US Rates Strategy Weekly

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- **Spending on AI-related equipment and software surged last year, rising 118% in the GDP accounts**. But is the AI contribution to economic growth as large?

- A significant portion of AI hardware investments is imported so the direct contribution to GDP is smaller. **We estimate spending on computers, servers and software added an average of 0.4% per quarter to GDP last year**. Outside of AI, the economy expanded solidly in 2025.

- The GDP statistics poorly capture the use of AI as an input into production. As a result, it may be hard to see the direct effects of AI on productivity.

- The retracement from peak stress reveals an important asymmetry across rates markets. Outright yields remain sticky, while volatility has largely normalized.

- We favor steepeners (2s10s) based on the view that front-end yields will remain anchored or fall, while the long end underperforms.

- Upper left vol should remain under pressure with the Fed to remain on hold, and positioning cleaner, while longer tails find support from macro uncertainty.

- Tuesday's PPI release headlines the week's economic calendar. This will be the first look at how producers' costs have responded to the ongoing Middle East conflict. **We look for headline PPI to rise by 2.1% MoM and core PPI to increase 0.8%.** PPI is particularly sensitive to raw energy costs which surged in the month.

AI: Less than it seems?

Spending on AI-related equipment and software surged last year, rising 118% in the GDP accounts and accounting for as much as 50% of last year's growth in output. **But while dramatic, is AI that big a driver of GDP growth and are we measuring it correctly?**

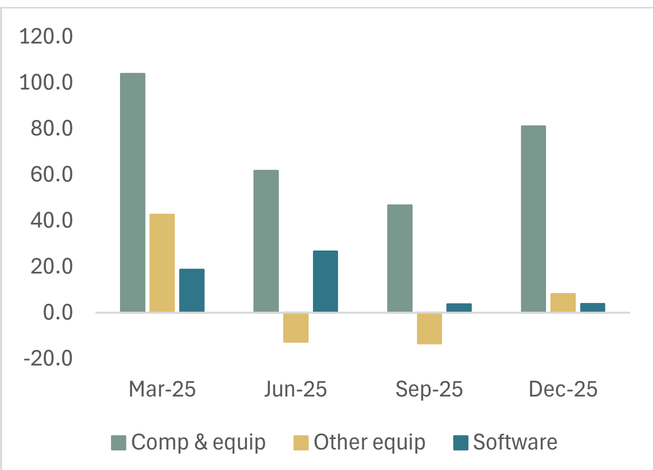
Following Carpinelli et al, we consider three aspects of AI-related activity.[1] First, there is investment spending tied to hardware. This includes spending devoted to designing and making AI chips, as well as server assembly. This sector is dominated by a few large, global firms. A significant portion of this activity occurs outside the US so hardware expenditures increase *both* investment and imports in the GDP accounts. Second, there is spending tied to cloud infrastructure which includes web hosting as well as AI model training. This spending tends to be more domestic; the largest providers are located in the US. Hyperscalers own and operate data centers and charge for AI-related use. The GDP calculation uses

[1] See, "Artificial Intelligence and the US Economy: An Accounting Perspective on Investment and Production", L. Carpinella, F. Natoli, and M. Taboga, Bank of Italy, January 19, 2026.

reported revenues from these providers. But these revenues also include non-AI earnings from web hosting and database management. Finally, AI is used as an input into the production of other goods and services. We have very little data on this activity. As AI is adopted and integrated with production, these unobservable inputs will become more important in productivity calculations.

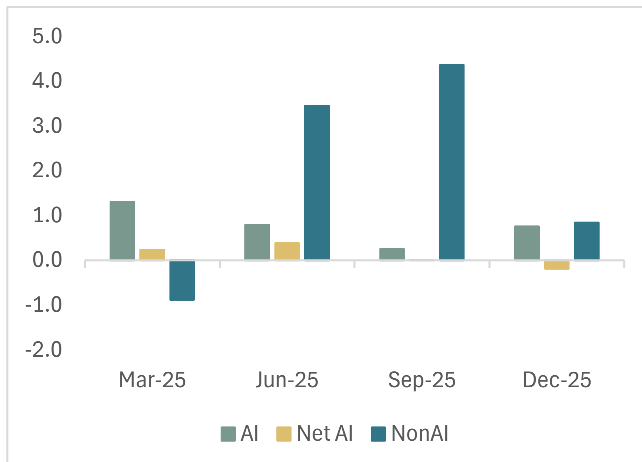
Within the GDP statistics, there is no AI-specific expenditure category. **Instead, we look at the GDP components most closely related to AI-related spending – specifically, fixed investment in computers and peripheral equipment[2], other related equipment and software expenditures**. These components grew very rapidly last year as spending on new plants and chip manufacturing surged. Cumulatively, these investments rose nearly 20% in 2025. The strongest growth in these expenditures occurred in the first half of the year although spending outside computers and equipment was somewhat lumpy (Figure 1). Consistent with the heavy non-domestic share of AI-related hardware, imports of computers, peripherals and parts also increased sharply in 2025; rising 90%. We netted out imports as GDP measures *domestic* production and recalculated the collective contribution of AI expenditures to quarterly GDP growth (Figure 2). **On average AI-related expenditures added about 0.4% per quarter to quarterly GDP growth**.

Figure 1: AI-related investment (% q/q, ar)



Source: BEA, SMBC Nikko

Figure 2: Contributions to GDP growth (% q/q, ar)



Source: BEA, SMBC Nikko

Two things stand out from these data. First, the imported content of these investments is high; netting out domestic production substantially reduces the direct contribution of AI investments to GDP growth. **Second, the non-AI economy was growing solidly last year although both it and AI spending cooled in Q4.**

However, these data measure only new investment. They do not measure the "value added" to GDP from the flow of goods and services created from existing capital. The BEA's "value added" measures from the manufacturing of computers and business services from computer design are similar in size to the GDP expenditure contributions (Figure 3).

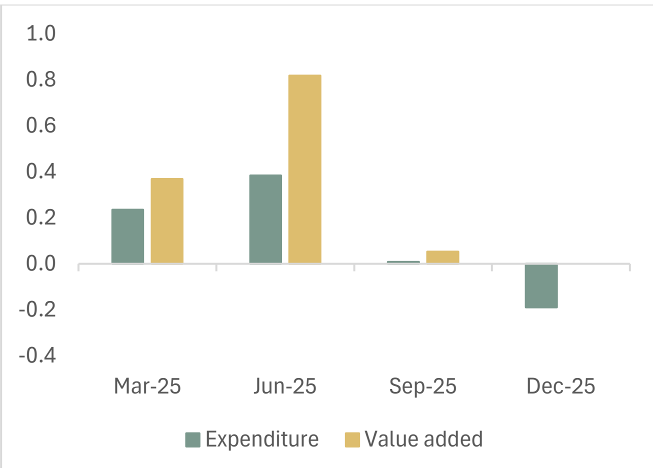
We are not considering obsolescence effects from rapidly evolving AI technology. This could mean that the AI investments have short lifetimes and that spending needs to remain elevated just to stay ahead of the innovation cycle. But this does not prevent the equipment from being reused for other, less

[2] This includes spending on servers.

technologically demanding purposes. As a result, we wonder if the "value added" approach to accounting for AI spending in the GDP accounts is more useful.

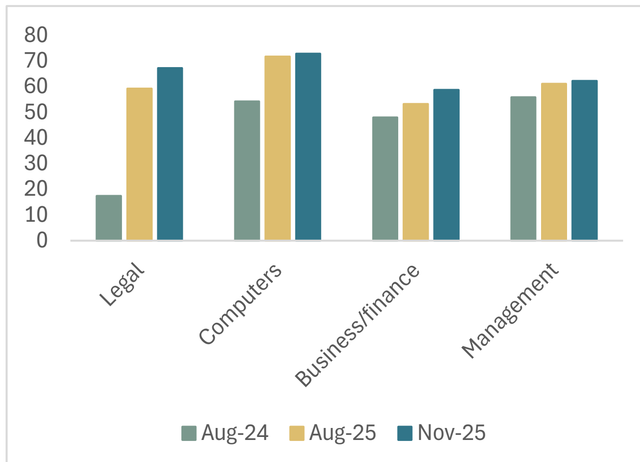
That said, neither of these approaches give us a sense of how AI inputs to production boost output or increase worker productivity. Instead, estimates of productivity are largely based on worker surveys. But these estimates are subject to some interpretation. This is particularly relevant to some types of business services which have seen very steep AI adoption rates. Adoption in legal services has increased since August 2024 even faster than in computer services (Figure 4). AI use in management appears to have plateaued since last summer. **That said, most of the current corporate work using AI is experimental or only at the pilot stage. And adoption is highest for relatively easy tasks that have readily defined, measurable outcomes**. These tasks are likely to be the first to be automated and replaced by AI once the technology is rolled out firmwide.

Figure 3: GDP growth contributions (% q/q, ar)



Note: The value added data are only available through Q3 25.
Source: BEA, SMBC Nikko

Figure 4: AI-adoption by occupation (%)



Source: Federal Reserve Bank of St. Louis, SMBC Nikko

Rates: Is the retracement sending a signal?

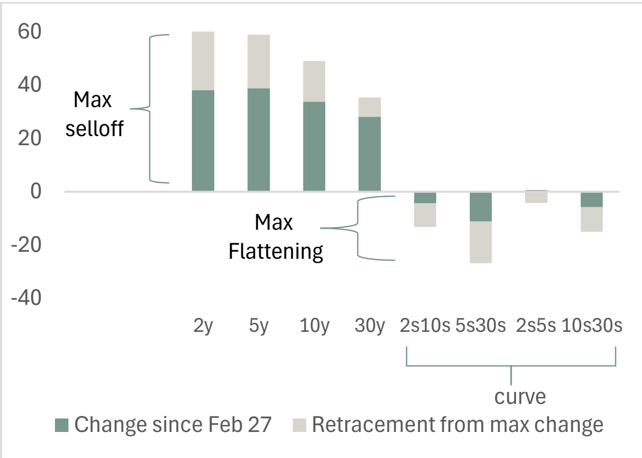
The retracement from peak stress (Figure 5 and Figure 6) continues to reveal an important asymmetry across rates markets. Outright yields remain sticky, while volatility has largely normalized. Nominal yields have retraced only 20-34% of the prior sell-off, with the long end lagging most at roughly 20%.

Part of this reflects the front-end retracing more due to a larger initial move. But the long-end's limited rally (about 6bp) also points to an increase in inflation risk premium due to higher oil and some fiscal concerns. Even if the budget deficit does not deteriorate much from here, the probability of improvement is lower.

Favor steepeners

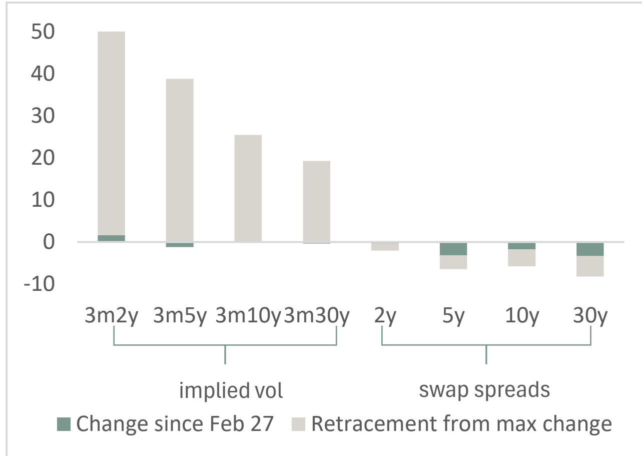
We continue to favor steepeners, particularly 2s10s, based on the view that front-end yields will remain anchored or fall, while the long end underperforms. The Fed is unlikely to hike and may cut in response to slowing growth and a softening labor market. In contrast, the long end remains exposed to both inflation risk premia and fiscal dynamics, which should limit the scope for a sustained rally. Investors may also find the 5s30s steepeners attractive due to carry considerations.

Figure 5: Retracement in UST and curve (bps)



Source: Bloomberg, SMBC Nikko

Figure 6: Retracement in vol and swap spreads

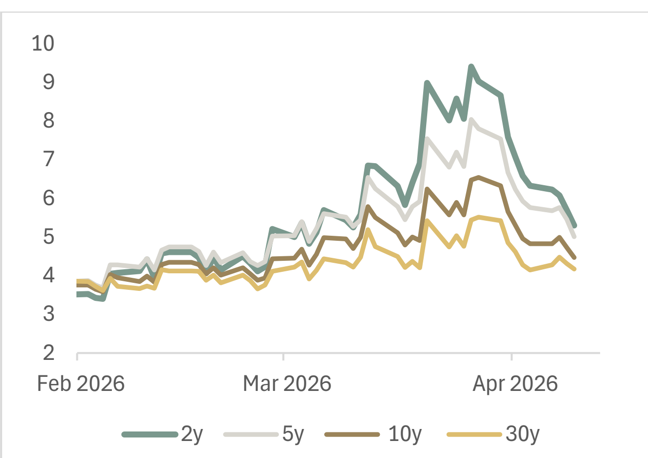


Source: US Treasury, SMBC Nikko, ICAP

Vol rotation out of the upper-left into longer tails

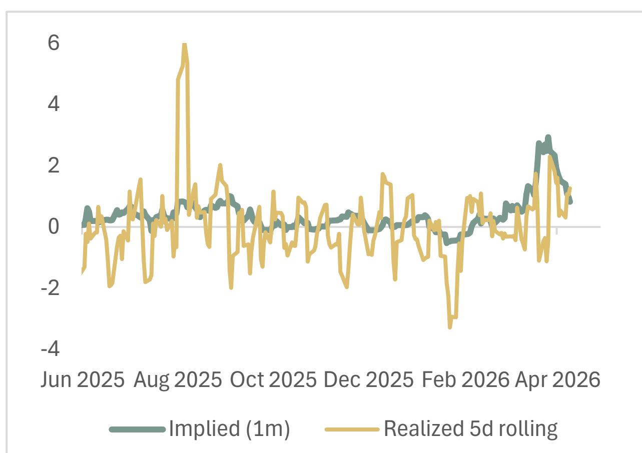
Figure 7 shows the positioning driven spike in implied vol across shorter tails relative to longer maturities. With the Fed on hold and uncertainty shifting away from near-term event risk toward a more persistent inflation-growth trade-off, volatility is likely to continue migrating rightward along the surface. This dynamic favors selling upper left vol (example 3mx2y) versus owning longer tails (3mx10y), particularly in scenarios where renewed geopolitical escalation triggers episodic spikes in front end vol similar to those observed into late March. Figure 8 further shows that the 1m2y vs. 1m10y implied vol spread had richened significantly to realized vol differential (5d vol on 2y vs. 10y). This dislocation appeared driven by positioning combined with the shock appearing after a large rally pricing 60 bp of cuts in 2026 due to private credit and AI led labor market concerns against fears that the Fed may adopt the 2022 type playbook to the supply side shock. However, with the Fed expected to remain on hold, and positioning cleaner, upper left vol should remain under pressure while the longer tails may find relative support, particularly as macro uncertainty becomes more persistent.

Figure 7:3m implied vol (daily normal bps)



Source: Bloomberg, SMBC Nikko, ICAP

Figure 8: Spread of 1m implied and 5d realized vol of 2y vs.10y (daily normal bps)



Source: US Treasury, SMBC Nikko

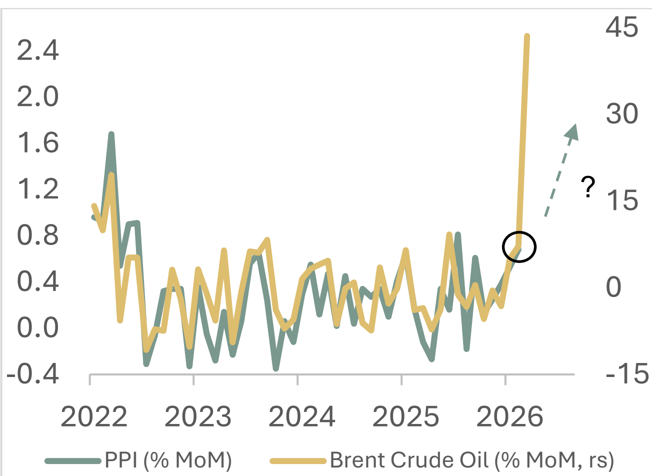
Week ahead

- **Existing Home Sales (Mar., Mon)**: The existing home market continues to be dogged by a lack of supply and demand (low home affordability). Consequently, the level of existing home sales has been depressed and has trended sideways since January 2023. While incoming housing supply has been incrementally positive, housing demand remains soft and home price outlook is weak.

- **Producer Prices Report (Mar., Tues)**: We are forecasting 2.1% MoM and 0.8% MoM for headline and core producer prices. Producer prices are highly sensitive to commodities prices which broadly rose in the month of March as a result of the Middle East conflict and the shutting of the Strait of Hormuz. Brent crude increased by 43.6% MoM, which is highly correlated with headline PPI prices (shown below), while commodities prices increased 10.9% MoM (Bloomberg commodity index).

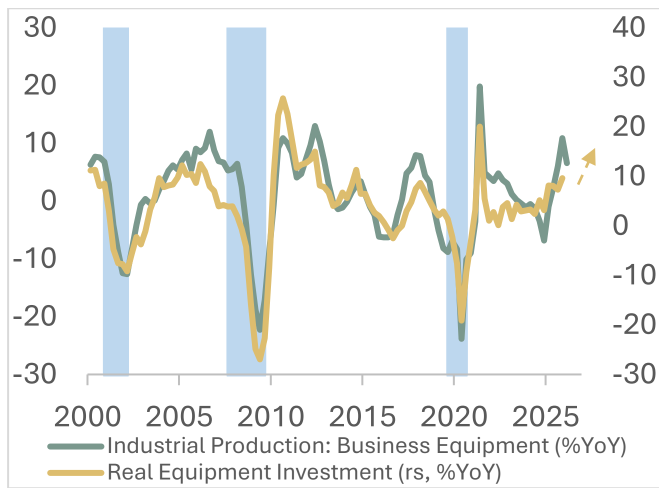
- **Industrial Production (Mar., Thurs)**: We are forecasting a 0.3% MoM jump in March industrial production. This follows a modest 1.6 point increase in the ISM manufacturing production index. We are particularly focused on the report's business equipment subcomponent, which is tightly correlated with real capital expenditures (CapEx), as shown below. This is critical as the ongoing CapEx cycle, from the AI ecosystem buildout, has been a significant driver of US growth in recent years.

Figure 9: PPI (%m/m) and Crude Oil prices (%m/m)



Source: BLS, FT, Haver, SMBC Nikko

Figure 10: Industrial Production of Business Equipment and Real CapEx (%y/y)



Source: Federal Reserve, BEA, Haver, SMBC Nikko

Table 1: Economic indicator forecasts

SMBC US Forecasts						
Date	Indicator	SMBC Forecast	Market Consensus (Median)	Prior	Range of Est.	Notes:
Apr 13	Existing Home Sales (10 AM)	-5.5%	0.2%	1.7%	-	Dogged by a lack of supply and demand, existing home sales have moved sideways since January 2023.
Apr 14	PPI MoM (8:30 AM)	2.1%	1.7%	0.7%	1.3% - +2.0%	PPI is highly sensitive to oil & commodities. WTI and Brent increased by 41% MoM and 43.6% respectively.
Apr 14	Core PPI MoM (8:30 AM)	0.8%	0.5%	0.5%	0.3% - +0.6%	Broad bloomberg commodities index increased by 10.9% MoM.
Apr 16	Industrial Production (9:15 AM)	0.3%	0.2%	0.2%	0.1% - +0.3%	ISM manufacturing production increased modestly by 1.6 points, from 53.5 to 55.1 in March.

Forecasts subject to change

Source: SMBC Nikko Securities US Economics Forecasts

Table 2: GDP and interest rate projections (%)

(%)	2025	2026				2027	
	Q4 Act	Q1F	Q2F	Q3F	Q4F	Q1	Q2
Real GDP QoQar	1.4	1.6	1.1	2.1	2.2	2.0	2.4
Real GDP YoY	2.2	2.8	2.1	1.6	1.8	1.8	2.2
Core PCE YoY	2.9	2.7	3.2	2.8	2.4	2.3	1.9
Unemployment	4.4	4.5	4.8	4.7	4.6	4.6	4.6
Fed Funds Rate Upper Bound	3.75	3.75	3.75	3.75	3.75	3.75	3.50
2 Year	3.47	3.79	3.65	3.60	3.60	3.50	3.50
5 Year	3.73	3.94	3.80	3.75	3.75	3.60	3.60
10 Year	4.17	4.32	4.20	4.25	4.30	4.30	4.30
30 Year	4.84	4.91	4.70	4.80	4.85	4.90	4.90

Source: SMBC Nikko

Disclaimers