



## Is client spend on AI starting to disappoint?

### From free-for-all to token rationing

#### Key points:

- **AI spending trends:** tech stocks retreated this week amid signs of a flattening in AI spending, after exponential growth earlier this year.
- **AI outlook:** whilst AI growth and infrastructure build is not set to slow or stop, the pattern of quarter-on-quarter acceleration may be beginning to moderate. This could suggest a more modest but still healthy U.S. growth outlook for 2027.
- **Inflation & energy risks:** we see U.S. inflation peaking at 4% early in the new year, but energy prices remain a wildcard – the chances of a sustainable de-escalation deal in the Middle East are low, and regional escalation could push prices much higher.
- **Fed rate path:** meetings with DC policymakers cemented our view that the next U.S. rate hike won't come before December, with the Fed seeing little to panic about in recent inflation data.
- **Europe and UK:** markets have largely followed U.S. moves, with some sovereign spread recovery. In the UK, Conservative Party poll gains may limit the ability of PM Burnham to call an early election, risking a nothing-burger policy agenda.

**London, 16 October 2026:** A retreat in tech stocks has seen fixed income yields fall during the past week, with investors looking for a safe haven in government securities. With many stocks in the sector trading at extremely elevated multiples, they are effectively long duration assets. In this respect, it has been surprising that the recent moves higher in longer-dated Treasury yields haven't dented the enthusiasm of stock bulls more.

Stock investors have held a much more singular focus on earnings growth momentum and have been impressively resilient. However, as the recent stumble at OpenAI suggests, there may be signs that this upward trajectory could be starting to level off to a degree. If this is borne out over the coming weeks, then this could herald a more significant stock reversal. This possibility adds to the attractiveness of core rates markets.

We can also reference comments heard from a private portfolio company whose underlying firms were flattening out AI spend after exponential growth earlier this year. Certainly, many other companies in sectors away from AI are showing signs of starting to be squeezed by higher rates.

For a growing number of CEOs, this appears to be translating into a greater focus on cost containment. Indeed, it seems that token spend is starting to be rationed by many managers after an initial free-for-all. This is not to suggest that AI growth and infrastructure build is set to slow or stop, just that the continued pattern of quarter-on-quarter acceleration across all metrics may be starting to moderate. This, in turn, could suggest a more modest (but still very healthy) growth outlook for the U.S. economy as we head into 2027.

In fixed income markets, Treasury yields shrugged off somewhat higher U.S. inflation data this week, as investors pushed back on speculation for back-to-back rate hikes from the Federal Reserve later in the month.

Our own meetings with policymakers in DC over the past week have cemented our views that the next hike in U.S. rates won't come before December, with the Fed noting there is little to be panicked about in recent inflation data.

It is worth pointing out that CPI in the mid-3s is still a very long way below where it was in 2022, when it rose above 8%. Ultimately, however, the trajectory of inflation will determine the path for rates. U.S. policymakers are clearly motivated to shift inflation closer to the 2% target over the coming year given the protracted length of its overshoot and the risk that forward price expectations are affected more materially.

On a more cautious note, therefore, energy prices remain a wildcard. Nothing we hear from the U.S. administration suggests there is any plan on how to draw an end to the conflict in the Middle East. On this basis, we have oil prices remaining at current levels as a baseline. There is obviously a risk of a slide towards greater regional escalation and this could push energy prices much higher, but the chances of a deal that creates a more sustainable de-escalation are low.

From the Federal Reserve's perspective, there is little they can do to control energy prices but they may need to react to them. Away from energy, price pressures are more muted.

Although the AI buildout is adding to prices, the Fed is also aware that if it needed to rely on policy to cool demand in that space, there is a risk that they would need to do a lot of damage to the rest of the U.S. economy. In this respect, a pullback in tech stocks and a self-moderation in AI enthusiasm would be welcomed on the part of policymakers.

Returning to U.S. inflation, we see this peaking at 4% early in the new year. In light of this, we expect the Federal Reserve to hike in Q4 and Q1 2027. Thereafter, we expect base effects to kick in, and a declining trajectory in CPI which will keep the Fed on hold thereafter. In this respect, we continue to feel that markets have priced too many Fed hikes for the year ahead and we remain constructive at the front of the yield curve.

Meanwhile, we have been more cautious on longer-dated bonds. We feel that the ballooning growth in government and corporate debt we are witnessing in the U.S., and globally, could lead markets to demand increased term premia. With yield curves relatively flat on both sides of the Atlantic, this means we are more biased towards a steepening trajectory looking forward.

European markets have largely reacted to U.S. moves over the past week, though there has been some recovery in sovereign spreads in the absence of new negative news to drive selling pressure.

In the UK, we await the upcoming budget, though away from this it has been interesting to observe opinion poll gains by the Conservative Party recently. This resurgence may limit Burnham's ability to call an early election next year and so there is a risk he ends up delivering a nothing-burger of a policy agenda in the coming weeks.

Japanese government bonds have also performed well and have been boosted by news of increased bond buying from domestic investors.

Elsewhere, the reversal in U.S. stocks has slowed the U.S. dollar's recent upward momentum. We don't have a strong view on the major FX crosses for the time being, though in Europe we would highlight the Hungarian forint, where hopes for medium-term euro membership have continued to build.

## **Looking ahead**

There is not much data on the calendar for the second half of the month and focus will move back toward central banks. However, we doubt any major central bank will be hiking at its next meeting, and this could make for a more stable backdrop for rates.

Otherwise, the past week has shown us how developments relating to the trajectory of the AI boom can have a bearing across all markets. In this respect, a healthy dose of reality in the wake of a heady frenzy may not be any bad thing at all.

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