

The next financial crisis could spiral into mutual destruction

Risk has migrated out of the banks, states have never been so indebted in peacetime, and artificial intelligence is upending markets. But the amplifying risk lies elsewhere.

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Financial crises cannot always be prevented. Regulation and supervision can contain risks, but shocks remain inevitable. What can be shaped is what comes next. The impact of a crisis depends less on the initial disturbance than on the response to it. That is the difference between robustness and resilience — and in the case of global financial crises, resilience requires international cooperation. Cooperation stabilises the system and keeps national policy responses from degenerating into mutually destructive spirals.

The 2008 financial crisis is a case in point. It did great damage. Yet, unlike the interwar period, it did not set off a cycle of retaliation among the major economies. There was no generalised turn to trade protectionism and no currency war. The United States and China kept their trade and monetary relations stable. Public interventions were closely coordinated within the G20. Central bank swap lines, which allowed monetary authorities to supply one another with liquidity, were essential to stabilising global markets.

Today's context could hardly be more different. Inhibitions about protectionism have largely vanished. So far, trade flows have proved remarkably resilient in the face of rising tariff barriers. But the interwar years teach us that once protectionism comes to be seen as an acceptable policy response, a financial shock can quickly translate into mutually reinforcing contractions in trade, capital flows and confidence. Few safeguards remain. Such a shock could therefore become far more dangerous than the initial disturbance.

All the more so because the transactional approach that currently prevails in international relations is poorly suited to crisis management. Cooperation between countries rarely rests on pure altruism. But as Charles Kindleberger argued, the stability of the international system requires at least one country willing to play a stabilising role — that is, to keep markets open and provide liquidity when the situation demands it. Today no country, and the United States least of all, appears willing to shoulder that responsibility. On the contrary, essential instruments of cooperation such as central bank swap lines risk being politicised, weakening one of the most effective tools of crisis management.

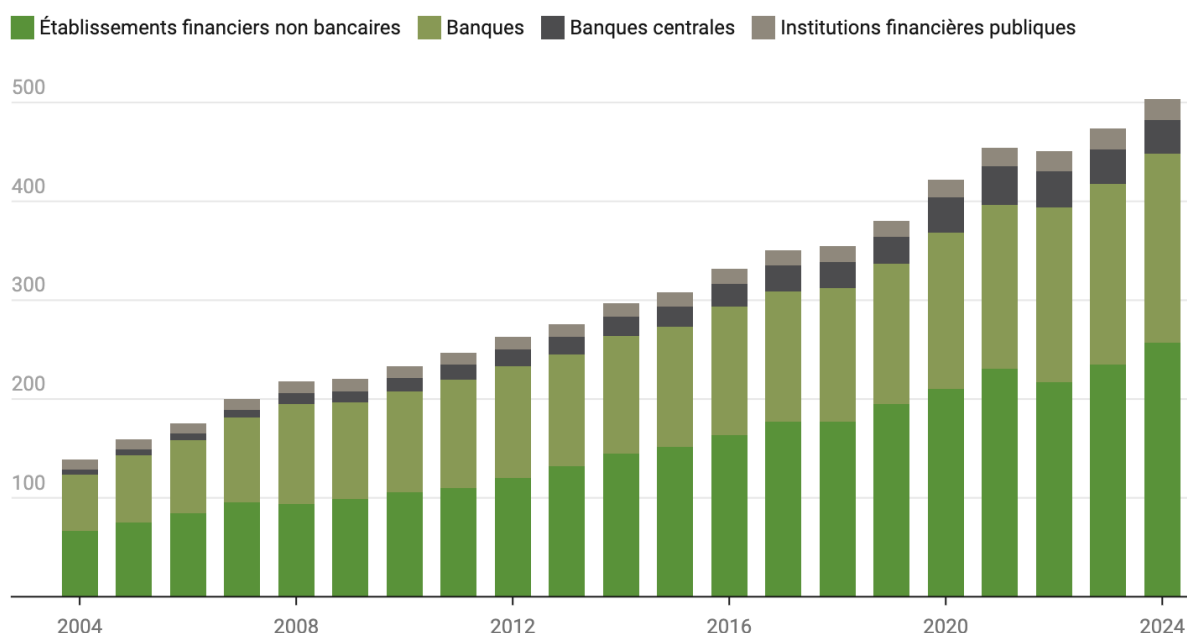
Against this backdrop, several new sources of vulnerability have emerged that could serve as crisis triggers. Rather than ranking them by importance, we set them out in a logical order, since many of them are interdependent. First, risk has moved rather than disappeared: pushed out of the regulated banking system, it has resurfaced in less transparent corners of finance. Second, a cluster of vulnerabilities surrounds public finances — debt sustainability, the

functioning of the main bond markets, and the supply of safe assets — with fiscal and financial dominance threatening central banks' capacity to focus on price stability. Third, technological advances bring many benefits but also serious disruption. Together, these forces point to a world in which shocks could be more frequent and harder to anticipate. But the greatest risk remains the deterioration of the international cooperation needed to contain them.

1 — The mutation of risk: non-bank finance and private credit

Total des actifs financiers mondiaux

En milliers de milliards de \$US.



Graphique: Le Grand Continent • Source: Financial Stability Board

Over the past decade, banks have withdrawn from certain segments of financial intermediation, leaving the field to non-bank financial institutions (NBFIs). The sector now accounts for roughly half of global financial assets and has grown twice as fast as the banking sector. The term covers a wide range of investors: some with long horizons, such as insurance companies and pension funds; others far more fragile, such as leveraged hedge funds financed through repo transactions with banks, money market funds, and open-ended bond funds.

NBFIs operate as an interconnected system of balance sheets. They transform maturities and use leverage, often embedded in derivatives, synthetic exposures and secured funding structures. The risks are therefore similar in nature to those of banks. But the complexity of the interconnections creates liquidity dependence across institutions and markets. Under stress, this can produce sudden market dysfunction and a rapid loss of intermediation capacity, often beyond the reach of central bank liquidity facilities.

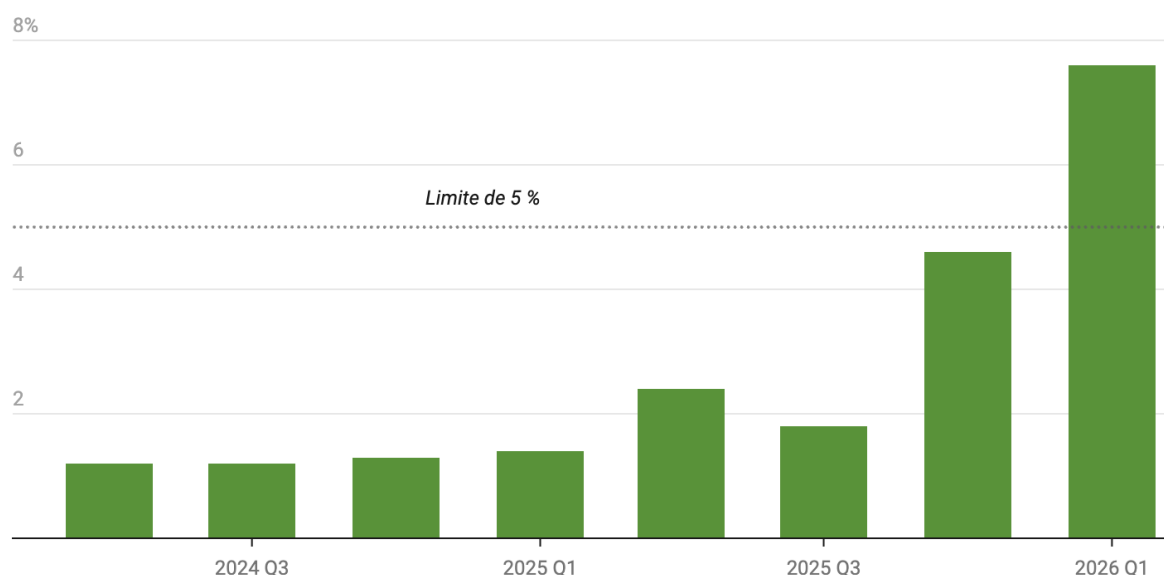
The system is also more opaque. Exposures are complex, data are incomplete, and supervisors often have limited visibility into leverage and concentrations. Private credit — non-bank lending to firms, originated, traded and held by private funds — is the most striking example.

The market has now reached nearly \$2 trillion, while total assets under management in these funds exceed \$2.5 trillion, the great majority of it originating in the United States. The sector has been shaken by a run of bad news, and investors in private credit funds have sought to recover part of their capital. Redemption requests reached \$22 billion in the second quarter of 2026, according to the *Financial Times*. Blue Owl found itself at the centre of this retreat from private credit because of its relatively high exposure to software companies, in the context of the "SaaSapocalypse."

The links with private equity are close: large alternative asset managers increasingly run both private equity and private credit platforms. Insurance is a second major axis. The growing integration of insurers, private credit funds, asset managers and reinsurers does provide a stable funding base, but it also increases insurers' exposure to illiquid and hard-to-value assets. Those assets are often rated by small agencies whose assessments may be inflated, as the Bank for International Settlements has pointed out.

The underlying stability risks are well known: leverage, maturity and liquidity transformation, opacity. Because private credit has no deposit base, it is less directly exposed to runs than banks; losses should, in principle, be borne by investors. Yet systemic risk rises through correlated stress among leveraged borrowers unable to refinance their portfolio companies. The recent redemption pressures on semi-liquid private credit vehicles — including the imposition of gates and withdrawal restrictions — are an early warning of trouble ahead.

Part des demandes de rachat dépassant le plafond trimestriel de 5% dans les BDC non cotées



Pour le T1 2026, les données vont jusqu'au 6 mars.

Graphique: Le Grand Continent • Source: Robert A Stanger & Co.

The regulatory response to this shift is paradoxical. Instead of extending oversight to private credit and other non-bank intermediaries, policymakers are easing requirements on banks so that they can compete with their less regulated rivals. The United States led the way by softening the supplementary leverage ratio and diluting the Basel endgame provisions; the

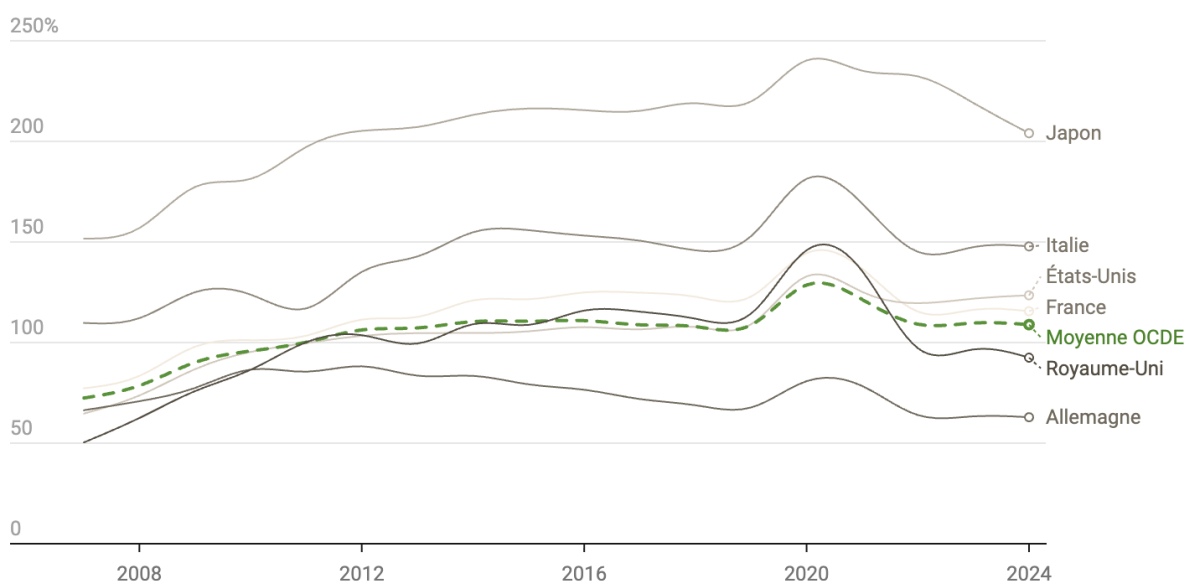
European Union, invoking the competitiveness of its banks, is currently debating a similar loosening of capital rules. The playing field is being levelled down, not up. This episode reveals a deeper political-economy reality: the costs of resilience — capital buffers, loans not made, lower return on equity — are visible every day, while its benefits materialise only in a crisis which, thanks to those very buffers, may never occur. Efficiency has a natural constituency; resilience does not. As the memory of the last crisis fades, the insurance premium comes to look like waste.

2 — Public debt at levels unprecedented in peacetime

At the end of 2024, public debt in OECD economies stood at 112% of GDP on a weighted basis. That is nearly 40 percentage points above its 2007 level, on the eve of the global financial crisis. Such a level has never been observed in peacetime. It is set to rise further, as population ageing drives up pension and healthcare spending while new public investment needs emerge in infrastructure, defence and the energy transition.

Dette publique des pays de l'OCDE

En % du PIB.



Graphique: Le Grand Continent • Source: OCDE

At this level, public debt already puts considerable pressure on fiscal policy. Interest payments amount to roughly 3.3% of GDP across the OECD. That now exceeds public spending on defence and is set to become one of the largest budget items in many advanced and emerging economies.

A self-reinforcing dynamic is at work. Rising debt pushes up risk premia and long-term rates. To contain their funding costs, governments increasingly resort to short-term instruments: Treasury bills now account for about 15% of outstanding debt, and since 2023 bill issuance has exceeded issuance of fixed-rate bonds. But shorter maturities make public debt more fragile. Nearly 45% of OECD sovereign debt matures by 2027. Refinancing needs on this scale expose states directly to market swings.

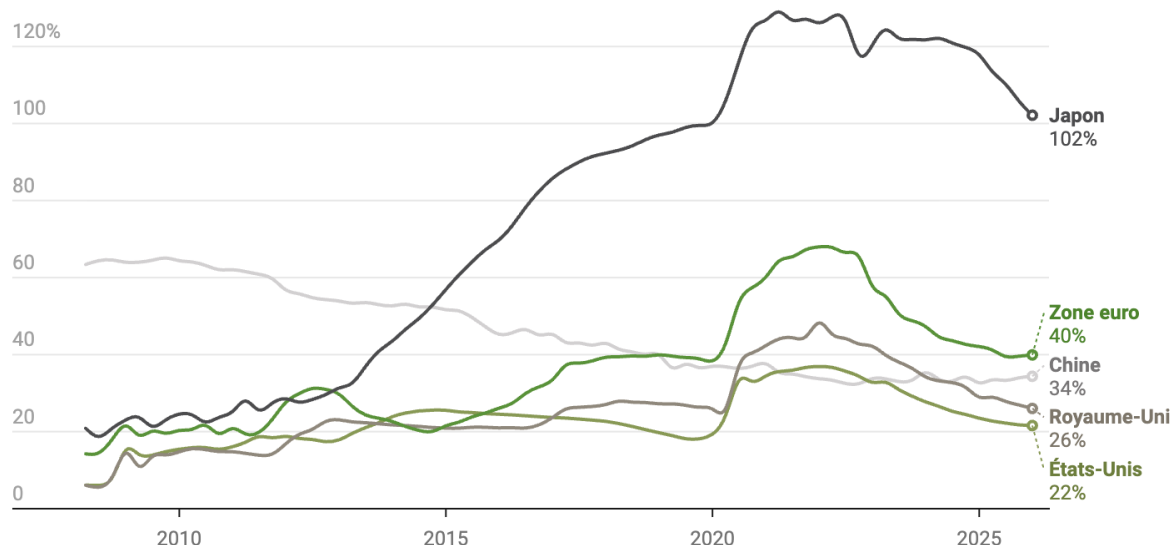
Public debt is on an unsustainable path. Higher interest rates aggravate the problem, since debt sustainability depends above all on the gap between real growth and real interest rates. In most countries, solvency is not at risk in the short term. But markets have become more volatile and more exposed to sudden shocks. The bond markets of the largest economies, and above all that of the United States, are the pillars and the benchmarks of the entire financial system. Any destabilisation of these markets would reverberate through the domestic and international monetary order, complicate the conduct of monetary policy, and put pressure on central bank independence.

"Risk has moved rather than disappeared: pushed out of the regulated banking system, it has resurfaced in less transparent corners of finance."

3 — Central bank independence and the risk of fiscal dominance

In the aftermath of the financial crisis and the pandemic, public debt levels are not only very high but on an unsustainable trajectory, while central bank balance sheets remain very large. Because that growth came from purchases of government bonds, central banks now hold a substantial share of public debt. Within the OECD, their holdings of domestic sovereign bonds peaked at 29% of the total in 2021, then fell to 19% by 2024 under the effect of quantitative tightening. The equilibrium of government bond markets therefore depends on how central banks manage their portfolios: shrinking, stabilising or expanding their balance sheets has a direct impact on interest rates and on the sustainability of public finances.

Bilans des banques centrales, en % du PIB



Graphique: Le Grand Continent • Source: Bank for International Settlements

This profoundly transforms the relationship between monetary and fiscal policy. It creates a risk of "fiscal dominance" — a regime in which monetary policy is subordinated to the needs

of financing the budget and stabilising the debt. The risk of monetary financing has objectively increased. In this context, the role of expectations is decisive: as theory and intuition both show, the mere anticipation of future monetary financing is enough to generate inflation today.

The problem is complicated by the fact that central banks could legitimately be led to buy bonds in the future for two very different reasons. The first is monetary easing: pushing down long-term rates to stimulate the economy when other tools are exhausted, for instance when rates reach the zero lower bound. If such purchases are read as monetary financing, however, they can fuel inflation. The second is market stabilisation: buying government bonds to remedy dysfunction or paralysis in the bond market, as was necessary in March 2020. One and the same instrument thus serves two objectives that do not necessarily coincide. In a period of high inflation, a central bank may find itself stabilising sovereign markets while maintaining a restrictive monetary stance.

The scope for ambiguity and doubt is enormous. Only a strong and unequivocal commitment to central bank independence will allow monetary authorities to act decisively when the situation demands it, without arousing suspicion about their true motives. Independence has become a condition not only of monetary stability but of financial stability. As the Trump administration's approach to the Fed shows — notably the pressure exerted on former Fed Chair Jerome Powell — it is no longer guaranteed today.

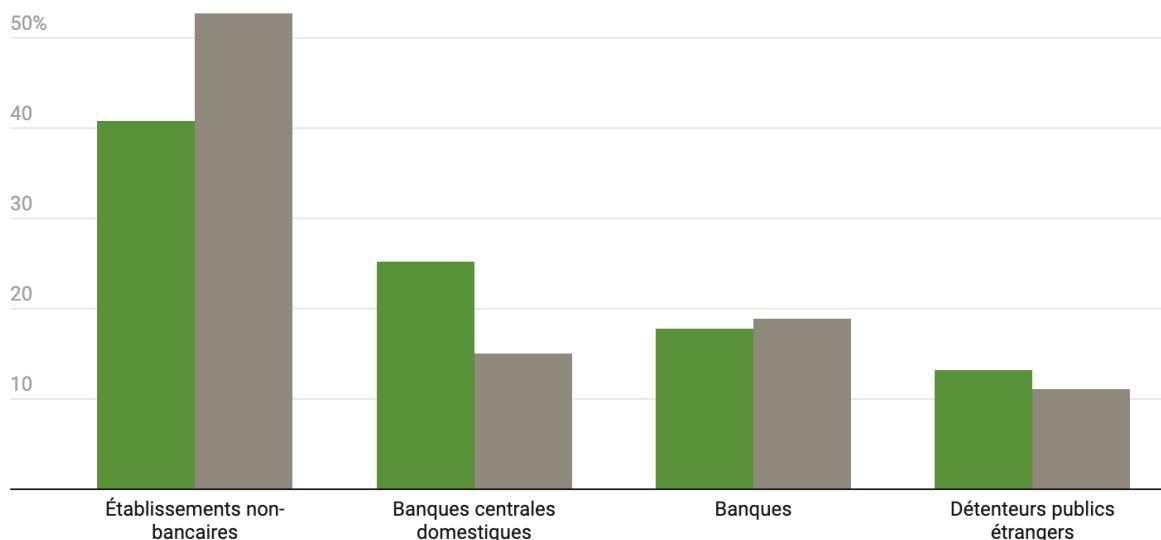
4 — The new fragility of benchmark bond markets and the risk of financial dominance

One of the main surprises of the past decade has been the fragility of benchmark sovereign bond markets, including those traditionally regarded as the deepest and most liquid. The US Treasury market, a central reference point for the global financial system, has experienced episodes of severe dysfunction, notably the "dash for cash" of March 2020. Liquidity vanished, selling became generalised, bid-ask spreads widened, price gaps opened between cash Treasuries and futures, and interest rates rose even as the macroeconomic outlook deteriorated sharply.

Détenteurs de la dette souveraine des économies avancées

En % du PIB.

■ 2021 ■ T4 2025



Graphique: Le Grand Continent • Source: Arslanalp et Tsuda (2014) ; Ferrara et al. (2024) ; FMI ; Office of Financial Research ; Tradeweb ; BIS

Beyond the immediate trigger — pandemic uncertainty — the causes are structural. The investor base has changed. The share held by official foreign reserve managers, traditionally stable investors, has declined. Banks have partly withdrawn, as regulation and shifting business models made trading and risk management more costly, at a time when sovereign debt markets were expanding at speed. Central banks themselves have stepped back through quantitative tightening. Markets have thus become dependent on more price-sensitive investors — hedge funds, households and certain foreign investors — whose funding and risk-management models differ markedly from those of banks. Leveraged hedge funds in particular are very active in both cash and futures markets. Funded by short-term repo borrowing, they are exposed to liquidity shocks and margin calls.

The result is a vicious circle, which the Bank for International Settlements describes as a new nexus between fiscal and financial stability. Fiscal shocks are amplified through market channels, creating structural fragility even in the most liquid markets. Faced with margin calls, leveraged investors are forced to unwind positions, amplifying price swings and stress. This dynamic was visible in the US Treasury turmoil of March 2020, as it was in the UK gilt market crisis of autumn 2022.

These episodes required large-scale central bank intervention to restore market functioning. Looking ahead, central banks may again be called upon to preserve the functioning of sovereign bond markets, which underpin the entire monetary and financial architecture, even where this cuts against the fight against inflation. This is what is known as "financial dominance," and it too undermines price stability. The scenario is no longer hypothetical. When strains reappeared in US money markets in autumn 2025, the Federal Reserve ended its quantitative tightening earlier than planned, announcing it in October for a December start,

freezing its balance sheet at around \$6.6 trillion. Whatever the technical merits of the decision, its message is clear: markets have become so dependent on public liquidity that the size of the central bank's balance sheet is, in practice, dictated by their needs. Balance sheet policy is therefore no longer a freely available instrument of monetary policy. Should inflationary threats reappear, the room for tightening would be constrained by the imperative of maintaining liquidity in key markets.

5 — The safe asset status called into question

A safe asset is like a good friend: it is there when you need it. Unlike other financial instruments, its nominal value remains stable in virtually every conceivable scenario. It serves as a benchmark and a reliable store of value. It does not depreciate — and may even appreciate — precisely in times of crisis.

For seven decades, the US dollar has been the only global safe asset. Treasuries are accessible to all, highly liquid, and considered free of default risk. US financial markets are the only place where foreign central banks and international investors can place their money in almost unlimited volumes and on almost unconditional terms.

Recent developments in US policy and posture have nonetheless raised questions about the future of the dollar's international role. They force us to contemplate a scenario long thought unthinkable: a partial, or even total, erosion of the dollar's reserve currency status.

Such a disappearance would profoundly alter the global financial architecture. Interest rates would be higher and more volatile, and liquidity scarcer. In the absence of a credible alternative to the dollar, countries would lose their protection against external shocks. They would protect themselves differently, most likely by introducing capital controls. The world would become more unstable, more fragmented and, consequently, less prosperous. The shift would be particularly damaging for low-income and developing economies, which depend structurally on access to external capital to finance investment and development. Their borrowing costs would rise considerably, while countercyclical financial support would shrink.

Would alternatives eventually emerge? Europe is debating the creation of a regional safe asset in the form of common euro-denominated debt instruments, but progress is slow. The problem is sharper still in Southeast Asia, where, in the absence of a regional safe asset, most regional savings continue to be channelled into the US financial system.

"Resilience is built before the shock, not during it."

6 — Emerging economies and global stability

For several decades in the late twentieth century, emerging economies were a major source of global financial instability. Recurrent balance-of-payments crises tested the global financial system. That is far less true today. Crises still occur, but they are localised and mainly affect the poorest countries.

Emerging markets are now better equipped to face and absorb external financial shocks, for several reasons. A larger share of public debt is issued in domestic currency, mitigating the "original sin" that once turned exchange rate depreciation into sovereign crisis. Exchange rates are also more flexible, absorbing external pressures rather than letting them build up. Foreign exchange reserves are larger. Above all, emerging economies are now highly experienced in macroeconomic and crisis management, with stronger fiscal and monetary frameworks, independent central banks and effective financial regulation.

Significant challenges nonetheless remain. Global capital markets differ from those of two decades ago and may be more destabilising. The same forces that have reshaped domestic financial systems are generating vulnerabilities at the global level: the growing predominance of non-bank intermediaries, heightened risk sensitivity and greater dependence on liquidity. The system also remains deeply asymmetric: the US dollar, and with it US monetary policy, continues to shape global financial conditions. Major shocks and market disruptions therefore cannot be ruled out.

7 — Artificial intelligence and financial stability

AI will transform finance. Its impact on financial stability, however, remains largely hypothetical at this stage. It is useful to distinguish two categories of risk: those generally associated with automation in finance, which AI can amplify, and those specific to AI itself.

Information gathering, information processing and market operations are already largely handled by algorithms. Systems rely on machine learning models to identify arbitrage opportunities, forecast short-term price movements and execute high-frequency trades. AI can further improve the efficiency of these systems, but it can also amplify their imperfections: modelling errors, selection bias, over-reliance on historical correlations, tacit collusion among algorithmic systems, and inadequate responses to rare events. Further episodes of evaporating liquidity and flash crashes are to be expected. A subtler danger is common-mode failure: if many institutions rely on the same underlying models and data, their reactions will be correlated precisely when diversity of behaviour is most needed.

Information asymmetries, pervasive in financial markets, could also widen. Large institutions, with superior computing infrastructure, proprietary datasets and advanced modelling capabilities, could gain a further edge over smaller firms and investors. This could create barriers to entry, reinforce concentration and increase the market power of dominant players, raising parallel concerns in markets: front-running, latency advantages and information extraction at scale. The network power that comes with data aggregation ultimately raises the question of market integrity.

Two further risks arise because finance mirrors the broader challenges AI poses to the economy and to society. The first is explainability: machine learning systems detect patterns humans cannot perceive, but their use in allocation decisions can make outcomes hard to interpret, contest or audit. The second is alignment: AI systems pursue operational objectives that do not fully coincide with human intentions. Agency problems are a permanent feature of finance — asset managers act on behalf of investors, and mandates and incentives are designed

to secure alignment. When AI takes the wheel, mandates and incentives are translated into instructions, constraints and reward functions. Specification problems arise, all the more so because it is difficult to define *ex ante* an acceptable level of financial instability, whether individually or collectively. The machine could end up endowed with excessive discretion. You can outsource thinking to the machine, but you should never outsource understanding.

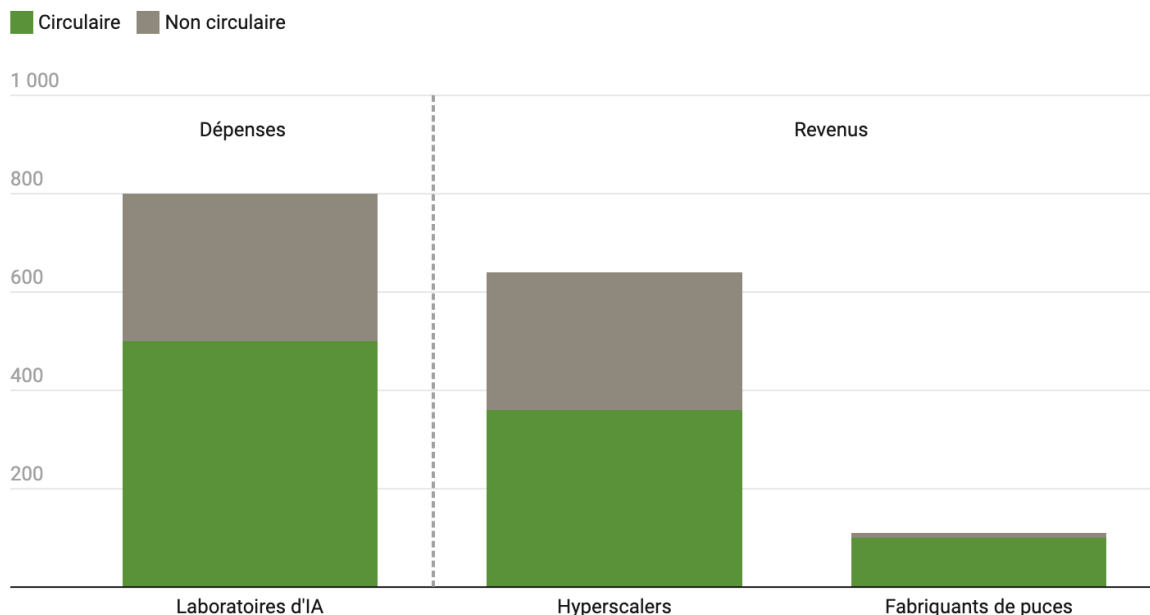
8 — Equity valuations resting on the promises of artificial intelligence

A sharp equity market correction could also trigger a crisis, and there is ample reason for vigilance. Valuations are high, particularly for AI-related companies, and imply earnings growth well above recent historical benchmarks. Moreover, market momentum is increasingly driven by a small number of AI-related firms, notably the large hyperscalers, in which valuation excesses are concentrated. These firms have enormous capital needs: in 2025 alone, nine major players raised \$122 billion in bond markets — close to half of all technology sector issuance, according to the OECD — and their planned capital expenditure for 2026-2030 exceeds \$4 trillion. If revenue growth falls short of expectations, an abrupt correction is possible.

Two amplification mechanisms deserve particular attention. First, the circular financing arrangements through which AI developers, chipmakers and large technology firms fund one another while buying each other's products. This creates opaque and potentially unhealthy interconnection. A disruption in one part of the network could trigger a chain reaction with broader market consequences. Second, investors, including retail investors, are increasingly encouraged to take risk through leveraged exchange-traded funds, which magnify both losses and gains and can generate strongly procyclical price movements under stress.

Une large part des flux financiers de l'IA reste interne à l'écosystème

En milliards de \$US. Engagements pluriannuels annoncés, tels que recensés en avril 2026



Le financement circulaire renvoie à une structure d'investissement réciproque dans laquelle les hyperscalers prennent des participations dans les laboratoires d'IA en échange d'engagements d'achat de la part de ces derniers, ce qui fait revenir le capital vers les investisseurs sous forme de revenus.

Graphique: Le Grand Continent • Source: Bloomberg ; CNBC ; LSEG Datastream ; S&P Global Market Intelligence ; The Wall Street Journal ; BIS

The AI enthusiasm also obscures other sources of risk. The conflict over Iran and the Strait of Hormuz is the most glaring example. Asset prices do not reflect these risks. They rest on the assumption that the confrontation will remain temporary and contained, and equally on the assumption that AI-driven earnings will keep propelling the market higher. Apparent resilience to geopolitical shocks may therefore be illusory. Should AI-related earnings prove lower than expected, the upward momentum that currently absorbs geopolitical risk would be called into question, and several corrections could occur at once.

That said, technology booms — even bubbles — do not necessarily destroy welfare, provided the enthusiasm helps overcome frictions in coordinating investment and, above all, that it is financed by equity rather than debt. In modern financial history, stock market crashes have generally been less damaging than credit collapses, except where equity purchases were debt-financed and margin calls forced fire sales. Pure valuation corrections affect the economy mainly through wealth effects: households, made poorer, consume less, weighing on aggregate demand. This mechanism could be more powerful today than in previous decades, since household exposure to equities has increased. Yet equity markets carry less intrinsic contagion risk and structural fragility than activities financed by debt and involving significant maturity transformation. The real danger arises when equity risk migrates quietly into debt — as is currently happening with bond-financed data centre expansion and private credit vehicles.

"You can outsource thinking to the machine, but you should never outsource understanding."

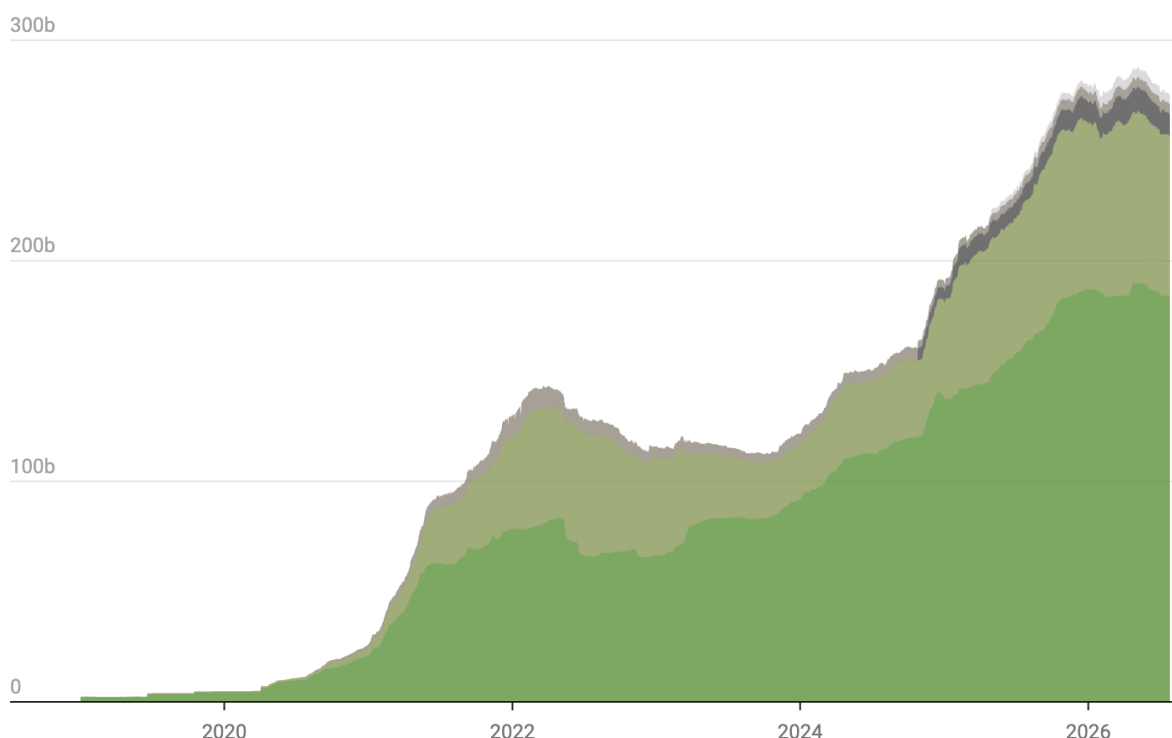
9 — The tokenisation of money and finance

The tokenisation of money and financial assets may well be the greatest financial innovation of recent decades. It means that money and securities can be represented by digital objects circulating over the internet. Digital tokens are easy to create; they are fungible, divisible and transferable; and they can be tailored to specific needs. Unsurprisingly, tokenisation has set off a wave of new private money initiatives.

Capitalisation des principaux *stablecoin*

En \$US.

■ USDT ■ USDC ■ USDS ■ DAI ■ USD1



Graphique: Le Grand Continent • Source: Coin Gecko

The digitalisation of money offers major opportunities. For the general public, a digital token stored on a mobile phone can faithfully reproduce the characteristics of cash, without the physical constraints of weight or distance. It can spur competition in fast and cross-border payments, foster financial inclusion for the unbanked, and deliver significant efficiency gains in the custody, trading and settlement of securities.

But tokenisation can also be disruptive and destabilising. It threatens the business model and core activity of banks, which face new competition in payments and deposits. It can also destabilise the economy if unstable forms of private money — notably certain stablecoins, tokens backed by conventional financial assets — are allowed to proliferate, and if citizens lose access to public money altogether with the disappearance of cash. Digital tokens also cross borders easily. They could open a new era of monetary competition, not only among states but among private networks operated by large technology firms. Digitalisation thus has the potential to reshape the international monetary system itself.

To date, private investor exposure remains limited, though it is growing, and immediate risks to financial stability appear contained. Yet tokenisation raises fundamental challenges for the integrity and stability of money. Incidents in unregulated segments, where poorly informed investors could suffer heavy losses, could have serious political consequences and provoke a public outcry. It is for reasons of stability and sovereignty that some central banks — first among them the ECB with the digital euro — have decided, or are seriously considering, to issue their own central bank digital currencies.

10 — Geopolitics: the risk that tears the safety net

We return to the starting point: the greatest threat to the resilience of the world economy is the weakening, or even the collapse, of international cooperation. Crisis triggers will certainly occur. The crucial question is how they will be handled. The 2008 crisis did not degenerate into a spiral of protectionism and recession thanks to close cooperation among the G20 countries and to the central bank swap lines that supplied dollar liquidity where it was most needed. To take up Kindleberger's idea, cooperation rests on the willingness of at least one country to stabilise the system by keeping markets open and providing unconditional financial support.

That may not happen today. International relations have become transactional and short-term in orientation, which is not conducive to coordinating policies and providing mutual support at very short notice, before financial dynamics spin out of control. Concerns are openly voiced about the risk of politicising swap lines, which would then be used to pursue geopolitical objectives rather than to ensure financial stability. While global trade has so far absorbed the resurgence of protectionist measures, it might not withstand a severe financial shock on top of it.

Resilience is built before the shock, not during it. A first priority should therefore be for countries willing to do so to establish a framework for financial cooperation together and to prepare for future contingencies — so that when the next trigger arrives, the system bends like the reed rather than breaking like the oak.

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