

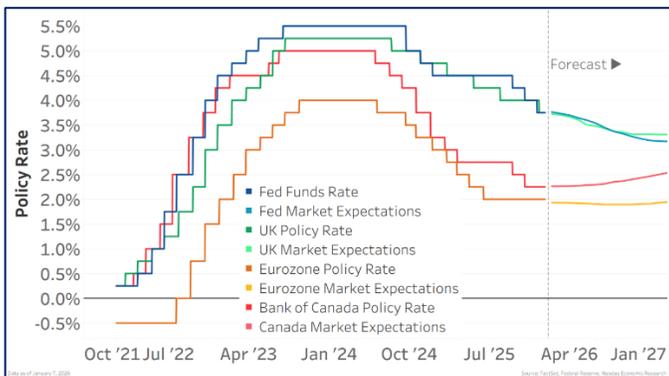
The first economic tailwind is lower interest rates.

Over the past 18 months, many major central banks have cut rates as inflation cooled and wage growth slowed. Markets think many central banks are now close to their “neutral” interest rate, with no more rate cuts expected.

In the U.S., the pause in rate cuts to see how tariffs affected inflation (they really didn't), left rates higher for longer. Markets are still pricing two more cuts (light blue line) in 2026, getting U.S. rates closer to 3% by year end.

The U.K. saw stickier wage growth than in most other countries, which has slowed their pace of their cuts. Markets are still looking for one or two more rate cuts in the U.K. this year (light green line) getting their year-end rates closer to 3%, too.

**Chart 3: Fed is one of few major central banks expected to cut rates in 2026**



Some worry that the next move in rates might be up. However, with unemployment low (and rising) and inflation near 2% (and falling), it's hard to see a near-term catalyst for that to happen. Especially with the labor market and wage growth are both in multi-year downtrends.

For example, the data in Chart 4 shows U.S. job openings and wages, which peaked with two jobs for every one unemployed person (purple line), have since slowed to a much more manageable one job for every worker looking for work.

In line with that softening labor demand, wage growth has also slowed (green line).

This should weigh on consumer spending, which has been one of the main drivers of the U.S. economy. That's one reason why growth is expected to remain somewhat slow.

However, companies have still *not* resorted to layoffs, which remains around their lowest dating back to 2000 (red line). That has helped consumers keep spending, even as data shows more have resorted to spending on their credit cards.

**Chart 4: The U.S. labor market has been cooling for years, but now needs rate cuts for support**



Lower interest rate cuts should also benefit companies, particularly smaller businesses.

As the data in Chart 5 shows, that's what we are starting to see.

- As the Fed started hiking rates in 2022, the ratio of interest expense to earnings more than doubled to 48% for small caps (green line), while it topped out below 30% for mid caps (blue line) and was essentially unchanged around 10% for large caps (orange line).
- With the Fed pivoting to cutting rates, the interest expense to earnings ratio has now started to fall for small caps. The National Federation of Independent Business reported that short-term loans rates paid by small businesses have recently fallen from a high of 10.1% to a 2½-year low of 7.9% – though that's still close to double its Covid-era low of 4.1%.

Chart 5: Lower rates will help small caps most since they rely more on floating rate debt

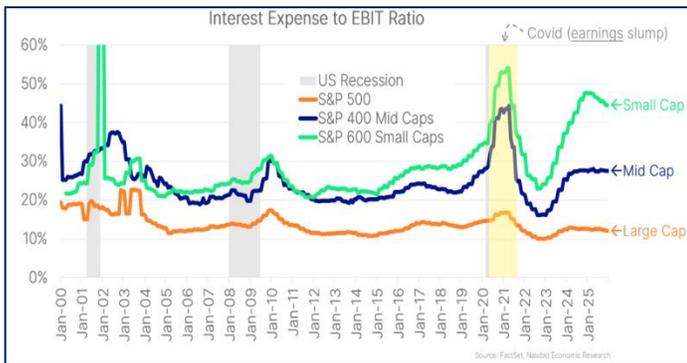
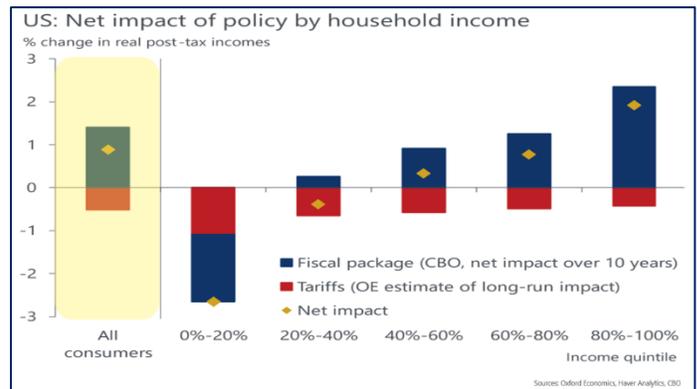


Chart 6: Tax cuts boost after-tax incomes, especially as you go up the income spectrum



**Tailwind 2: Government policy to support spending and business investment**

Additional government and business investment should also be a tailwind.

In Europe, some of these changes reflect a renewed interest in self-defense given their proximity to Russia and a potential reaction to U.S. tariffs and military support.

In the U.S., tax cuts and deregulation were put in place in mid-2025, with the passage of the One Big Beautiful Bill Act (OBBBA). That bill included corporate and personal tax cuts that the Congressional Budget Office (CBO) estimates will [boost 2026 GDP growth](#) by 0.9%.

For businesses, the tax breaks are mostly designed to increase business investment, with provisions like 100% bonus depreciation and R&D expensing. That’s why the Tax Foundation estimates that the OBBBA will save businesses [over \\$900 billion](#) in the next 10 years, with more than half of the total savings going to the capex-heavy industries of Manufacturing and Information Technology.

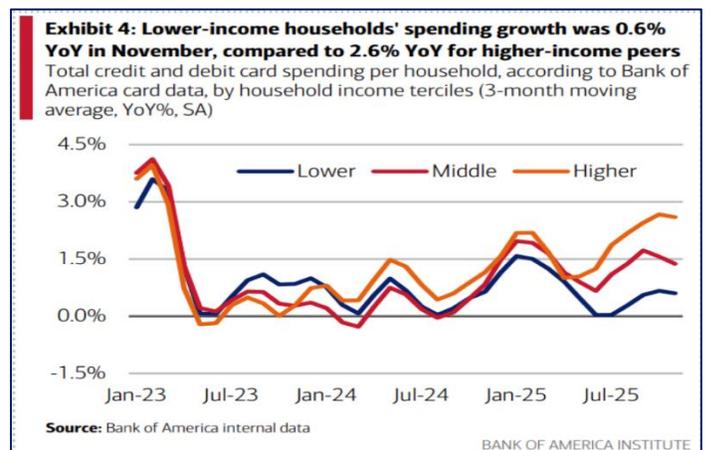
For consumers, the CBO projects that real after-tax incomes will rise about 1½% (left bar, blue portion), with the benefit increasing as you move up the income spectrum.

Tax cuts boost after-tax incomes, especially as you go up the income spectrum

Giving higher-income households a bigger tax benefit should extend the “K-shape” consumer dynamic we’ve seen in the last couple of years.

Data from the [Bank of America Institute](#) highlights this trend in wage changes and consumer spending (Chart 7). Since mid-2023, *average* consumer spending growth has remained positive. But dipping into the details, we see spending has accelerated for the *top third* of households by income (orange line), while it’s started to stall for the *bottom third* of households (blue line).

Chart 7: The K-shape consumer sees higher-income households spending, but lower-income pull back



There are a couple of reasons for this.

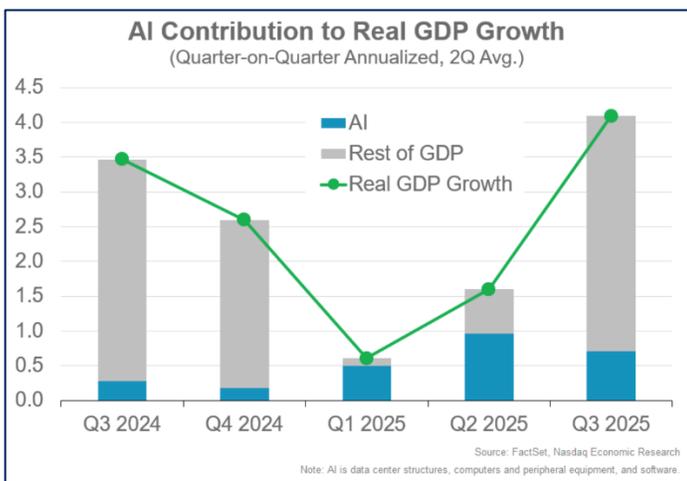
1. **The wealth effect.** Higher-income households tend to have [higher shares of equity](#) and [home ownership](#). Record high stock and home prices make them feel wealthier, giving them the confidence to keep spending. Many also locked in long-term fixed mortgage rates around Covid lows, reducing the impact of interest rate hikes. In contrast, lower-income households are less likely to own stocks (though that's [changing](#)) and many rent homes – and rent has been rising (and adding to sticky U.S. inflation).
2. **Wage growth divergence.** Wage growth has [slowed steadily](#) over the last few years, especially for the bottom quarter of households. Interestingly it's held up for the top quarter of households – after falling behind, their wages are now growing faster than low-income wages.

**Tailwind 3: Continued AI spending is real dollars for the economy and earnings**

The third economic tailwind is AI.

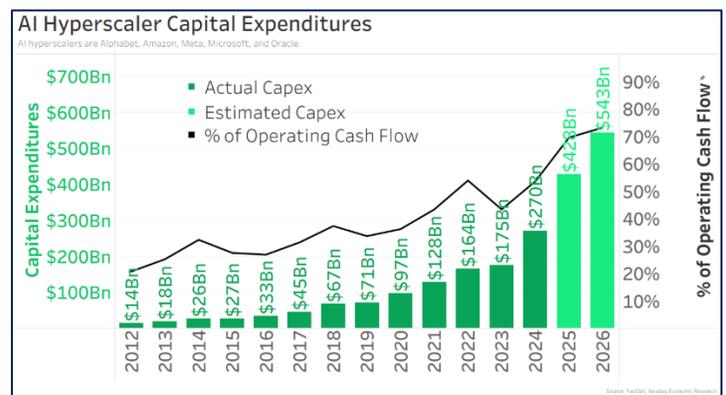
Currently, most AI spending is on data centers, computer equipment and software. It's helped contribute to real GDP growth (blue bars), which should continue.

Chart 8: AI and tech spending drove more than half of GDP growth in the first half of 2025



Much of the AI spending comes from the five major AI hyperscalers — Alphabet, Amazon, Meta, Microsoft, and Oracle. Their capex spending is estimated to have grown over 50% from 2024's \$270 billion to 2025's projected \$428 billion. In 2026, it's estimated to increase another 25% to nearly \$550 billion, making it likely that AI will remain a key driver of U.S. economic growth this year.

Chart 9: AI hyperscaler capex is expected to grow another 25% in 2026

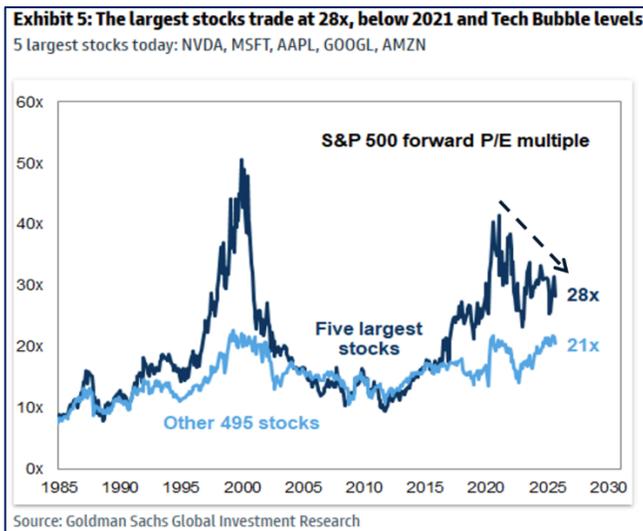


However, with talk of an AI bubble swirling, it's worth pointing out that one company's expense is another company's income. Demand is strong for companies offering chips and other tech hardware, cloud compute and AI chatbot services.

On the expense side, data shows that these companies, which already run profitable businesses, are investing free cashflows back into AI (black line above). That's in contrast to the tech bubble in 1999, where many new companies spent equity dollars to build internet technology before they could scale customer revenue growth.

On the revenue side, data shows valuations (PE ratios) have been falling over the last few years for the five biggest companies in the S&P 500 (dark blue line) – all of which are part of the AI ecosystem. That's because, after rallying in expectation of earnings growth, those revenues have now materialized, and have been growing faster than stock prices.

Chart 10: AI spending is driving real earnings, so PEs for the biggest S&P 500 companies are falling

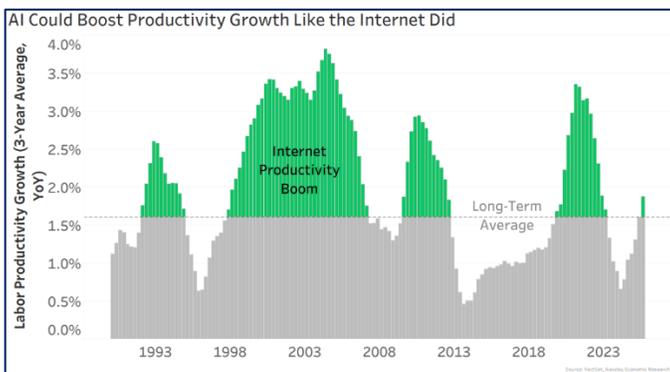


As with all major investment cycles, there are likely to be winners and losers. But from the broader economy’s perspective, the bigger question may be whether all this AI spending (Chart 9 show over \$1 trillion) will pay off.

The hope is that AI’s payoff will come in the form of higher productivity growth. That’s what we saw with the internet, which boosted U.S. productivity growth to 3% per year from the mid-90s to mid-aughts – nearly double its trend rate in the of earlier 1990s.

If we see a similar boost from AI, with U.S. GDP of \$30 trillion, a boost of 10% over 10 years would add more than \$3 trillion to the U.S. economy alone.

Chart 11: Investors are betting that AI spending will pay off by boosting productivity in the long run



Although that productivity payoff isn’t likely to help economies much in 2026.

**Another strong year expected for earnings**

In contrast to the economic growth, the combination of lower interest rates, lower wage costs, tax cuts and continued AI spending should help many, especially smaller companies, significantly improve profitability. In fact, analysts estimate that earnings growth for the Russell 2000 small cap index will nearly 5x to 61% p.a. in 2026. That could be especially important in U.S. jobs, where data shows small businesses have done the majority of job cuts in recent months.

But it’s not just the U.S. companies that are expecting to see these benefits. Earnings growth is expected to be solid around the world. Emerging markets and Asia are expected to see over 15% p.a. earnings growth this year, while Europe trails with a still healthy 13% projected gain.

Interestingly, the Nasdaq-100® is the only index in the chart above expecting to see earnings growth slowing from 2025. Although to be fair, these companies are coming of the highest 22% gain last year, and still expect a strong 17% p.a. earnings growth this year.

Chart 12: Earnings growth likely to broaden out in 2026 as small caps and international earnings rise



Higher profits should, over time, spur businesses to increase hiring. That’s especially important in the U.S., where data shows small businesses have done the majority of job cuts in recent months.

**2026: Not too hot, not too cold, which is good for companies.**

For 2026, slower jobs and wages growth should keep inflation and interest rates low. Combined with more government stimulus and AI spending, these tailwinds should help keep economies growing. Although put together, likely relatively slowly.

This environment should be better for companies. Less input cost pressures, more balanced labor supply, and lower interest rate costs combined should help boost profits.

In short, a positive year for economies and a stronger year for companies.