# Cracks start to widen in AI boom

**Nick Beams**
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The fissures that have been developing in the high-tech and AI boom over recent months became significant cracks last week, as some of the biggest names in the US and global economy saw hundreds of billions of dollars wiped off their market value.

The tech-heavy NASDAQ index closed 3.5 percent lower and briefly entered so-called "correction" territory, down 10 percent from its high on October 6.

The selloff began on Thursday when shares in Alphabet (the owner of Google) dropped 13 percent and its market value fell by $500 billion—its largest ever one-day loss and one of the largest in Wall Street history. Shares in Intel, one of the long-time leaders in chip production for PCs, plunged 29 percent on Friday after significant earlier falls cut $140 billion from the company's market value. It was the biggest decline since August 1974.

The big tech companies were hit hard, losing a total of $900 billion after announcing plans to increase spending on the AI buildout. The major concern is that they will not be able to generate sufficient revenue and are going deeper into debt.

The initial phase of the AI boom was financed by the cash reserves held by these companies, but they have been largely exhausted. Google is a case in point.

It boosted its AI spending to more than $50 billion in the third quarter and has started to burn cash. It is expected to spend even more in the current quarter, some $71 billion.

Google announced that its free cash flow, the money it has in hand from its business operations after paying out for capital, had fallen deeper into negative territory in the September quarter, coming in at minus $9.1 billion compared to minus $5.9 billion in the June quarter.

Summing up the major concern in the market, Deutsche Bank analysts wrote in a note: "The results raised questions about whether the payoffs will come fast enough to justify the company's record capex spending."

All the corporations involved in the AI buildout are more than aware of the dangers involved. But they are compelled to continue spending in order to obtain their share in the profits expected from the use of AI. If they do not, they run the risk of falling behind in the race to the top.

The situation facing Google is complicated by the fact that the development of AI, in which is it is compelled to participate, is hitting its core business and major revenue-generating activity—the money it receives in advertising derived from its search engine.

The company revealed that its Google Services unit generated $96.3 billion in the third quarter, below Wall Street expectations of $98.3 billion. Google Search revenue grew 12 percent in the year to the third quarter down from 17 percent growth in the second and 19 percent in the first.

This is an indication that Google is missing out on revenue because users can bypass its sponsored links through the use of AI. This means that in further developing AI, Google runs the risk of essentially cannibalising its major source of revenue.

Shares in the four major hyperscalers—Amazon, Meta, Microsoft and Alphabet—all fell after their third quarter results revealed that capital expenditure almost doubled, rising from $113 billion a year earlier to $207 billion, with a further $232 billion to be spent in the fourth quarter, which would take spending this year to $740 billion.

While Google was the most prominent, the others also experienced falls in expected revenues that hit their share price. Amazon, for example, reported that its advertising services unit grow by 11 percent, the slowest rate of expansion since it was established as a separate category in 2022, and its online stores business grew by just 2 percent, the lowest level in three years.

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The change in market sentiment was outlined by one analyst cited by the *Wall Street Journal*. Until recently, she said, "if you were spending, that shows conviction in this buildout. You get rewarded for spending money. All of a sudden spending cash is seen as a headwind, not a tailwind."

Peter Boockvar, the chief investment officer at a large investment management firm told the *Journal*: "Right now, we're seeing tremors in the ground. You can't necessarily connect the cracks to each other. But when enough cracks take place, does that eventually lead to the road caving in?" Past experience shows that it does and the massive speculative AI bubble portends a financial crisis beyond anything seen in the past.

Sentiments in Asia are even more downbeat than in the US. Japan's tech-heavy Nikkei 225 index closed down 2.1 percent. Leading the way was the major OpenAI investor SoftBank whose shares fell 6 percent. Since its June peak, its shares have fallen 48 percent.

As one equity strategist told the *Financial Times*: "The major tech names are entering a no man's land where they become uninvestable. When heavyweights like Softbank halve in value over a few months, its neither a buy or a sell, Investors will simply want to keep out of the way."

In South Korea, shares in Samsung Electronics fell by more than 4 percent after its chipmaking division, which supplies data centres, reported a lower-than-expected operating profit. It shares are now down more than 30 percent from their peak in June amid the uncertainty which is spreading everywhere about the sustainability of the hundreds of billions of dollars being spent on the AI buildout.

The basic scenario advanced is that AI will bring about such an increase in productivity that eventually there will be enormous profits for those firms that are able to claw their way to the top by producing, through massive spending, a product superior to those of their rivals.

But considerable doubt has been cast on this prospect in a recent analysis by Torsten Slok, the chief economist at the major US asset management firm Apollo, whose comments are widely followed.

"Despite massive investments and widespread hype around artificial intelligence, the technology has delivered zero financial payoff to corporate America outside of tech."

Profits were rising for the so-called Magnificent 7 but profit margins for the other 493 companies in the S&P 500 remained flat and there are "no signs of AI boosting productivity growth."

"The bottom line is that the AI story will be decided in the S&P 493, not the Mag 7 and so far there is no evidence that revenue growth or margins are improving outside the tech sector."

That does not deny the enormous increase in productivity of human labour, knowledge and capacity which AI has the potential to bring. But the capitalist system functions on the extraction of profit—a sufficient rate of return on the enormous outlays that have been made and which are to come. And that is increasingly being called into question.

The worsening situation has been underscored by a report from the consultancy firm Gartner. It estimated that to cover their capital and financing costs, data centre owners would need to generate $8.5 trillion in revenue by the end of 2030. But it projected the consumer and corporate spending on AI would provide "no more than $3.6 trillion."




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