

The IMF thinks that there could be a financial crash

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It is always good to know that my concern about the irrationality of stock markets is shared, and today the IMF has made clear its concerns, laying on the towel very thickly to make it clear just how worried it is. [In a report issued to coincide with what would have been Davos](#), but isn't, it said:

While there is for now no alternative to continued monetary policy support, there are legitimate concerns around excessive risk-taking and market exuberance. This situation creates a difficult dilemma for policymakers. They need to keep financial conditions easy to provide a bridge to vaccines and to the economic recovery. But they also need to safeguard the financial system against unintended consequences of their policies, while remaining in line with their mandates.

Translated, that means QE is going to continue, but the IMF is well aware that there are very real risks in markets. This is, of course, [precisely my motivation in discussing alternative bond investment structures this week](#).

The IMF added:

With investors betting on persistent policy backstop, a sense of complacency appears to be permeating markets; coupled with apparent uniform investor views, this raises the risk of a market correction or “repricing.” A sharp, sudden asset-price correction—for example, as a result of a persistent increase in interest rates—would cause a tightening of financial conditions. This could interact with existing financial vulnerabilities, creating knock-on effects on confidence and jeopardizing macro-financial stability.

Again, to de-jargonise this, what they are saying is that if interest rates do ever rise there could be a major financial crash as it becomes apparent that the current stock market bubble is nothing more than a bit of financial engineering in response to low interest rates that has no real value behind it, with which suggestion I would completely agree.

So what to do to prevent this? The IMF says:

Policymakers need to use this time to safeguard financial stability by employing macroprudential measures (for example, stricter supervisory and macroprudential oversight, including targeted stress tests at banks and prudential tools for highly levered borrowers) and developing new tools as needed. For example, policymakers are considering whether the macroprudential framework for nonbank financial institutions may need to be strengthened to address weaknesses that became apparent during the March turmoil.

That is also just jargon. Basically, it means require banks to increase capital, reduce stressful loan books, and pray.

Alternatively, [as I have suggested](#), come up with new models that reduce the need for QE and take excessive cash balances out of the market altogether whilst providing funding for the Green New Deal. Now, which of those looks and feels better?