Could Credit Markets Derail the AI Boom?

AI's investment boom may have plenty of runway, but increasingly demanding credit markets could determine its price and pace.

Key Points

- The scale of AI-related borrowing is unprecedented, and even the strongest companies could be competing for capital as financing needs continue to grow. That could make access to credit more expensive and its terms more demanding.
- Credit investors are already becoming more selective, particularly among higher-leverage AI-related borrowers. For long-term investors, changing market conditions could create opportunities to secure better pricing and more attractive structures.
- The risks aren't confined to the weakest borrowers. Guarantees, leases, and other arrangements are increasingly connecting stronger corporate balance sheets to more financially vulnerable parts of the AI ecosystem.
- The implications could eventually extend beyond credit markets. How companies respond to higher financing costs could influence the amount and timing of AI investment, with potential consequences for economic growth, inflation, and yields.

Insight From Sub-Adviser Wellington Management



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What if the biggest threat to the AI boom isn't a technology failure, an earnings disappointment, or even an equity-market correction, but the bond market? Credit investors are beginning to push back against the extraordinary amount of debt needed to finance AI infrastructure, even as equity investors continue to reward the spending.

Spreads[1] have widened for some AI-related borrowers, liquidity has deteriorated in pockets of the market, and investors are demanding better pricing and stronger protections. Credit markets may not end the AI investment cycle, but I believe they could begin to impose a speed limit on how quickly it proceeds.

AI's Financing Needs Are Reaching a New Scale

Current estimates discussed by our investment teams suggest AI-related debt financing could reach $700 billion in 2027. That total includes roughly $300 billion of unsecured borrowing from hyperscalers and semiconductor companies, $150 billion of data center financing, and $250 billion of GPU financing.

For context, the US-dollar investment-grade corporate market is generally estimated to total approximately $12.5 trillion.

The issue isn't necessarily creditworthiness. Many of the largest technology companies possess exceptionally strong balance sheets and cash flows. Rather, it's the scale and persistence of their capital requirements. As financing needs expand, AI borrowers may increasingly compete with one another, and with other companies seeking capital. Financing may remain available, but at wider spreads, higher yields, or with more lender-friendly structures.

> The scale of AI's capital needs could make financing increasingly competitive.

Credit Markets Are Becoming More Demanding

Weakness among higher-leverage AI-related credits has been accompanied by thinner liquidity and wider credit-default-swap spreads (the cost of insuring against a borrower's default). Borrowers are responding with smaller deals, shorter maturities, multicurrency issuance, and larger pricing concessions. They're also turning to structures such as amortization, combinations of debt and equity-like capital, stronger backstops, and residual-value guarantees. The market remains open, but the terms are changing.

That shift could create opportunity for long-term credit investors through stronger structures and more attractive new-issue concessions. Existing bonds, however, may remain vulnerable as successive waves of issuance reprice secondary markets.

The Weakest Links in AI Financing May Matter Most

Companies with weaker balance sheets or business models dependent on continued external financing are naturally more sensitive to higher borrowing costs. Hyperscalers and semiconductor leaders have substantially greater financial resources, but that doesn't necessarily insulate them from the broader financing challenge.

As stronger companies increasingly use their balance sheets to support weaker participants through guarantees, leases, and other arrangements, they may take on more of the economics and risk themselves. That support can help sustain investment, but for creditors and shareholders, the question is how far those companies will extend their balance sheets to support the AI investment cycle.

Growing AI Debt Supply Could Pressure Credit Markets

The prospective volume of issuance also deserves attention. Historical analysis suggests that rapid debt growth across a significant portion of a sector can pressure spreads. Sustained AI issuance could continually reset clearing levels, forcing borrowers to pay larger concessions to attract capital.

That potential supply pressure reinforces the need for selectivity. As a team, we currently favor maintaining a structural underweight to some aggressive borrowers and areas facing substantial supply, while remaining willing to add exposure when new issues offer sufficient compensation. Importantly, technological success, borrower quality, and bond valuation aren't necessarily the same thing.

AI Financing Costs Could Have Broader Economic Effects

The bigger question extends beyond individual securities. If credit markets demand steadily higher borrowing costs, companies have several options. They can accept lower returns, adjust financing terms, raise more equity, or lean on stronger balance sheets. Ultimately, they may also choose to slow investment.

How companies respond could have broader economic implications. A slower build-out could moderate economic growth and inflation. Conversely, if AI investment proves relatively insensitive to higher financing costs, even more capital could be drawn into the sector, potentially putting upward pressure on yields and spreads elsewhere.

That's why credit markets warrant as much attention as AI earnings, adoption, and equity valuations. Financing demand could expand the opportunity set for bond investors, but supply, structure, liquidity, and borrower discipline will matter enormously. The AI revolution may continue, but credit investors could increasingly help determine the price and pace at which it gets financed.

To learn more about today's opportunities in fixed income, talk to your financial professional.

[1] Spreads are the difference in yields between two fixed-income securities with the same maturity but originating from different investment sectors.

Important Risks: Investing involves risk, including the possible loss of principal. • Fixed income security risks include credit, liquidity, call, duration, and interest-rate risk. As interest rates rise, bond prices generally fall. • Focusing on one or more sectors, may be subject to increased volatility and risk of loss if adverse developments occur.

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