Conditions for a financial crisis building up

Nick Beams
23 June 2025

An immediate economic fallout from the US bombing of Iran, such as from the closure of the Strait of Hormuz and an escalation in oil prices appears to have been averted. However, there is a growing amount of combustible material in the financial system which could ignite as US imperialism continues its military rampage.

Two recent reports have pointed to some of the potential triggers for financial turmoil.

Last week the Financial Stability Board (FSB), a global body comprising regulators from major economies, issued a warning about “vulnerabilities” in the global $12 trillion commercial real estate (CRE) market arising from the high level of debt and the rise in interest rates over the past three years.

Earlier this month, a study of the private credit system carried out by Moody’s Analytics, together with the US Securities and Exchange Commission and a former top adviser to the Treasury, reported that it was so intertwined with the banking system that it could become a “locus of contagion” in a financial crisis.

The CRE sector was hit by the decline in demand for office space as a result of COVID-19 and the rise in interest rates that followed.

The report said that CRE had “weathered the recent adverse developments” but warned that problems were by no means behind it. Non-performing loans issued by US and Australian banks for office buildings had “increased significantly” in 2023.

The FSB said that interest rates for commercial real estate-backed mortgage securities, comprising individual loans bundled into a package, had risen compared to other corporate loans.

“Distress was evident in multiple sectors” of the markets. Office and real estate segments had “the highest rate at 12.6 percent and 11.2 percent respectively” as of September last year.

The CRE market is vulnerable to shocks, the report noted, because there is an “inherent opacity in the valuations” of assets.

“The CRE market is illiquid [meaning assets are not easily turned into cash] and, as a consequence, it may be difficult to price assets in times of stress. Book valuations for assets and collateral disclosed by market participants (both banks and non-banks) may recognise losses with delay, and losses may therefore emerge abruptly in a prolonged downturn.”

It also pointed to the practice of “extend and pretend” whereby banks roll over loans based on book valuations rather than recognise that losses have already been incurred based on market valuations.

Another source of instability is that banks not only provide loans directly to the CRE sector. They also finance non-bank financial bodies such as hedge funds and real estate investment trusts which then finance CRE development. But these connections are “complex and difficult to capture.”

“Shocks to the CRE sector could spill over to the banking sector, thereby highlighting the importance of monitoring banks’ lending to non-bank CRE investors in addition to banks’ own CRE loan portfolio.”

The report pointed to the high level of leverage (debt) in the sector which globally was about 45 percent of total assets. The figure is an average and at the extreme was much higher. There was a “tail” of real estate investment and other property funds in the US, Canada, Singapore and Germany that has “large levels of leverage with debt being at least three times equity.”

It said there were still “considerable data gaps” on the links between banks and non-banks and called on regulators to take action. There have been many such calls in the recent period as non-bank private sources of credit play an increasing role in the financial system, but there has been little movement on this front.

The Moody’s Analytics report was described by the

Financial Times (FT) as "one of the most comprehensive analyses to date on how private credit would affect the broader financial system during a period of market upheaval."

It found that these funds had become enmeshed with the banking system creating "new linkages [that] introduce new modes of systemic stress."

The significance of private funds has grown in leaps and bounds since the global financial crisis of 2008 and the introduction of tighter lender standards on the banks. But just as water finds the gaps in any system meant to contain it, finance has managed to fund new ways to get around the restrictions in the search for higher returns that come from riskier loans.

The report said that the "opaqueness" of private credit funds and their "role in making the financial network more densely connected mean they could disproportionately amplify a future crisis."

Reporting on the analysis, the FT said the researchers had found that "during moments of market stress, business development companies had become more tightly correlated with the turmoil in other sectors than they were previously."

The implication of this development is that a crisis which develops in one area of the market is much more difficult to contain than it was in the past.

"Today's network of interconnections in the financial system is more distributed, with a denser web of connections than it had pre-crisis, when the system operated more like a 'hub and spoke' model with banks at the centre of the model," the report said.

In a report issued in May, the Boston branch of the Federal Reserve also warned that bank lending to the $1.6 trillion private credit sector posed risks to the entire US financial system.

"Banks' extensive links to the private credit market could be a concern because those links indirectly expose banks to the traditionally higher risks associated with private credit loans," the Boston Fed report said.

A potentially toxic mix of high debt and elevated interest rates is developing in conditions where there are number of shocks being delivered to the economy—from tariff hikes to war.

"Private credit lenders' reliance on banks for liquidity could pose systemic liquidity risks to the banking sector if a sufficient number of private credit lenders… draw down on their bank credit lines simultaneously in response to adverse aggregate shocks," it said.

All the conditions are present for the eruption of a new crisis in the US and global financial system. How rapidly it will emerge cannot be predicted. But the characteristic feature of the present period is the speed of events.

In just a matter of months, the post-war trading order has been upended, democratic rights in the US are being shattered, the most powerful bombs, short of nuclear weapons, have been used against Iran, the dollar has declined, and the price of gold has hit new record highs—a 30 percent increase so far this year. In this situation a financial crisis is likely to make its appearance very much sooner than later.