SECTOR IN-DEPTH
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TABLE OF CONTENTS

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Credit Conditions – Global

Six risks that could threaten credit in 2026

Summary

Global economic growth is likely to be subdued but stable this year. And although we expect the default rate to decline during 2026, it would not take a particularly big shock for it to rise instead. This report examines six scenarios that could significantly disrupt the credit landscape this year. These examples highlight only a selection of potential shocks, as numerous economic, technological and climate-related risks could still emerge unexpectedly. None of the scenarios outlined here represent our base case—nor are they necessarily how we would expect risks to crystallise. Instead, our aim is to show the wide range of plausible scenarios that could lead to more negative credit outcomes.[1]

» **Geopolitical fractures.** As political polarization becomes an enduring feature of the geopolitical landscape, there is a rising risk that a specific event triggers shocks that would swiftly spill into credit markets via higher risk premia and funding stress.

» **Inflation fears reignite.** In a year when there will be a leadership transition at the US Federal Reserve, should the declining trend in inflation halt or reverse, there is a risk of inflation expectations becoming de-anchored, driving yield volatility and distorting credit pricing.

» **AI equity price correction**. An AI-driven tech correction would hit startups, semiconductors, data-center assets and tech-hub commercial real estate (CRE). It would likely also result in tighter financing conditions and weaker economic growth.

» **AI productivity shock drives job losses**. Rapid AI-driven efficiency gains could trigger major white-collar layoffs, weakening demand and tax revenues while straining public finances and increasing social and political instability.

» **Stress in private credit generates contagion**. A widespread downturn in asset quality reveals structural weaknesses in private credit, coupled with lower recoveries. Contagion through insurers, banks and hybrid funds could lift risk premia more broadly as investors' risk appetite diminishes.

» **Sovereign yields spike**. Fiscal fragilities and record refinancing needs are pushing term premia higher and steepening curves for major advanced economies. Persistent yield pressure would tighten financial conditions and weigh on global growth.

Geopolitical fractures

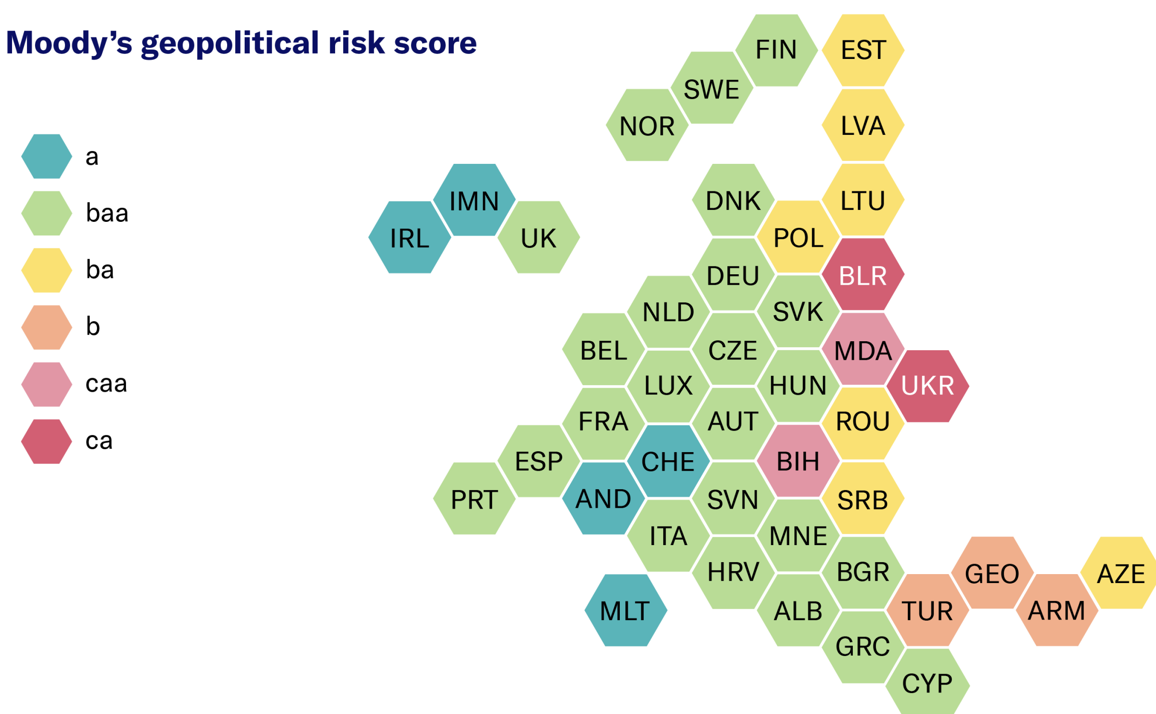
US actions in Venezuela, US-European tensions around Greenland, the ongoing Russia-Ukraine conflict, and heightened frictions across Asia all underscore a shift toward a more fragmented and volatile geopolitical landscape, where major powers increasingly exert influence across competing spheres. When fractures of this kind raise security risks or threaten major trade disruption, the resulting deterioration in economic sentiment and tightening in financial conditions can quickly weaken credit conditions.

Several geopolitical events in recent years have had limited global credit impact as financial markets and business activity rebounded after the initial shock. However, an event perceived to have material global ramifications—such as fractures within NATO or conflicts in the Middle East or Asia involving larger economies—still poses a risk of sustained capital flight, asset repricing, and liquidity stress. Rising risk premia would push up borrowing costs, with lower-rated issuers, particularly those with cross-border exposures or heavy reliance on wholesale funding, likely feeling the most immediate impact. The impact on broader credit conditions would be especially pronounced if severe, disorderly market repricing occurred against a backdrop of wider global economic risks.

Conflict can also manifest through trade and investment barriers, as well as more restrictive access to goods such as semiconductors and critical minerals. Heightened strategic competition over rare earths and energy supply chains introduces additional vulnerabilities for industries in countries such as Japan, India, the US, and Germany.

For governments, heightened security risks may prompt defence spending to rise further beyond current plans. For those with limited fiscal space, this risks crowding out investment in infrastructure, health, and education—areas critical to long-term growth and social stability. While defence-related industries may benefit, the broader macroeconomic consequences are typically negative, particularly where higher defence spending accelerates fiscal deterioration and weakens debt metrics.

Exhibit 1
Geopolitical risks are already elevated across Europe



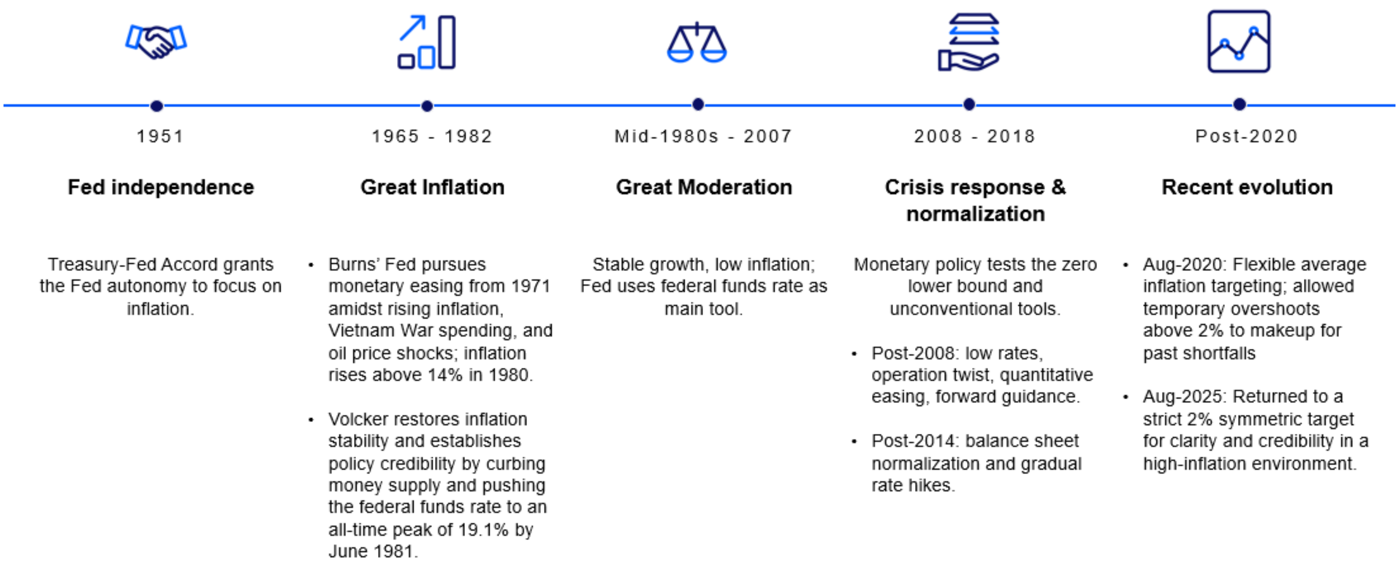
Source: Moody's Ratings

Inflation fears reignite

With Jerome Powell's term as Chair of the Federal Reserve expiring in May, uncertainty is growing over who will lead the institution next and how a new Chair may interpret its mandate. If a looser reading of the Fed's price-stability objective results in a slower policy response to emerging inflationary pressures, the likelihood of inflation expectations becoming de-anchored would increase.

Historical precedent underscores the dangers: rate cuts in 1970–72 under Arthur Burns temporarily boosted growth but ultimately unleashed sustained inflationary pressures, which were only quelled with aggressive monetary tightening by Paul Volcker in 1979. Credibility of the Fed's low and stable inflation commitment was subsequently established only after the rather severe 23-months-long double-dip recession starting from January 1980, during which the rate of unemployment peaked at 10.8% in December 1982. This hard-won policy credibility, once lost, would be difficult to restore.

Exhibit 2
Credibility has become the cornerstone of the Federal Reserve's policy



Source: Moody's Ratings

While a similar shift in the policy stance today may or may not immediately trigger a bond market reaction, a deterioration in inflation indicators would drive a steepening of the yield curve, particularly at maturities from 10 to 30 years. As uncertainty over the future policy path increases, long-duration assets would become more volatile, prompting investors to rotate toward safer, shorter-duration holdings. This would amplify swings at the long end of the Treasury curve and heighten global duration sensitivity.

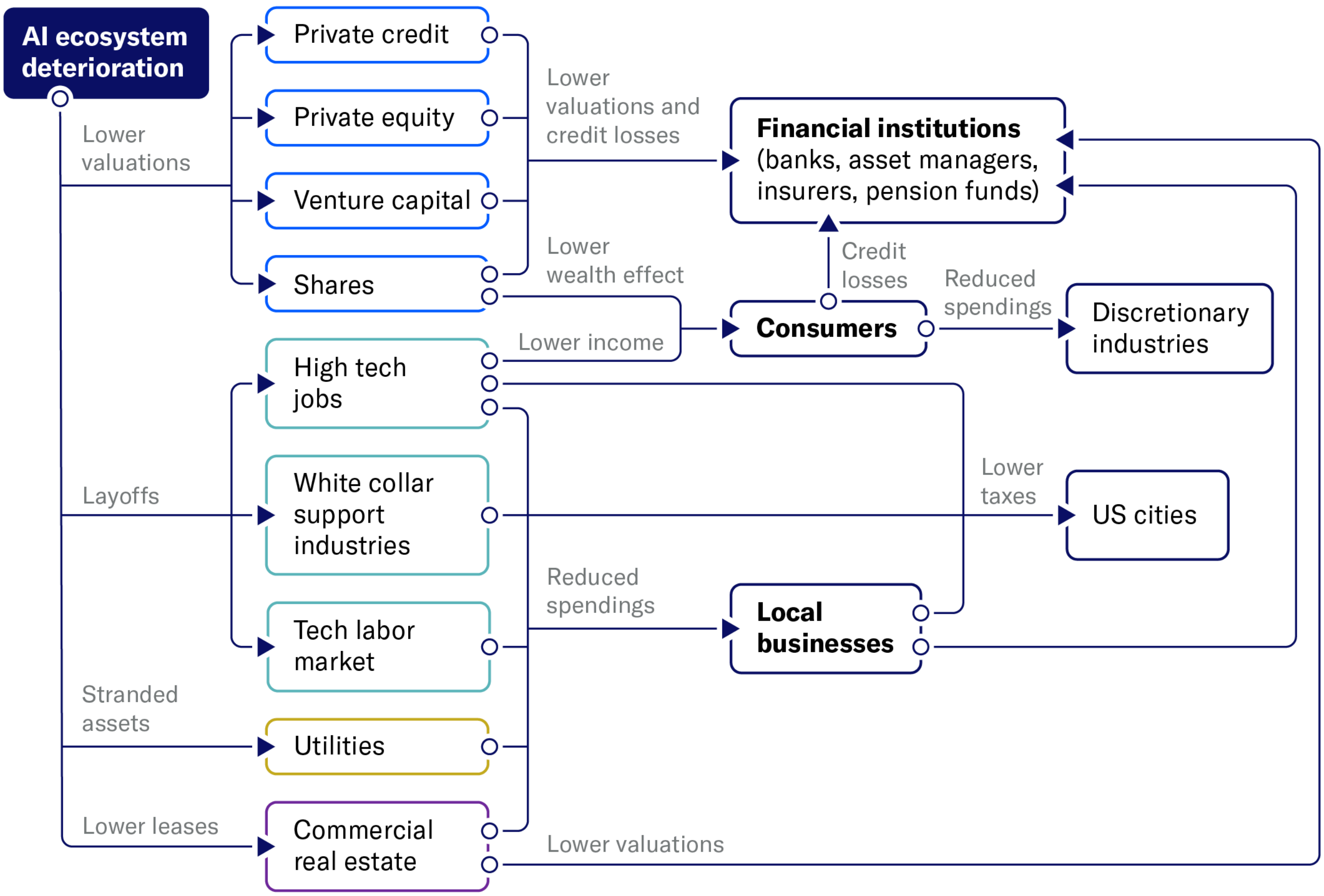
A weaker credibility anchor would also put downward pressure on the US dollar, with global spillovers likely given the centrality of US assets in international portfolios. Less predictable Fed policy and more volatile cross-border financial conditions would increase the risk of abrupt portfolio adjustments in both advanced and emerging markets, making the global system more prone to large swings in risk sentiment.

Finally, a policy mix that tolerates rising inflation alongside stronger near-term growth could distort credit pricing. Excess liquidity and artificially low real rates would fuel misallocation of capital, weaken underwriting discipline, and compress risk premia. Such an environment heightens the risk of a boom-bust dynamic in credit markets — with the subsequent correction posing material risks to corporate refinancing, asset quality and overall financial stability.

AI equity price correction

Global corporate investment in AI has surged since the pandemic, driving US equity valuations and tech-sector concentration to levels reminiscent of the dot-com era. This cycle is supported by stronger fundamentals: healthier corporate balance sheets, a well-capitalized banking system and broader adoption of AI. But set against this, any disappointment in productivity gains, earnings shortfalls from major AI firms, tighter financial conditions or a broader economic slowdown could all trigger a correction that would spill over into the wider economy (see Exhibit 3). And any downturn in the US would be felt globally, given its central role.

Exhibit 3
An AI bubble correction would hit a broad range of organizations
Contagion channels of an AI bubble burst in the US



Source: Moody's Ratings

Startups building AI models would be most vulnerable to any pullback in lending and demand, as most remain unprofitable and rely on constant capital infusions. Any overcapacity would weaken the earnings of semiconductor companies, but those like NVIDIA (Aa1 positive) and AMD (A1 stable) are better positioned than in past cycles. Some data center infrastructure could also lose value, though existing leases with major tenants, constrained capacity and strong demand prospects would help soften the blow. Utilities that have invested heavily to support AI-driven data centers could face slower growth and lower electricity prices. Commercial real estate in tech hubs would be hit by falling office valuations, shrinking city tax bases and weaker credit quality for local governments. Large tech companies though are better positioned by virtue of their financial strength.

A deep and sustained equity market correction would also manifest as a wealth shock for households, though its effect on aggregate spending would be limited given healthy balance sheets and low debt service (at 11% of disposable income). If falling equity prices trigger hiring freezes and layoffs as businesses cut costs, consumer spending growth could soften. And while empirical evidence shows that equity bubbles tend to cause milder downturns than credit or real estate bubbles, economic growth could still weaken further from an already-subdued pace.

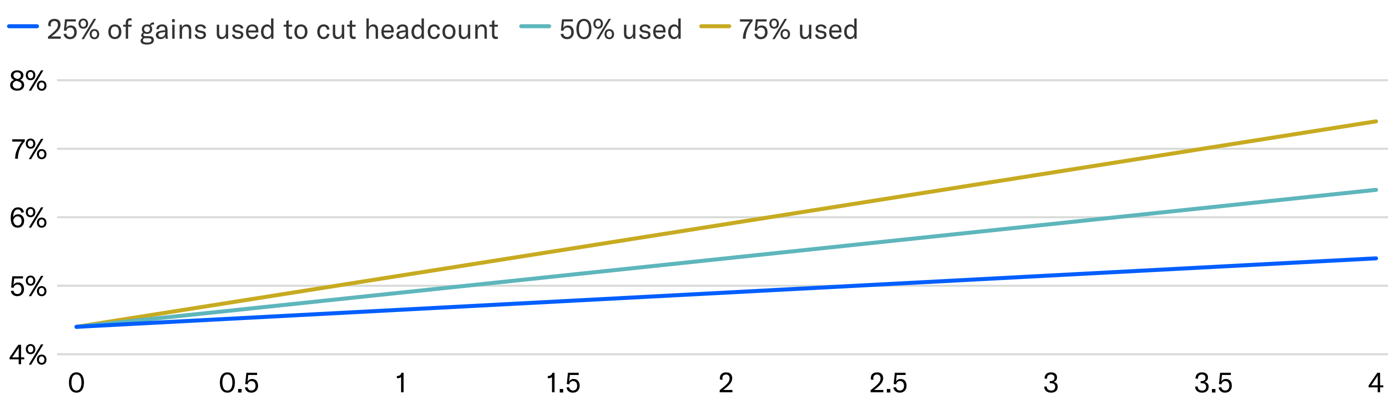
AI productivity gains drive job losses

A rapid acceleration in AI adoption this year has the potential to deliver a powerful boost to productivity. Using the US as an illustrative example—given its advanced investment and early adoption—next-generation systems could automate complex cognitive tasks at scale, enabling companies to reduce costs while increasing output. Efficiency gains would ripple across sectors, fundamentally reshaping business models and competitive dynamics.

While productivity growth is generally positive for credit quality overall, a fast transition would be disruptive to labour markets. As firms restructure to capitalize on automation, junior- and entry-level roles could be hit hard; but white-collar and service-sector roles once considered more secure would also become vulnerable. Job displacement would be widespread and retraining pathways likely limited, with most new opportunities concentrated in highly technical fields.

The result would be a sharper divide between digital-intensive industries and the broader workforce, intensifying income inequality and putting downward pressure on wage growth as displaced workers compete for fewer roles. The bigger the efficiency gains, the bigger the potential labour effects: a 1% increase in output per hour, if half were channelled into labour reduction, could eliminate around 800,000 jobs in the US—enough to lift the unemployment rate to almost 5% from 4.4% (see Exhibit 4).

Exhibit 4
Productivity gains could lead to substantial job losses
Simulated impact of productivity gains (X axis) on US unemployment rate (Y axis), %



Scenarios start from reported 4.4% unemployment rate in December 2025. These are marginal effects (ie where other job creation and destruction is excluded) and labour force is held constant for simplicity.
Source: Moody's Ratings

Over time, displaced workers would find new roles, but only often for lower wages.[2] But transmission channels to credit risk would emerge much more quickly. Lower employment and slower wage growth would hit spending by lower-income consumers and erode income-tax and consumption-tax bases, even as fiscal spending needs could rise to support displaced workers and limit social instability. Larger deficits and elevated borrowing requirements could thus ensue, especially if policymakers expanded social-support programs. Higher debt burdens would weaken fiscal strength and increase sovereign credit risk.

For companies, credit outcomes would diverge sharply. Highly automated firms could experience margin expansion and stronger cash flow, clear credit positives. And while labour-intensive sectors—including retail, hospitality, traditional services and parts of healthcare—could see some AI gains, they would still face relative decline. Weakening business models in the face of reduced demand, rising restructuring costs and reduced pricing power would weigh on ratings and heighten refinancing risk, particularly for already-leveraged issuers.

For lenders, a spike in unemployment would increase household credit stress, pushing up delinquency rates across consumer loan books. Banks and other lenders with concentrated exposure to vulnerable sectors or lower-income borrowers would face higher credit losses and weaker profitability, and potentially tighter funding conditions if risk sentiment deteriorates.

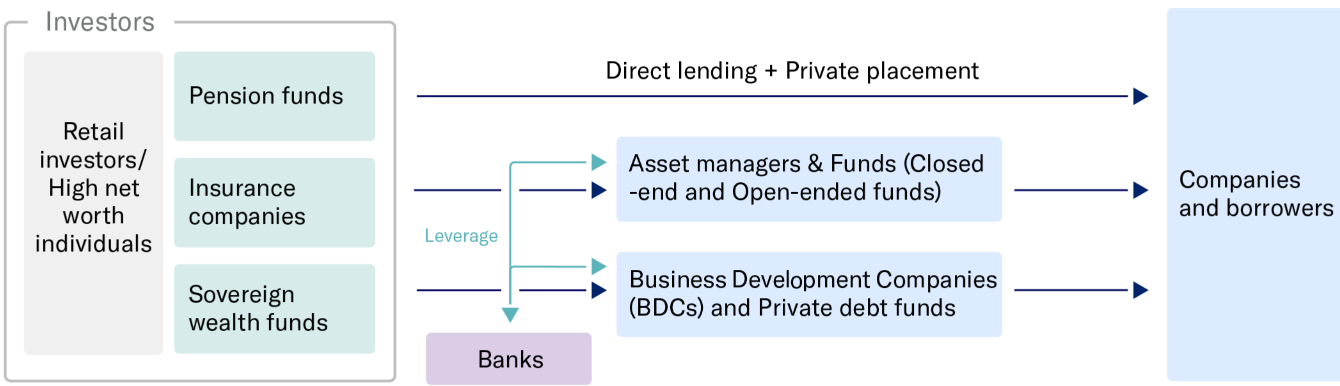
Stress in private credit generates contagion

Private credit has grown into a central financing channel for a wide range of borrowers, supported by strong investor demand and customized lending structures. As the market expands, so too does the potential for vulnerabilities to emerge, particularly in areas where transparency is limited and financing chains have become more interconnected.

At the same time, new partnerships and illiquidity increase the risk of broader financial contagion (see Exhibit 5). For example, US and European insurers have raised their exposure to private credit assets to around 36% and 13% of total investments in 2024, respectively.[3] Banks too have become increasingly important providers of credit for non-bank lenders and are co-lending to private credit borrowers, which is increasing financial interlinkages. Large, more heavily regulated banks are well capitalized and may be able to absorb these losses. And for insurers, the risks are partially offset by their adherence to asset-liability management, capital buffers, diversification and regulatory safeguards.

Exhibit 5

The world of private credit is becoming increasingly more complex



Source: Moody's Ratings

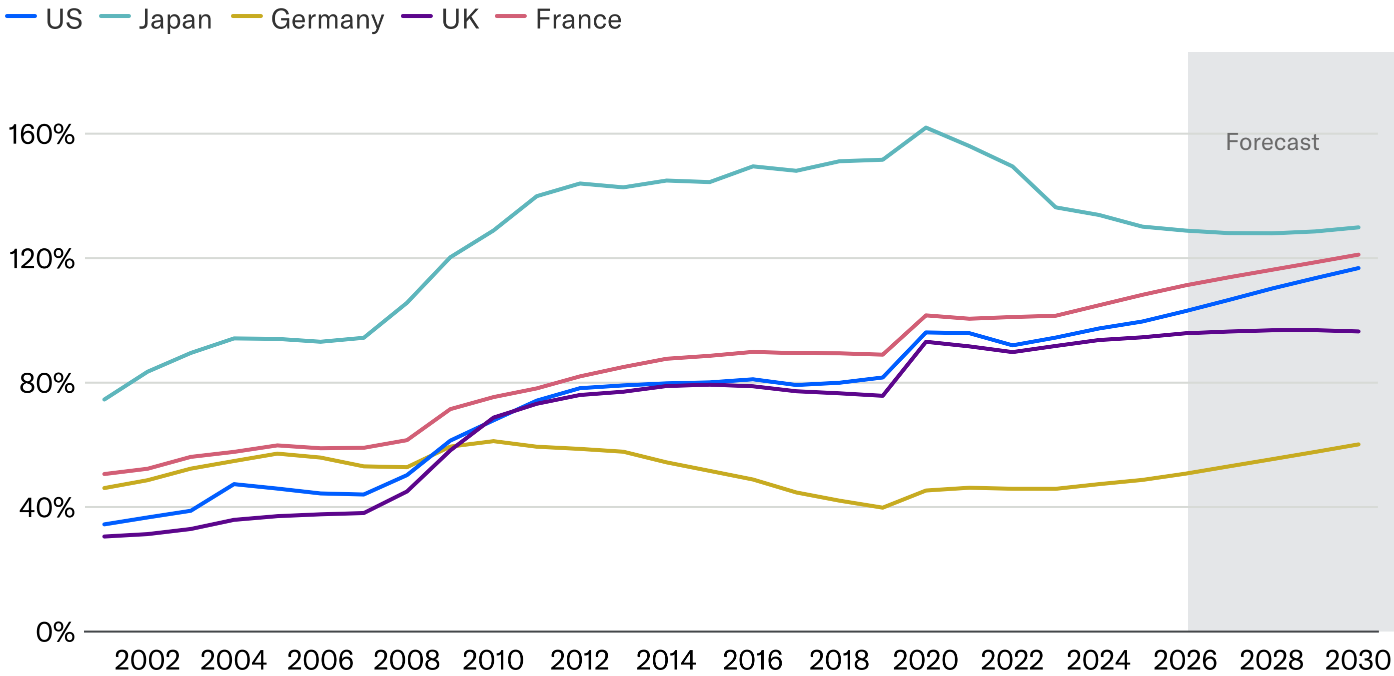
The growing concentration of non-bank lenders in private credit, many of which also operate in private equity, could amplify aggregate risk by increasing correlated exposures and making the credit system more vulnerable to common shocks. If losses become severe and doubts arise about their ability to meet obligations, these lenders could lose access to new funding—both debt and equity—and may be forced to default and restructure their own debts.

These direct effects could still be limited in the context of large financial systems (of which private credit remains a relatively small part). But a deterioration in private credit asset quality could also hit investors' broader risk appetite, increasing risk premia across a range of other financial markets. If funding withdrawals in one segment lead to forced asset sales, that would depress valuations and amplify disruption. For example, vehicles like interval or evergreen funds offering early redemption could be forced to sell portfolio assets, which then drag down valuations more broadly. If these effects drive increased risk aversion across the whole financial sector, that could trigger systemic concerns.

Spike in sovereign yields strains fiscal positions and slows economic activity

Sovereign bond markets are entering 2026 in a period of vulnerability as fiscal sustainability concerns collide with large refinancing needs. For large advanced economies (AEs), structural deficits, ageing populations and weak productivity are raising doubts about those governments' ability to stabilise debt trajectories (see Exhibit 6). The scale of issuance amplifies these risks, leaving sovereigns increasingly exposed to shifts in market sentiment.

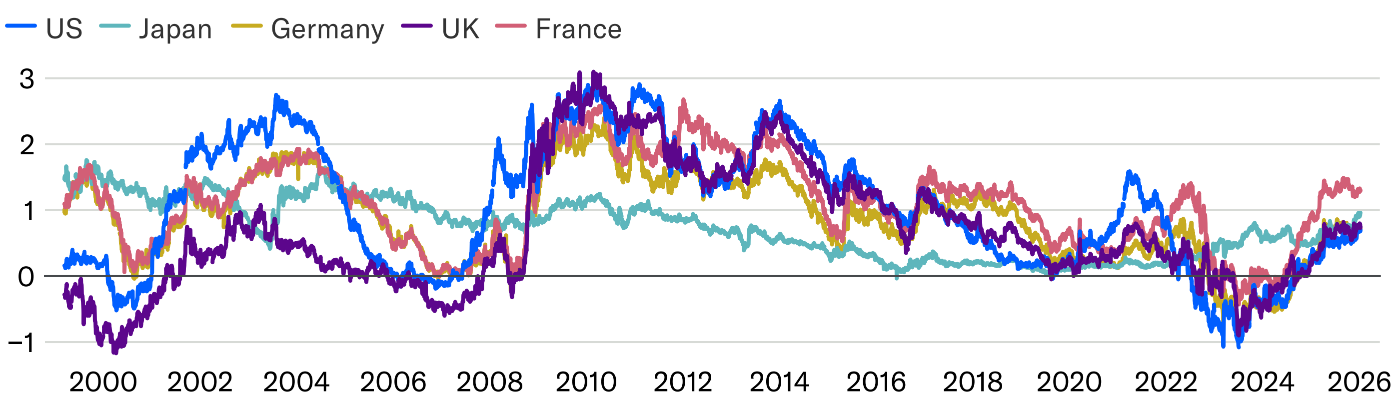
Exhibit 6
Persistent and rising debt burdens will keep markets on edge
General government net debt, % of GDP



Source: Moody's Ratings

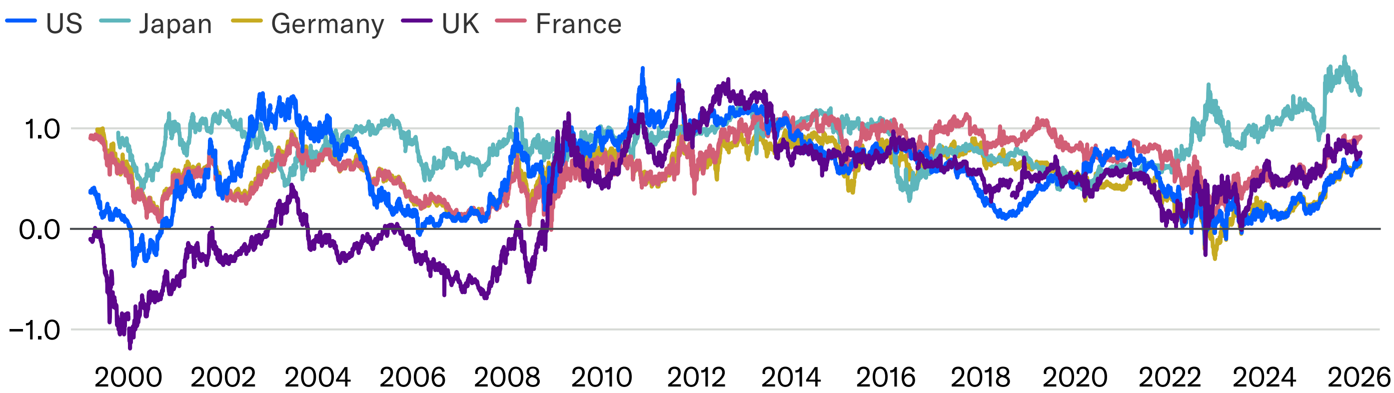
These structural pressures have already begun to reshape yield curves for large AEs, which are global benchmarks. Markets are demanding a higher premium to hold long-dated debt in countries with rising debt burdens and little political appetite for consolidation. As a result, the long end of the curve has steepened—even in jurisdictions where policy rates have started to fall—reflecting investors' efforts to hedge fiscal and inflation risks by reducing exposure to duration (see Exhibits 7 and 8).

Exhibit 7
The yield spread is widening...
Spread between 2- and 10-year government bonds



Sources: Haver and Moody's Ratings

Exhibit 8
...including at the long end
Spread between 10- and 30-year government bonds



Sources: Haver and Moody's Ratings

Signs of strain are also emerging in primary markets. In 2025, gilt auctions required higher concessions to attract demand, while France's long-dated Obligations Assimilables du Trésor (OATs) recorded weaker bid-to-cover ratios. Japan's experience shows the limits of policy insulation: as global term premia rise, even a central bank with aggressive yield-control measures is forced to accept higher long-term yields to maintain market functioning. If these pressures reassert themselves in 2026, governments may face materially higher funding costs at a time when fiscal flexibility is already constrained.

A sharp increase in yields for large AEs would have far-reaching consequences. Higher sovereign borrowing costs feed directly into the broader cost of capital, tightening financial conditions without any central bank action. In highly indebted countries, this can set off a destabilising feedback loop: rising interest bills worsen fiscal positions, further eroding investor confidence and pushing yields higher still. In Europe, this dynamic would limit governments' capacity to support growth and heighten fragmentation risk within the euro area. Globally, persistent upward pressure on long-term rates in major AEs that act as benchmarks would depress investment, restrain consumption and raise volatility across risk assets. Without credible medium-term fiscal plans, the risk of a disorderly adjustment in bond markets—and a broader slowdown—remains elevated in 2026.

Endnotes

1 While each scenario is presented separately, they are not independent; for example, geopolitical risk could trigger a spike in sovereign yields.

2 Milton Friedman (1968) famously stated that full adjustment in the labour market could take decades.

3 Our definition of private credit here includes non-bank lending to middle market companies, middle market CLOs, private ABS, privately placed investment grade corporate assets, fund finance and real estate lending, including commercial mortgage loans, as well as infrastructure lending and asset-based finance.

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