

Video Transcript

Zooming In: Deciphering AI's economic impact on Inflation, Rates, Employment & more

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Released on 17 July 2026

Neha Sahni:

Hi everyone!

Welcome to a brand-new episode of our CIO Zooming In series, where we discuss burning market and investor questions. Today's topic of discussion is assessing the economic impact of artificial intelligence. To understand how AI will impact inflation, growth rates and jobs, today, I'm joined by James Pomeroy, who's a senior economist at HSBC's Global Investment Research division.

James, welcome and thanks for joining us today.

So, James, let's begin by discussing AI's impact on inflation. AI built out, particularly the data centre construction boom, has created a memory crunch of sorts. Demand for memory chips is through the roof, but their supply is bottlenecked. And these same memory chips are also used in producing phones, laptops and cars, creating an input shock. At the same time, AI is also very energy-intensive and is driving up energy bills for US consumers. So, in your view, is AI, on balance, an inflation risk in the near term or an inflation dampener over time through productivity gains and lower labour costs?

James Pomeroy:

So, this might sound like a very economist answer, but it is a bit of both. So, we're seeing this ongoing boom in CapEx, it's causing bottlenecks, those cost increases. But with a wider set of firms really investing in that hardware and software, those higher costs are now spreading more throughout the economy. So, some of those costs for firms is now needing to be passed on. And that creates at the margin a little bit of inflation. And if you double that up with broader cost inflation, with energy and other commodities at the moment, that does create some upside lift.

But actually, when the adoption starts to pick up and importantly, companies start to use the technology well, which isn't universally the case at the moment, then this is when the productivity gains really start to come through. And when you get those productivity gains coming through into the economy, that should mean much, much lower costs in a wide set of businesses. And what that does is it creates a pretty disinflationary impulse.

So essentially, we're in a negative supply shock at the moment that over time becomes a pretty positive supply shock that helps to pull down inflation. Now what am I looking for in terms of that transition? I'm looking for the growth not just to be in the build-out phase, which is essentially all your chip sales and data centre investment and those sorts of things. What I'm looking for is companies using it and using it well, and we can track some surveys, like from the Fed trying to get a handle on what's happening. But also we want to get a sense of hiring if we start to see impacts on professional services hiring, that's potentially a sign that more and more companies are using AI, and using it well. When that starts to build, then that disinflationary impulse will build.

Neha Sahni:

Assuming an uneven and initially CapEx heavy AI diffusion, how do you expect AI adoption to feed through interest rates over the next 12 to 24 months versus the next 3 to 5 years? Which channel, in

your view, whether it's growth or inflation, dominates your base case? And what could most likely flip this base case? Could it be faster diffusion, lower energy constraints, regulation or something else?

James Pomeroy:

There's a lot of moving parts here. So firstly, AI is really supporting GDP growth at the moment in some economies, but it's really concentrated in certain pockets. So, be those chip producers, data centre manufacturers or essentially people who have owned the equity markets. So, you've got this whole load of people who have seen an enormous amount of windfalls from those rising equity prices.

So, all else being equal, you would expect this to lift growth. And it is in those economies like the US and some parts of Asia. That might mean higher rates as a result. But actually, over the medium term, when you start to get that sort of bigger impact on the labour market, it flips into being quite a disinflationary force and it could be one of very strong productivity growth, which obviously would typically mean lower inflation. And that puts less pressure on central banks to keep rates higher.

So, what I think we're going to see is switch about to happen as that adoption spreads and keeps going. And if we do see this actually is quite a big factor, depressing wage growth over the course of the next few years, helping to keep inflation in check. So, at the moment I'd say it's potentially at the margin higher rates today, probably lower in the future because of AI. When that flips, it really comes down to this big question of that adoption rate hitting certain thresholds.

Neha Sahni:

James, how do you expect AI to impact the labour market in terms of job creation versus job displacement, the unemployment rate, participation rate, and wage dynamics? What policy responses or business responses are needed in your view? And do you foresee a scenario where governments will have to impose an AI tax on corporates to fund a universal basic income?

James Pomeroy:

So yes, I think in the short term fear matters a lot. We haven't really seen many jobs lost to AI yet, but it does give firms the cover to lay people off. And that matters, because if people are nervous about their job prospects, they're less likely to ask for a pay rise. They've worried about finding another job. You do start to see an impact on consumer spending, so there is a little bit of a short-term impact, even if not many people are losing their jobs to AI today.

Over the medium term, I'm pretty worried about job losses. I think you're going to see quite substantial numbers, potentially in professional services. We're seeing almost a taste of this in graduate hiring at the moment, where vacancies are down sort of 20 or 30%. It won't be that bad across the entire economy, but we're starting to get a sense of the magnitudes that could start to appear. And also, there's some parts of the physical economy that will become under threat as AI gets embedded into robotics.

So, there's some big risks. Of course, other jobs will be created. Whether that's enough remains to be seen, but there are quite clear cases where a lot of today's jobs just won't exist in 5 or 10 years' time. And as a result, we're going to have to see a huge focus on skills training. So, some of that is going to be for roles that are materially impacted by AI. We're going to have to think about the skills to work alongside these tools, how to get workers to do less automatable tasks or jobs. But also, we might have to rethink education.

We've got to think about what people are learning whether they're learning the right things to operate well in an AI heavy world. And then, of course, you've got big discussions around government policy. So, it's going to have to be big questions about tax and government spending. It does bring things like universal basic income into question. Is that something we're going to need? Quite possibly.

But also, we're going to have to think about scenarios where governments have to think quite seriously about where they're getting their taxes from, less so from workers and less so from consumption, and potentially much more so from things like capital gains, corporate taxes or elsewhere. And they would want to free up some of that money to put back into a universal basic

income. Because if you don't do that, then you could be talking about a world where an economy is much more unequal, and therefore growth could be quite a lot slower.

Neha Sahni:

So, James, we've already talked about AI's potential impact on inflation, productivity, rates and unemployment. But are there any other extreme economic scenarios with regards to AI which have a very low or high probability, but are currently under the radar?

James Pomeroy:

So, Neha, there is a scenario I am worried about. And it's essentially this doom loop around workers and spending. Because if you see workers cut back because of their nervousness about the labour market, then firms start to lay people off. Then you get into this doom loop where consumption could be much weaker, particularly without some of the government support that we've just been talking about.

But there is also a positive scenario, a positive scenario where AI unlocks abundance and we start to see the creation of whole new industries, businesses, job creation, ideas, breakthroughs in science and technology that we didn't think were possible at the speeds that could happen. That's a very positive scenario. And in that outcome, you would be talking about much stronger GDP growth and improvements to quality of life over the course of the next 5 or 10 years. And what's fantastic as an economist at the moment is both of those scenarios are live, the things that could happen. And that's what makes this subject so interesting and something we've all got to follow in the years to come.

Neha Sahni:

Thank you, James, for sharing your insights with us today. We'll now move on to our Private Bank view on AI.

To wrap up, AI is likely to be inflationary at first as investment demand collides with supply constraints, but disinflationary later if productivity delivers. That's why rates could stay higher in the near term but then fall as adoption becomes economy wide. It is the labour market, though, where the real social and political pressure builds, as disruption is likely to be uneven across sectors and skills. The big challenge is how societies manage this new transition, especially around jobs, skills and inequality. For investors, the opportunity is real, but so is the volatility and the signpost to watch are real world adoption, labour market data, energy constraints and policy responses.

Thanks for joining us, and we'll see you next time with another new episode of CIO Zooming In.