Northmarq

VIEWPOINT

SPECIAL MID QUARTER EDITION

Economic Commentary:

Inflation Broadens as AI Investment Risk Rises

November 2026

Commercial Real Estate Debt + Equity | Investment Sales | Loan Servicing | Fund Management

VIEWPOINT

November 2026

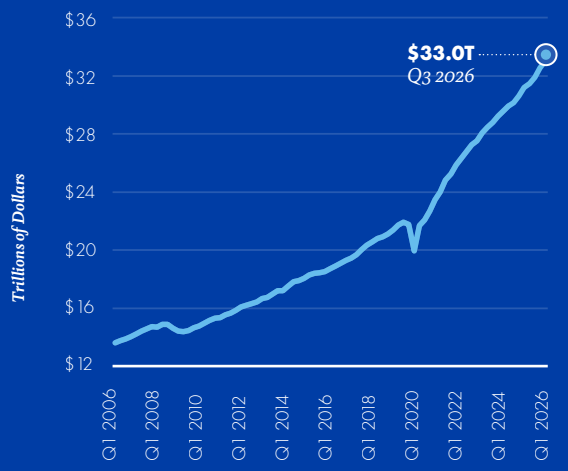
Along with ongoing concerns about energy prices and the economic impact of the war, the November elections brought the prospect of slower AI investment growth to the forefront of economic discussion. AI investment has been the primary driver of economic expansion over the past several years. With elevated interest rates already weighing on traditional, or "old economy," businesses, the potential slowdown in AI investment represents an additional macroeconomic risk. This further complicates the Fed's policy calculus as it weighs the risks of tightening monetary policy in an increasingly bifurcated economy whose primary engine of growth may be losing momentum.

Inflation broadens beyond energy prices

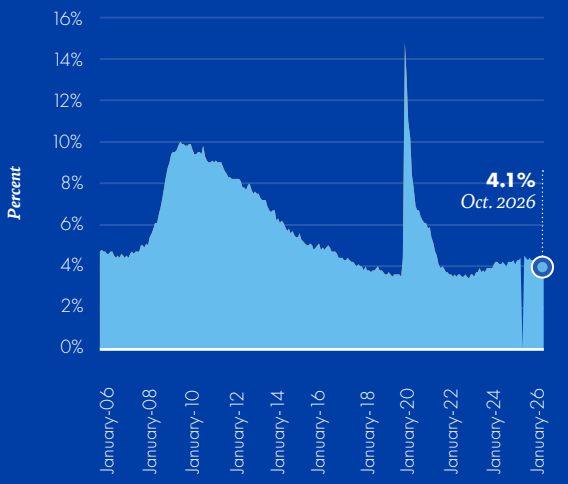
Inflation readings for September and October were generally stronger than expected. Headline Consumer Price Index (CPI) inflation rose 0.6% in September, driven in large part by a 9.1% increase in gasoline prices, and that was followed by a stronger than expected 0.4% increase in October, bringing the year-over-year reading to 3.9%. The increases have been broad-based, with no major category registering a decline. Core CPI rose 0.3% in both months. This was the third straight month of a 0.3% reading for core CPI, and the three-month pace at 3.7% annualized is the highest since April 2024. The Producer Price Index (PPI) has also firmed, pushing its year-over-year increase to the highest level since 2022. Energy prices, particularly diesel, remain the primary driver of producer price pressures. The Fed is concerned that inflation is broadening, and these recent reports do not alleviate that concern.

The Fed's preferred inflation measure, core Personal Consumption Expenditures (PCE), increased 0.3% in September, lifting the year-over-year rate to 3.1% from 3.0%. The three-month annualized trend accelerated to 2.9%, up from 2.2% in August and 2.6% a year earlier.

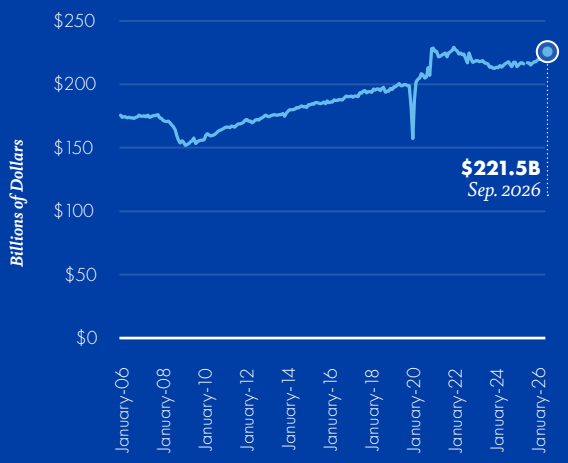
GROSS DOMESTIC PRODUCT (GDP)



UNEMPLOYMENT RATE



RETAIL / FOOD SERVICE SALES



Source: Northmarq, U.S. Bureau of Economic Analysis, U.S. Bureau of Labor Statistics, U.S. Bureau of the Census; Oct. 2025 data not available

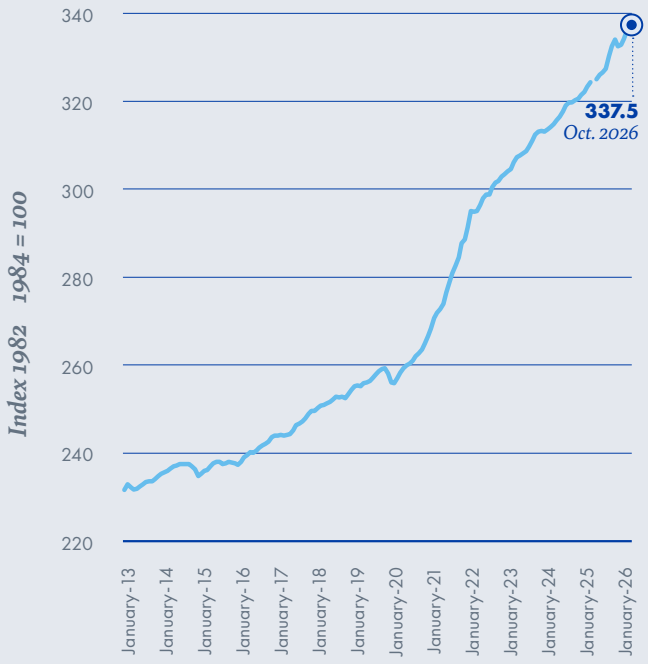
The inflation outlook remains vulnerable to higher energy prices and fiscal pressures. The surge in diesel prices represents the primary upside risk to inflation, as higher fuel and freight costs can feed into core inflation by raising the cost of producing and transporting consumer goods. An increasing share of small businesses also plans to raise prices, citing inflation as the primary reason. The energy shock is entirely exogenous and, in its economic impact, is akin to a tax increase. The implication of Fed Chair Kevin Warsh's monetary policy stance is that demand destruction may be the only available transmission channel for bringing inflation back to the Fed's 2% target unless oil prices decline rapidly. Because current inflationary pressures are fundamentally supply-driven rather than demand-driven, higher interest rates can counter them primarily by weakening demand enough to offset the loss of supply.

Strong GDP growth, strained consumers

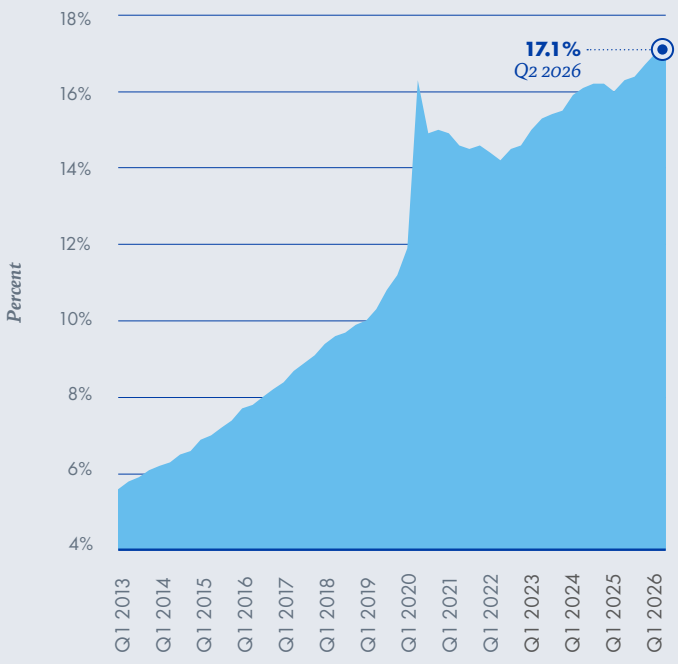
The initial estimate of third-quarter GDP showed a strong 3.4% annualized increase, up from 2.2% in the second quarter. On a year-over-year basis, however, GDP growth was 2.1%, down slightly from 2.2% in the second quarter.

- AI-related business investment remained a major engine of growth
- Consumer spending proved resilient
- Productivity increased at a robust 3.6% annualized pace
- Unit labor costs declined at a 0.7% annualized rate

CONSUMER PRICE INDEX (CPI)



E-COMMERCE RETAIL SALES (% TOTAL SALES)



Source: Northmarq, U.S. Bureau of Labor Statistics, U.S. Bureau of the Census; Oct. 2025 data not available for CPI

Real final sales to private domestic purchasers, a measure of consumer spending and gross private fixed investment, increased 4.9%, marking the strongest quarterly reading since second quarter 2021. Looking ahead, election-driven constraints on data center investment represent a meaningful macroeconomic risk, given that AI investment has been the primary driver of economic growth over the past several years.

The September personal income and spending report once again highlighted growing pressure on consumers. Real consumer spending was flat for the first time since January, although it remained up 2.5% year over year. On the income side, real disposable personal income declined 0.3% during the month, bringing its year-over-year growth rate to just 1.0%. With income growing at less than half the pace of spending, the personal saving rate declined to 3.8% from 4.0%, matching its lowest level in the past three years.

Consumer spending remains uneven and disproportionately supported by higher-income households. The squeeze on real incomes from higher energy prices is likely to increasingly weigh on lower-income consumers, who devote a disproportionate share of their budgets to energy. Despite the strong third-quarter GDP reading, September's personal income and spending data suggest a considerably weaker handoff into the fourth quarter.

Manufacturing and services continue expanding

The ISM Manufacturing Index rose to 55.5 in October from 54.5 in September, marking the tenth consecutive month of expansion and signaling a broadening industrial recovery. Computer and electronic products continued to expand, while supply shortages across AI and data center supply chains persisted. Production registered its strongest reading since late 2021, and inventories returned to expansion territory. Price pressures remained elevated, although the prices index eased modestly from the prior month.

The ISM Services Index edged lower in October, declining to 54.4 from 54.9. While business activity and new orders moderated slightly, the report continued to indicate solid expansion across the services sector. Notably, the employment index, which has lagged broader services-sector growth over the past year, increased for the second consecutive month. The prices index also remained elevated, declining only modestly from September, when it reached its highest level since 2022. Signs of continued supply chain stress, combined with the energy price shock, suggest that inflation will remain sticky in the near term.

Hiring strengthens as unemployment declines

Nonfarm payrolls increased by 165,000 in October, substantially exceeding expectations. In addition, employment gains for the prior two months were revised upward by a combined 84,000. Private-sector payrolls rose by 159,000, while government employment increased by 6,000. Hiring was strong and broad-based. Average hourly earnings increased 0.4% during the month, while year-over-year wage growth moderated to 3.1% from 3.2% in September. With year-over-year productivity growth exceeding 2%, labor costs do not currently appear to be a significant source of additional inflationary pressure.

The unemployment rate declined to 4.1% from 4.2%, as household employment increased by 463,000 and the labor force expanded by 421,000. The labor force participation rate rose to 61.9%, its highest level since March. A less encouraging development was the 356,000 increase in the number of people working part-time for economic reasons, reflecting slack work or unfavorable business conditions.



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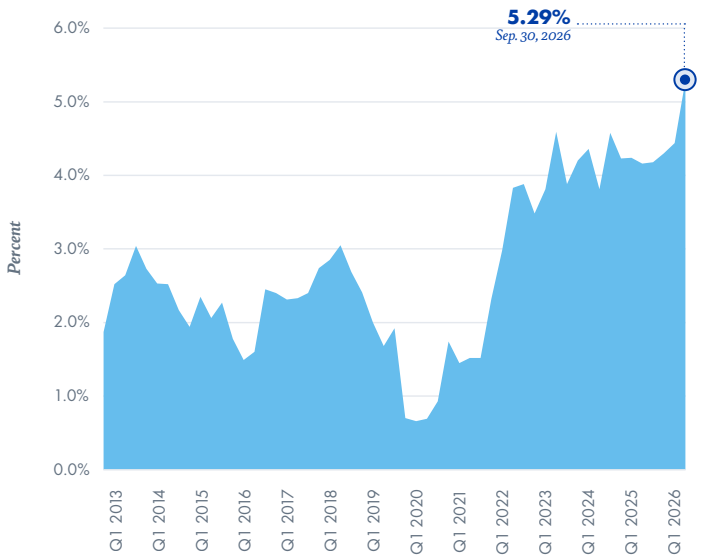
Markets expect a December rate hike

The Fed's next meeting is scheduled for December 8–9. In addition to reviewing inflation and employment conditions, policymakers will need to consider emerging signs of credit stress at the weaker end of the market. CCC-rated credit spreads are among the first areas showing signs of strain, consistent with the tendency for financial stress to emerge among weaker borrowers before spreading more broadly. Furthermore, the full effects of the Fed's September rate increase have yet to materialize, as changes in monetary policy typically affect the economy with a lag.

As noted at the outset, shifting expectations surrounding the AI buildout are also becoming an increasingly important consideration. As AI investment transitions from being primarily cash-funded to increasingly debt-funded, higher interest rates and widening credit spreads become more consequential for the sector. A growing disconnect is emerging between AI companies' borrowing ambitions and what investors appear willing to finance. The prospect of accelerating leverage has unsettled markets and raised questions about the sustainability of the investment cycle.

Based on the recent strong readings for inflation and employment, markets are pricing in an interest rate hike at the December meeting as well as two more in 2027 despite the fact that the recent AI selloff and widening credit spreads have already delivered some additional financial tightening.

10-YEAR TREASURY RATE



Source: Northmarq, U.S. Federal Reserve; graph includes quarter-end values and may not illustrate daily high or low points throughout the quarter

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