

Bank for International Settlements warns of AI “investment bust”

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The annual report of the Bank for International Settlements (BIS), the umbrella organisation of the world’s central banks, released on Sunday, presents a picture of a global economy full of triggers that could set off a major financial and economic crisis.

Examination of the report recalls the lead-up to the global financial crisis of 2008 when the BIS was one of the very few organisations which warned that the cheap money policies pursued by the US Federal Reserve were blowing up a financial bubble, the bursting of which would have significant consequences.

The focus of its latest report is the AI boom while also dealing with the implications of the rise in government debt, now hitting record highs and the new situation that has been created by the increased intervention of so-called nonbank institutions, private credit and hedge funds, into bond markets.

The thrust of the report was that the massive spending by the five largest AI hyperscalers, estimated to be more than \$1 trillion from the end of 2025 to the end of this year, could lead to an “investment bust” which would hit financial markets and the global economy.

Pointing to what it called the “current AI exuberance” it said that not all the investors would make the returns on which their decisions have been based.

“Disappointments in returns could trigger a sudden pullback in financing and turn the capex [capital expenditure] boom into a protracted investment bust, with potential knock-on effects on financial conditions.”

Turbulence was already evident as the report was about to be released. The beginning of last week saw a major selloff of tech stocks around the world. At one point on Tuesday the South Korean KOSPI index, which is heavily dependent on the semi-conductor giants Samsung and SK Hynix, dropped by 10.5 percent, prompting a 20-minute halt in trading.

On Wall Street, the previous day, shares in Elon

Musk’s SpaceX lost \$400 billion in market value, 16.4 percent, leaving them 31.5 percent below the high they reached after \$86 billion initial public offering earlier this month.

Markets subsequently bounced back on higher-than-expected earnings announced by the chipmaker Micron and lower oil prices, but the high volatility was described as “unnerving.”

The BIS said that the “ongoing AI investments boom raises questions about the sustainability of the current economic expansion” with the “investment race” being driven by the perception that “only a small number of players with superior technology will ultimately dominant the market shares.”

This intense competition raised “the risk of firms over-committing resources to investment projects with still uncertain returns, leaving all firms vulnerable to disappointments in AI payoffs.”

The report recalled the canal mania of the 1830s, the British rail mania in the 1840s, electrification of the roaring 20s and the dotcom boom of the late 1990s “which shared a common trait: a genuine technological breakthrough that attracted capital in excess of what commercial returns could ultimately justify.”

It went on to note that two features of the present situation further added to instability and impact the broader economy.

“Should inflation rise significantly or AI-led investment turn to a bust, the macroeconomic consequences could be amplified by existing financial vulnerabilities. A tightening of policy rates needed to contain inflation could precipitate a sharp pullback in asset prices after a prolonged period of exuberant risk-taking, triggering disruptive macro-financial feedback loops.”

On top of this, any reversal of “AI optimism” could also have major financial consequences “given AI firms’ rising leverage and growing footprints in credit markets.”

It warned that a major equity market correction could have larger macroeconomic consequences than in the past. The seriousness of such a warning comes into sharp relief when the effects of the 2008 crisis are considered. Up to 10 million homebuyers in the US lost their homes and millions were thrown out of work with the unemployment rate in the US rising to as high as 10 percent.

And because of the extent of the share market boom in the US, with US shares accounting for 64 percent of the MSCI global index, “the wealth impact from the US-led repricing could propagate globally.”

It also warned that what it called the “opacity” of AI-sector financing compounded the vulnerabilities and hyperscalers, chip makers and labs were linked through a complex web of private arrangements.

“The most prominent of these is circular financing: chip makers and hyperscalers take equity stakes in AI labs or neocloud providers, who in turn commit to multi-year purchases of chips or computing power.... The terms of such deals are typically poorly disclosed with the risk of the same asset being pledged multiple times.”

The report said that what it called “synchronised corrections” in both equity and credit markets were rare but there were notable exceptions in the 2008 crisis and the March 2020 dash for cash, at the start of the pandemic, and that a “repricing of risk this time, whether triggered by higher interest rates or an AI bust, has the potential to be similarly disruptive.”

While the thrust of the report was directed to AI, the BIS made some significant observations about the operations of governments and central banks in what it calls “shifting financial markets.”

“Central banks,” it said, “face mounting challenges from the interplay of near record-high public debt with the growing role of non-banks in sovereign debt markets. This new fiscal-financial stability nexus amplifies and accelerates the transmission of markets stress.”

This means that conditions can change very rapidly such that government bond market liquidity can be ample for prolonged periods, but can “dry up quickly in response to shocks, raising borrowing costs.”

No doubt the authors of the report had in mind the experience of March 2020 when the US Treasury market—the foundation of the global financial system—dried up and for several days when there were no buyers for US government debt, requiring intervention by the Federal Reserve amounting to several trillion dollars.

One of the reasons for the freeze was the activity of

hedge funds and private credit for which operations in the Treasury market form part of their speculative strategies. In the six years since then, these operations have increased.

As the report noted, on top of the increase in government debt, the structure of the sovereign bond market has changed markedly with hedge funds “playing an increasing role in intermediating government debt, often through highly leveraged and funding strategies that hinge on both banks and other non-bank financial institutions.”

It said that “hedge funds employ highly leveraged strategies that rely on short-term financing on favourable terms, creating risks of fire sales and de-leveraging feedback loops. Financial stresses can now propagate quickly and broadly through funding markets, across borders and between banks and non-banks.”

The report did not spell out the implications of such a development, but they are nonetheless clear. Not only are the stock market, currency markets and commodity markets arenas for highly speculative activities but so too are bond markets which provide the basis for governments to finance their activities. They too are assuming the character of a giant casino.

The concerns evinced in the report about the prospects of an AI bust direct attention to a central contradiction of the capitalist system: that between the growth of the productive forces and the social relations (the profit system) with which they are encased.

AI contains within it the potential for an enormous growth in the productivity of labour and thereby human advancement. But within capitalist social relations it threatens to result in a crisis on a scale going beyond what has been seen before. While it was, of course, not the intention, the BIS report underscores the objective necessity for the ending of the profit system and the establishment of socialist economy in which the enormous advances in technology are employed to meet human need.



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