

Federal Reserve Bank of New York

Financial Advisory Roundtable

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Outline

- Brief comments on the systemic risk questions
- Brief background on monetary policy and AI
- Implications of AI capital spending for monetary policy transmission

Systemic Risk

- Key risks associated with AI investment financing
 - Maybe this is just another boom, and it will be followed by a bust
 - Reasons to be concerned about that
 - This is not just another boom, but it could still end badly for investors if competition keeps prices low
- What might be done to limit the risks?

Monetary Policy and AI

- Monetary policy currently aiming to balance two risks
 - Inflation expectations could come unanchored
 - Output and employment could slow significantly
- AI could cause additional challenges
 - Depends on who understands the effects on productivity growth and when
 - Could make either higher or lower rates appropriate
 - More uncertainty for the Fed

AI Investment and Monetary Policy Transmission

- Monetary policy transmission could be more powerful
 - A lot of AI-driven investment is financed with debt, so higher rates and tighter lending terms and standards should have relatively large effects on spending
 - And AI-driven investment has large up-front costs with profits out in the future, so interest rate changes should have a big effect
 - And stock prices of AI-focused companies are relatively high beta, and they make up a large share of aggregate stock indexes. So higher rates may have a bigger effect on stock prices and on consumption spending.

AI Investment and Monetary Policy Transmission

- On the other hand...
 - Interest rate effects on investment generally seem surprisingly small
 - AI firms are scrambling to dominate what they think will be a very profitable business – high rates may not discourage them
 - The very large tech firms (e.g., Alphabet, Meta, etc.) that are investing in AI have very deep pockets
 - So the impact of tighter credit conditions may be different across AI-related firms
 - And if stock prices are driven by a bubble, it isn't clear that plausible changes in rates will have a big effect
- Another source of uncertainty for the Fed