ECB says financial system recalls subprime bubble that sparked 2008 crisis

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19 November 2026

The European Central Bank (ECB), second only in importance to the US Federal Reserve within the global financial system, has warned that the present AI boom has "parallels" with the subprime mortgage bubble that sparked the global financial crisis of 2008.

The warning came in the central bank's Financial Stability Review issued on Wednesday.

It said high-tech firms involved in the development of AI had methods of financing in which they amassed trillions of dollars' worth of commitments in off-balance-sheet operations in addition to the major debts they were now taking on.

"Big tech firms are estimated to have total off-balance-sheet commitments of more than $4 trillion as of the second quarter of 2026," the review said. This was "well in excess" of on-balance-sheet liabilities.

There were "historical parallels with the dotcom and subprime bubbles" creating risks for financial stability.

The report identified a number of possible triggers for a crisis all of which derive from the fundamental modus operandi of the AI buildout boom in which data centre developers and firms providing compute power borrow enormous amounts of money from banks, private credit, and investors on the promise of future cash and profit flows.

Setting out the general condition of financial markets, the report said the outlook was being shaped by an "optimistic narrative surrounding artificial intelligence (AI)" but then went on to point to the growing risks.

"Markets remain vulnerable to broader sentiment shifts should news on the rate and form of AI adoption disappoint. Such disappointment could have adverse implications for corporate earnings expectations, with the risks of spillovers across asset classes and geographies."

The risks were compounded because AI financing remains opaque due to interlinked ownership structures and mutual purchasing and finance commitments inflating future revenues and heightening spillover risks from circular financing.

In the stock markets pricing rested on what it called "extraordinary" expectations of growth in the earnings for AI firms and equity prices "depend largely on their ability to keep doing so going forward."

Speaking on Monday on the eve of the release of the review, but basing himself on its findings, the ECB vice-president Boris Vujcic said the stability of the financial system confronted two threats: those arising from AI and government debt.

"A reassessment of the AI narrative may trigger an abrupt repricing in markets and significant valuation losses. This could lead to a surge in investment fund redemptions, increasing the risk of forced asset sales."

He noted that most risks in the review had been "on our radar for quite some time" but there were two which "stand out very prominently compared to the situation a year ago. These relate to developments in artificial intelligence (AI) and sovereign debt markets."

The threat to financial stability from AI had risen because corporations were increasingly using "opaque" off-balance-sheet financing structures and "circular financial arrangements" to fund data centres.

Commenting on the surge in initial public offerings (IPOs), of which the massive IPO by Anthropic is the latest, he said they threatened to exceed the previous record high in the dotcom bubble.

"Historically," he warned, "such surges have often coincided with market peaks, pointing to the risk of excessive investor optimism. This is concerning given that, while current market valuations rest on expectations of extraordinary earnings growth, the outlook remains highly uncertain."

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He estimated that the total investment by leading US companies was set to reach $5.5 trillion by 2030.

This money has to be provided to the hyperscalers as increased debt since their cash reserves financed the initial stages of the AI boom following the release of ChatGPT by OpenAI at the end of 2022. But the free cash flow—the amount of money available after paying the costs of the business and capital equipment—has largely turned negative.

This means the fevered pace of expansion requires the raising of debt, through the issuing of corporate bonds, under conditions where interest rates are rising sharply, not least due to the surge in inflation since the start of the US war on Iran, as governments take on more debt to finance their rapidly expanding war budgets.

"The substantial financing needs associated with the AI investment boom raise questions about potential competition for capital between public and private borrowers, including whether AI-related debt issuance could put upward pressure on financing costs or crowd out other investment," Vujcic said.

On top of inflation expectations, the recent rise in bond yields (interest rates) had been driven by "growing concerns about debt sustainability."

"Higher borrowing costs and structural headwinds that hinder potential growth could further strain fiscal positions and rekindle concerns in highly indebted countries."

In the past when "highly indebted countries" were spoken of it was taken as a reference to the poorer countries in the global economy. Today the debt crisis is increasingly concentrated in the major economies.

In the US, the world's largest economy, the national debt has gone over $40 trillion, with no sign of slowing down and an interest bill of around $1 trillion a year; while in France, the second largest economy in Europe and the seventh largest in the world, the debt to GDP ratio is over 120 percent.

In the financial crises of 2008 and 2020 at the start of the COVID pandemic, governments stepped in to bail out corporations and the financial markets to the tune of many trillions of dollars. Much of the betting in the financial markets is that in the event of another crash they will do so again.

But the question is now being raised as to whether, because of the accumulation of past debts, they will have the wherewithal to do so again.

The ECB review pointed to what it called "sovereign vulnerabilities."

"More severe and prolonged energy supply disruptions and weaker growth prospects could trigger a reassessment of sovereign risk by market participants."

In other words, governments may find that when they seek to raise money to finance bailouts in a crisis investors will either not supply the money at all or only at very high interest rates deepening the crisis and ripping through real economy.

The ECB review pointed to this prospect, albeit in somewhat guarded terms, warning that a reassessment of sovereign risks "could further constrict fiscal space, limiting governments' ability to shield the economy [in reality the banks, financial speculators and giant corporations} from future shocks."

But it clearly indicated the direction of policy stating that fiscal consolidation was "overdue" and "increasingly important in an environment of growing presence of news-sensitive leveraged investors in sovereign bond markets."

In other words, government spending in all areas of social spending must be slashed and the war against the working class intensified in order to provide governments with the resources to bail out the oligarchs when the financial house of cards they have created collapses once again.



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