A gathering crisis in the US financial system

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21 September 2026

The elevation of the yield (interest rate) on the 10-year US Treasury bond to above 5 percent last week is a significant milestone in what is an emerging crisis in the US financial system. The yield was the highest since 2007, before the eruption of the global financial crisis the following year.

It has been characterized in some quarters as something of a “normalization” of the bond market after the very low yields for much of the past two decades. But the conditions which now prevail indicate it is far from that.

The most outstanding development is the accelerating growth of US debt—a more than fourfold increase from under $10 trillion in 2007, or 62 percent of GDP, to $40 trillion, around 125 percent of GDP, today.

The seriousness of the situation is well-known in financial ruling circles. As former Fed chair Jerome Powell noted, before he stepped down earlier this year: “It will not end well if we don’t do something fairly soon.”

Potentially even more significant than the absolute size of the debt mountain is the increase in the interest bill, particularly following the elevation of interest rates which began in 2022.

In 2019 it was $575 billion. Today the interest bill is $1.25 trillion and is fast becoming the biggest item in the US budget, giving rise to what has been characterized as a “doom loop” in which the rise in interest payments makes necessary further borrowing, increasing the interest bill still further.

US debt is financed through the $32 trillion US Treasury market where new debt is issued by the government and where already issued bonds are bought and sold. The daily average level of trades is around $1.2 trillion.

The 10-year bond forms the basis of the US and global financial system because it has been regarded as a “risk-free” asset. But since the March 2020 crisis, when the Treasury markets froze and no buyers could be found for US government debt, that assumption, which has prevailed for as long as anyone can remember, has been called into question.

The crisis, which many US financial officials have come to regard as even more serious than that of 2008 even though it did not have the same flow-on economic effects, was resolved through a massive intervention by the Fed in which it outlaid some $4 trillion, forming a backstop to every financial market.

Subsequent investigation has revealed that the speculative activities of hedge funds, using large amounts of borrowed funds to make their bets, played a major role in triggering the crisis. Their involvement is a significant change in the structure of the US Treasury market.

Previously it was dominated by large financial institutions, banks, major insurance companies and the like which held long-term government debt for the returns it could bring. Today the activities of hedge funds, which, by their nature, move rapidly in and out of trades financed by large amounts of short-term borrowing, are becoming dominant.

It has been estimated that about $1.5 trillion of Treasury bonds are tied up in so-called basis trades in which hedge funds and others borrow large amounts of money to make a profit from the tiny difference between the price of a bond and its price in the futures market.

Earlier this year the Fed released research which showed that hedge funds had doubled their exposure to US government debt between 2023 and 2025 and now hold about 8.5 percent of the market, meaning that they can play a decisive role setting off a “rush for the exits” in a time of turbulence.

As the report noted: “The combination of large scale, high concentration and elevated leverage creates the potential for systemic stress if multiple participants face simultaneous pressure or if severe shocks affect the largest participants.”

Another source of instability is the shift by foreign investors, including central banks, out of US debt reflecting a growing lack of confidence in the state of government finances. While dollar-denominated assets still predominate, gold now occupies a larger proportion of central bank reserves than US Treasuries. The latest figures show that the value of US government debt held by China fell to $618 billion in July, less than half its level of $1.3 trillion in 2013.

International inflows into US stocks are now running at 2.8 percent of GDP, higher than the investment in Treasury bonds at 2 percent except for a brief period during the pandemic. International capital is clearly seeking to cash in on the AI-fueled stock market boom.

But such activity, described by one Deutsche Bank analyst as a “huge shift in US asset markets,” has the potential to bring major consequences. Foreign capital inflows have long been a key factor in sustaining the US debt market. If money flows elsewhere then this threatens to bring an increase in bond rates, lifting the cost of the debt to the AI hyperscalers, thereby potentially choking off the AI boom which is playing an increasing role in sustaining the broader economy.

Rising interest rates are also heavily impacting on private credit funds which borrowed heavily when interest rates were at ultra-low levels. Their business models have been based on buying companies and then carrying out "restructuring" before selling them off at a profit.

Higher interest rates hit private equity on two fronts. They must increase what they pay on their debt, and they find it increasingly difficult to sell the companies they have acquired for a sufficient profit, if at all.

Reporting on this development the *Wall Street Journal* noted that investors had been clamoring to recover a record $349 billion in "zombie firms"—companies that could not be sold—and that the "pain" of private-equity funds, which hold more than $2 trillion in US assets, was "reverberating through the financial system."

A warning of what could take place in the US in one form or another is provided by Turkey, where authorities last week liquidated 131 investment funds as a result of what has been described as a massive Ponzi-like scheme.

A recent comment in the *Financial Times* advised US Treasury Secretary Scott Bessent to pay attention because, while Istanbul was a long way from Wall Street and it was easy to dismiss the problems of "emerging markets," the scandal in Turkey "has more parallels with developed markets than observers might care to admit."

Financial markets depend not only on the movement of money but also on confidence that the authorities of the state, charged with ensuring the safety of the system itself, know what they are doing and have a clear perspective.

That confidence has already been severely shaken by the actions of President Trump—his tariff hikes, wars, threats against independence of the Fed and his incessant demand for interest rates to be lowered to 1 percent.

But a new destabilizing factor has emerged in the form of Bessent, who was regarded in financial circles as the so-called "adult in the room." But his recent actions indicate that the highest levels of the state's financial apparatus are grappling with a situation threatening to move out of their control.

At the end of July, Bessent organized an intervention with Japan to halt a fall in the value of the yen lest it led to a sale of dollars in currency markets as Japanese authorities tried to counter it. After that failed, he strong-armed the Bank of Japan to increase its interest rate at its meeting last week in the hope this would stabilize the yen. That initiative too appears to have failed. He even defied markets to bet against him declaring: "I am the house."

Concerned about the rise in bond yields at the longer end of the markets in the US, Bessent announced that the Treasury would lift its buybacks of longer-term debt from $2 billion to as much as $6 billion per operation.

That also has failed. And it took place as the Fed for the first time in three years lifted its rate by 0.25 percentage points and indicated more is to come. The upshot has been that while one arm of the financial apparatus of the state was seeking to lower rates at the longer end of the market another arm was raising them at the shorter end.

These kinds of off-the-cuff actions have led to growing comments that the US, the center of the global financial system, is coming to resemble a so-called "emerging market" economy.

The immediate issues which arises from this developing crisis is: Whither the financial system? And what are the implications for the working class as it confronts the deepening attacks on its living standards and social conditions?

A clear indication of what lies directly ahead was provided by a recent op-ed piece in the *New York Times* by Jared Bernstein, chair of the Council of Economic Advisers in the Biden administration.

"For years," he wrote, "I wasn't an alarmist about the national debt. During the Biden administration, I even criticized those calling for more austere budget policy. I thought that fiscal austerity would do more harm than good. Our fiscal reality has changed significantly since those days, and so has my stance on public debt."

He warned that with the compounding debt growing faster than the economy the US risks "entering a debt spiral."

The implications for the working class are clear—US capitalism, as even a self-styled "non-alarmist" like Bernstein recognizes, is caught in the vortex of gathering crisis.

The representatives of the capitalist state and the oligarchs it serves are making their preparations for a further massive assault on the working class. The austerity program they are demanding cannot be carried out peacefully but only through increasing levels of state violence of which the measures carried out so far under Trump, with the connivance of the Democrats, are just the beginning.

The working class must advance its struggle against this class-war program through the development of rank-and-file committees in factories, workplaces and communities and take forward the political struggle for socialism.