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Artificial Intelligence

The good, the bad, and the ugly

AI has the potential to drive significant improvements in productivity and open up new opportunities for businesses…

…but not everyone will benefit equally, and some fear the technology could even pose a threat to humanity

Who to believe? We go through the arguments and evidence about the good, the bad, and the ugly aspects of AI

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Artificial Intelligence

The good, the bad, and the ugly

The AI revolution is upon us. As with the internet in the late 1990s, AI technology has the potential to lead to significant productivity improvements. However, these benefits are unlikely to be evenly distributed. To help investors understand the impact that AI is likely to have on the economy, we look at the good, the bad, and the ugly of AI.

Exciting times

AI has been productively employed in many areas of the economy now for several years, but in the past 18 months, public interest has boomed. In financial markets, the technology has gone from being the specialist subject of a handful of analysts to one of the most widely discussed themes, with announcements on the topic capable of precipitating major market moves.

Why the excitement now? What's changed, of course, is Generative AI. Before the release of ChatGPT in late 2022, most people believed there was something uniquely human about the act of being creative. ChatGPT (and other models since) have clearly shown that AI is also very capable at this skill.

This has been a psychological shock for some. The response has been a significant degree of polarisation. We see lots of hype from those who are excited about this technology and its potential to drive productivity. Others worry about the potential side-effects, such as jobs being displaced. The more pessimistic fear the scope for significant harm or even an existential threat to humanity.

Who to believe? Well, in our view, the most likely outcome is probably somewhat more prosaic than the arguments at either end of the spectrum. Broadly speaking, we see grounds to be optimistic about the wider economic impact of AI, though not all companies, markets and people will benefit equally. But while we are not necessarily convinced by some of the arguments about the perceived threat of AI, we think it is useful for investors to understand them, given that they have the potential to shape opinions towards a technology already driving huge shifts in asset prices.

The full note, available to clients of HSBC Global Research, explores the arguments and evidence about the good, the bad, and the ugly aspects of AI, from aggregate productivity (good), to a look at capital vs labour (bad), to what the nature of "truth" is (the ugly) – and so much more.

The good

- **Aggregate productivity**. Generative AI technology has the potential to lead to broad productivity increases across the entire economy, with estimates implying an annual boost in the range of 0.1-1.0%. If realised, this would be a significant tailwind for equity markets. However, past examples of similar technological development suggest this boost may be more elusive than many currently expect. We look to history to see what can be learned from similar technological leaps.
- **Broad benefits**. We look at the wide range of sectors – including design, pharmaceuticals, financial services, hospitality and logistics – that are already employing AI to increase efficiency and improve services for customers.
- **Winners vs losers**. Within sectors, companies that use AI more effectively are likely to outperform those who do not. Identifying the best-placed competitors could allow active investors to more effectively invest in the AI theme. We discuss which metrics investors should be watching.
- **Timelines.** How quickly could the potential benefits become clear? Since markets are constantly trying to price in future expectations, changes in the consensus opinion will lead to sharp price movements. Investors should consider carefully their own view on this, so they can take advantage of any perceived mispricing.

0.1-1.0%

Potential increase estimates in labour productivity from AI by McKinsey and PwC

The bad

- **Capital vs labour**. An increasing number of roles are at risk of being replaced by AI-powered automation. Even if AI doesn't lead to a significant loss of jobs, it is likely to lead to a shift in the share of profits between capital and labour. Investors could consider the impact on the sectors they cover.
- **Some cautionary tales**: While it's easy to see the opportunities of how AI could be transformational to the global economy, it's important to keep in mind the historical examples of similar technological breakthroughs that looked to have a similarly transformational impact at the time, only to be false dawns. We look at the potential parallels.
- **Competition.** The potential benefits from AI may appear so appealing that companies are prepared to over-compete for them. For example, training large language models is costly, but how far they can be directly monetised is debatable. Investors should consider whether competition will push the price of AI services so low that *consumers* end up being the beneficiary rather than the companies most directly exposed to the AI theme.

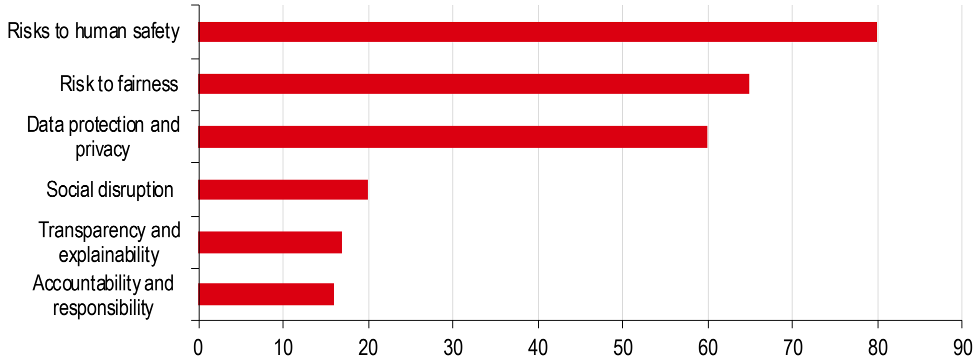
15%

Of tasks could be impacted by AI, based on estimate from OpenAI

The ugly

- **The nature of truth**. Over several generations, humans have developed many heuristics which have, thus far, served us well. Most notably, we say that 'seeing is believing'. Well, not any more thanks to Generative AI. This has significant implications for cyber security, fraud, and political harmony.
- **Greater energy use**. The greater use of power-hungry AI tools means a faster growth in electricity demand, meaning technological breakthroughs in power supply may be needed to keep up with greater use of AI.
- **Distributional impacts, including on EM**. While developed markets (DM) have a greater share of the jobs that are more likely to be affected by AI in the short term, emerging markets (EM) could face greater disruption in the long term if tasks that are currently being outsourced to EM can be made more efficient by AI. This would likely reduce the demand for jobs to be offshored, and have a significant influence on the pace of development in many EM markets.

Top challenges addressed in emerging AI-related regulation



Source: OECD.AI, HSBC

It is still relatively early days for AI. Its impact in the areas above and others besides will become clear in time. But there are already more than enough potential consequences for economists, businesses, regulators – and of course investors – to weigh up.

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