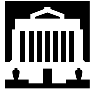
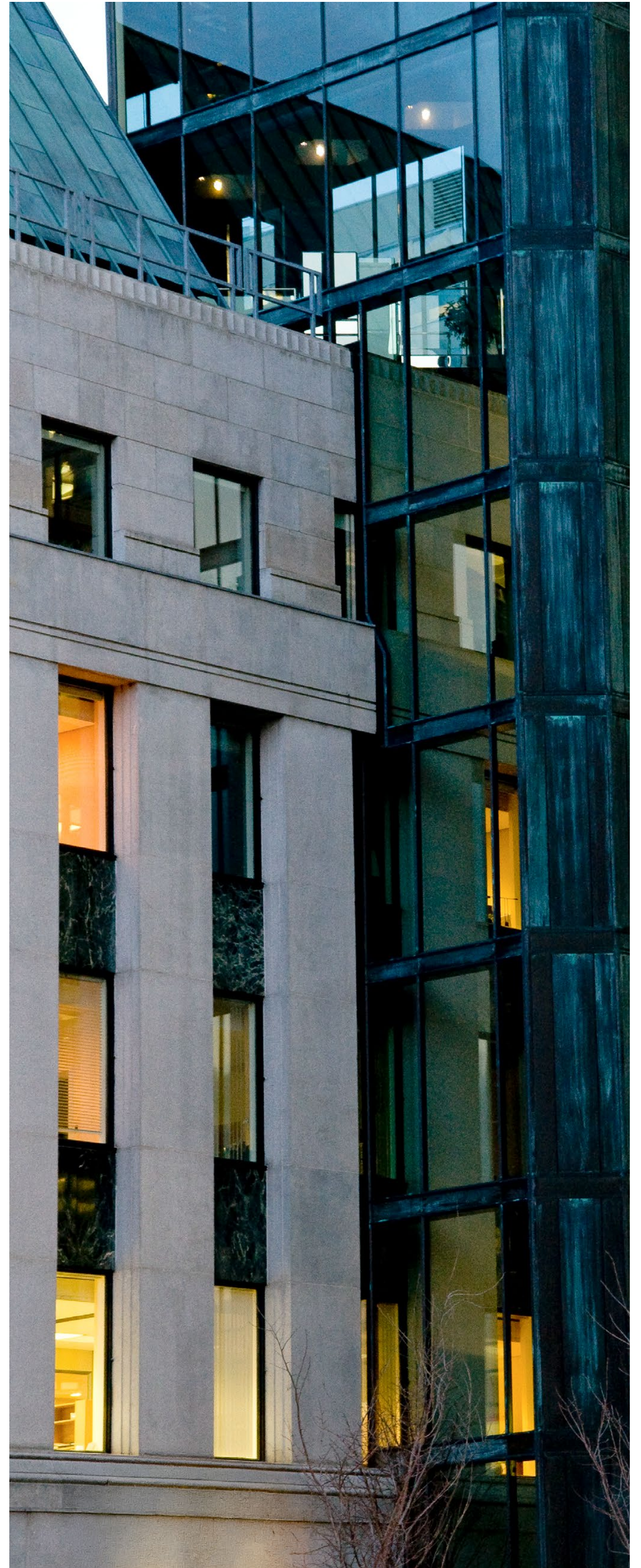




Financial Stability *Report*

2026

A stable and efficient financial system is essential for sustaining economic growth and raising standards of living. In the annual *Financial Stability Report*, the Bank of Canada assesses the resilience of the Canadian financial system and focuses on key risks that could undermine its stability.

Overall assessment

Canada's financial system has continued to function well despite US tariffs and trade uncertainty. But a more turbulent global environment poses risks to financial stability, particularly if several vulnerabilities crystalize at the same time.

The Canadian financial system continues to be resilient. Households and businesses remain in stable financial condition, and banks have strengthened their capacity to absorb shocks.

However, vulnerabilities have increased in some parts of the system. Valuations of many financial assets have continued to rise, increasing the risk of a sudden correction. At the same time, global sovereign debt issuance is growing, and hedge funds have increasingly absorbed this debt in recent years.

Individually, these vulnerabilities are manageable. But with increased economic and geopolitical risks, it is more likely a new shock or a combination of shocks could cause multiple vulnerabilities to crystalize at once. If this were to happen, these vulnerabilities could interact and reinforce each other.

In the extreme, a cascading series of events could cause a sharp loss of investor confidence. This could lead to liquidity hoarding or rapid asset sales, putting pressure on core funding markets. Stress could then spread across the financial system and the broader economy.

Financial system resilience

At the time of the previous Report, the United States had only recently begun pursuing its new trade policy. The situation was highly volatile, making it difficult to predict how the Canadian economy and financial system would be affected.

So far, the impacts have been less widespread than was initially feared. Most Canadian trade with the United States remains tariff-free, the Canadian economy has been resilient, and changes in US trade policy have not led to a broad and lasting deterioration in financial conditions. Still, sectoral tariffs have hurt activity in affected industries, and the future of Canada's trade agreement with the United States and Mexico remains uncertain.

The war in the Middle East has added to global uncertainty, disrupting shipments of oil and other key commodities through the Strait of Hormuz, damaging regional energy infrastructure and driving up commodity prices. Energy and financial markets have been volatile in response to evolving developments but have so far continued to function well.

Against this backdrop:

- Households and businesses remain in broadly the same financial condition as in the previous Report. After having increased since 2022, indicators of both household and business financial stress have plateaued over the past 12 months. Household indebtedness remains high but below recent peaks, while household wealth and incomes have risen. Businesses have maintained healthy balance sheets (see the **Households** and **Non-financial businesses** sections).
- Canada's large banks have grown more resilient due to higher profitability and a stabilization in the performance of their loan portfolios. In response to the dramatic shift in US trade policy and its impact on the economy, banks have also set aside more funds to cover potential credit losses (see the **Banks** section).
- Vulnerabilities related to non-bank financial intermediaries have continued to grow. Asset managers have further increased their use of repurchase agreement (repo) leverage,[1] leaving them vulnerable to a sudden increase in liquidity needs or a reduction in the funding available in repo markets. However, some asset managers have taken steps to reduce their risk exposures (see the **Non-bank financial intermediaries** section).
- Financial markets have also grown more vulnerable. Geopolitical developments have led to periods of increased volatility, while corporate bond and equity valuations are stretched relative to historical norms. Growing government debt issuance globally is also contributing to rising term premiums in sovereign yields (see the **Financial markets** section).

Valuations of risk assets remain elevated

Despite recent volatility and temporary pullbacks, valuations of risk assets have continued to climb, driven by elevated earnings expectations and declining risk premiums.

Moreover, a growing share of stock market capitalization is concentrated in a handful of large technology firms that are heavily invested in artificial intelligence (AI). This large and increasing concentration means that a correction in these sectors would have an outsized impact on broader stock indexes.

An abrupt repricing or a deterioration in economic fundamentals could cause asset managers to face significant losses, a sudden increase in liquidity needs and forced asset sales to reduce leverage.

Hedge fund activity increases vulnerabilities in sovereign debt markets

As global sovereign debt issuance has grown in recent years, the role of hedge funds in government bond markets has also grown. In Canada, hedge funds account for over 40% of purchases of government bonds at auction, roughly the same level as at the time of the previous Report. They also account for around one-quarter of trading between Canadian bond dealers and clients, a slight decrease.[2] This activity improves sovereign debt market liquidity and efficiency but also creates vulnerabilities.

Hedge funds typically rely on leverage obtained from overnight or short-term funding. Disruptions to their access to funding or sharp changes in the prices of the securities underlying their trades could lead hedge funds to suddenly sell off their holdings of government bonds. This could have important repercussions across the financial system (see **In focus: A resilient repo market is important for financial stability**).

Because hedge funds use a range of strategies and trade in many different markets—including across borders—they can transmit stress during periods of turmoil.

Financial system risks

Three key risks to the financial system have emerged

Market participants are navigating a complex and frequently changing series of geopolitical and economic shocks, and there is considerable uncertainty around how and when these issues will be resolved. In this turbulent environment, three key risks have emerged: global trade, geopolitical risk and AI.

US tariffs and trade policy uncertainty persist

If the United States imposes tariffs on a broader set of goods or increases current tariff rates, the resulting impact on cross-border trade could have significant negative economic effects similar to those explored in the trade war scenario in the previous Report (see **In focus: How a severe and long-lasting global trade war could affect financial stability** in the 2025 Report).

Geopolitical risks have escalated

The war in the Middle East has caused one of the largest disruptions to global energy markets in history. The effective closure of the Strait of Hormuz is disrupting supply chains, which is weighing on energy and other commodity prices. This is putting downward pressure on global growth and upward pressure on inflation. The associated market volatility has also led to margin calls and, at times, strained liquidity in certain markets.

Considerable uncertainty remains about whether the war will escalate, how long it will last, how it might be resolved and what it will mean for commodity prices and financial conditions. Even after hostilities end, it will likely be months before the production and distribution of oil, natural gas and other commodities return to normal. The risk premium in oil markets may unwind gradually rather than disappearing immediately.

In a situation where financial conditions amplify an oil price shock, the resilience of the financial system could be tested (see **In focus: How a financial market correction could worsen the effects of an oil shock**).

AI-related risks are growing

A wide range of risks related to AI are intensifying and will require close monitoring.

AI could raise productivity and support growth over time, but it could also create disruptions as adoption becomes more widespread. The recent drop in the share prices of some software companies, which was driven by concerns about AI, shows how quickly new developments can affect valuations. This has already led to stress in private credit markets (see **In focus: Rapid growth in private credit has created vulnerabilities**).

AI may also increase cyber security risks across the financial system by making it easier for software vulnerabilities to be identified and exploited. This means more frequent and time-compressed software updates will be required, which could create operational risk.

These cyber and operational risks are amplified by the widespread reliance of financial institutions on shared systems, vendors and infrastructure. A cyber attack on any of these shared systems could have significant repercussions. For example, banking or other financial services could be disrupted, confidential data could be compromised, or trading or payments platforms could be forced offline.

There are also risks related to the scale and financing of the build-out of AI infrastructure, which is expected to be increasingly funded by debt. If earnings fall short of investor expectations for even just a few of these firms, there could be a sharp repricing of AI-related stocks and credit.

A significant shock could trigger multiple vulnerabilities at once

Over the past 12 months, the global financial system has faced a series of economic and geopolitical shocks. So far, the financial system has been resilient, in part because market confidence has remained strong.

However, vulnerabilities continue to build. If one of these vulnerabilities were triggered by a stress event, the fallout would normally be contained. But because the environment is increasingly volatile and uncertain, the possibility of a significant shock causing multiple vulnerabilities to crystalize at the same time has risen.

If this were to happen, it could set off a cascading series of events where these vulnerabilities interact and reinforce each other. For example:

- A sudden loss of confidence among market participants could lead to a severe repricing of risk. This could cause a sharp correction in asset valuations resulting in sudden liquidity demands such as margin calls or redemptions by fund investors. In turn, this could lead to a forced sale of assets. If traditionally safe and liquid assets such as government bonds were also affected by the correction, it could lead to further losses and liquidity demands. In the extreme, actions taken

by market participants to raise cash could result in a self-reinforcing liquidity spiral.[3]

- A sharp drop in investor appetite for sovereign debt could reduce market liquidity or, in the extreme, disrupt core funding markets. This would also cause strain in other fixed-income markets, in turn affecting any instrument using government bonds as a pricing benchmark, a hedging vehicle or collateral. Banks and asset managers that rely on repo markets could face significant liquidity pressures.

Other feedback loops could also materialize. If adverse developments in the financial system intensify economic volatility, this could lead to weaker growth and greater uncertainty for households, businesses and market participants. These impacts could, in turn, trigger further financial system vulnerabilities.

Canada's financial system has proven resilient to recent shocks

Canada's financial system has shown it can withstand stress. Multiple significant shocks have occurred over the past 12 months. While these shocks generated periods of heightened market volatility and short-lived liquidity strains in government bond markets, they did not lead to stress in the overall financial system.

The Bank will continue to monitor and assess the health of Canada's financial system. The objective is to foster a stable and resilient financial system that absorbs shocks and can support the economy through periods of turbulence.

Endnotes

1. A repurchase agreement, or repo, is essentially a short-term collateralized loan. It is structured as a financial contract that provides for the purchase/sale of securities while simultaneously entering into an agreement to resell/repurchase the same securities for a predetermined price at a later date.[←]

2. For more details, see A. Uthemann and A. Walton, "**Hedge funds and their trading strategies in the Government of Canada bond market**," *Sparks at Bank*, Bank of Canada (February 2026).[←]

3. Asset managers hold liquid assets to meet large cash needs. If many asset managers attempt to sell these assets at the same time, significant price reductions may be required to clear the market. If this causes asset prices to fall sharply, it can generate additional volatility and cash needs for asset managers, creating a downward spiral. In the extreme, this dynamic can lead to a freeze in fixed-income market liquidity.[←]

Financial markets

The war in the Middle East has led to periods of increased volatility and reduced liquidity in certain markets, particularly in energy. Nevertheless, markets have generally remained resilient. Equity valuations are still elevated, and credit spreads are compressed.

Financial markets have been hit by a series of shocks over the past 12 months. While markets have generally continued to function well, some vulnerabilities have grown.

Equity and corporate debt valuations appear increasingly stretched compared with historical levels. When asset valuations are stretched, there is an increased likelihood of a sharp correction if a shock occurs. Sovereign debt levels are also rising. A sudden shift in demand for sovereign bonds could have significant implications for the financial system.

Given the volatile environment—including the war in the Middle East, the unpredictability of US trade policy and the potential for artificial intelligence (AI) to disrupt existing business models—the risk of shocks remains elevated. Growing vulnerabilities could amplify the impacts of these shocks.

Financial market vulnerabilities

When asset prices are high relative to economic fundamentals or historical norms, asset valuations are considered stretched. This makes them more likely to fall sharply if investors reduce their appetite for risk or if their earnings expectations are revised down.[1] Price declines could be magnified if leveraged investors face significant losses or margin calls that cause them to suddenly unwind their positions.

Valuations in equity and corporate bond markets—already elevated at the time of the previous Report—have continued to rise over the past 12 months (**Chart 1**). For example:

- The equity risk premium of the TSX compressed further, falling to the second-lowest percentile of its recent historical distribution,[2] while the risk premium of the S&P 500 remained at the fifth-lowest percentile.
- The forward earnings yield of both the TSX and the S&P 500 declined over the past 12 months after share prices rose more rapidly than corporate earnings expectations. This is despite the fact that corporate earnings expectations are well above historical averages—17% for the S&P 500 and 25% for the TSX over 2026.[3]
- Investment-grade credit spreads compressed, falling to the lowest percentile in both Canada and the United States. High-yield spreads also became more compressed in both countries.

Chart 1: Risk premiums and spreads are compressed and valuation measures are elevated relative to their historical distribution

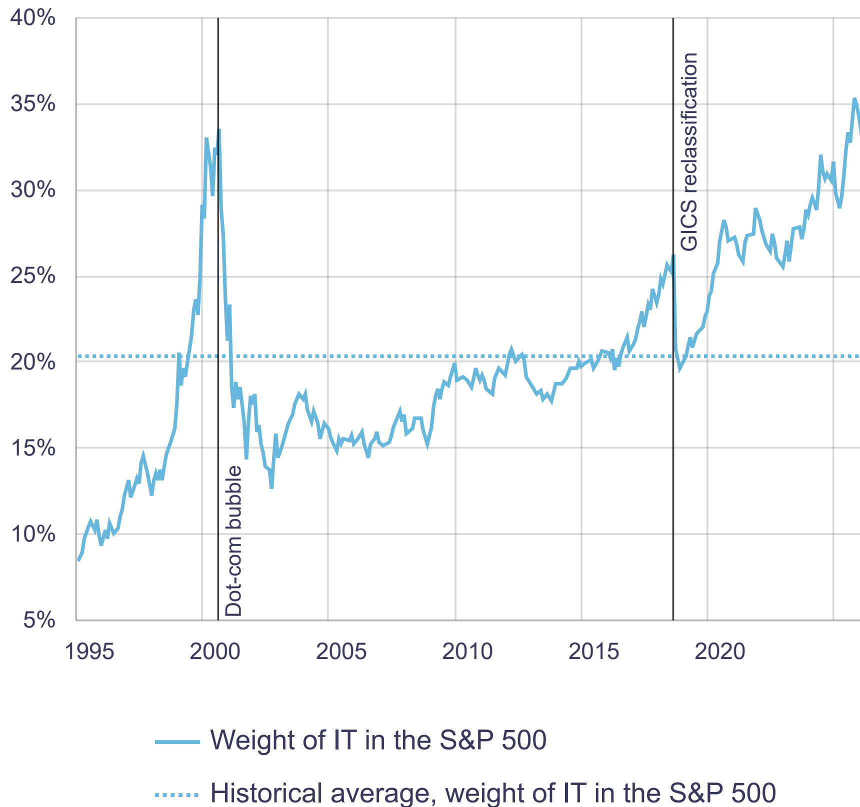
Percentile of historical distribution

Note: Percentiles reflect the period of June 2008 to May 2026. *1-year forward earnings yield* is the inverse price-to-earnings ratio.
Sources: Bloomberg Finance L.P., London Stock Exchange Group and Bank of Canada calculations
Last observation: May 20, 2026

Heightened asset valuations are increasingly concentrated in a small number of sectors, particularly in the United States. The S&P 500's information technology (IT) sector now accounts for nearly the same share of the S&P 500's total market value as it did at the peak of the dot-com bubble (**Chart 2**).

Chart 2: Information technology makes up an increasingly large share of the S&P 500

Percent of overall S&P 500 valuation



Weight of IT in the S&P 500

Historical average, weight of IT in the S&P 500

Note: GICS is the Global Industry Classification Standard. IT is information technology.
Sources: Bloomberg Finance L.P. and Bank of Canada calculations
Last observation: May 2026

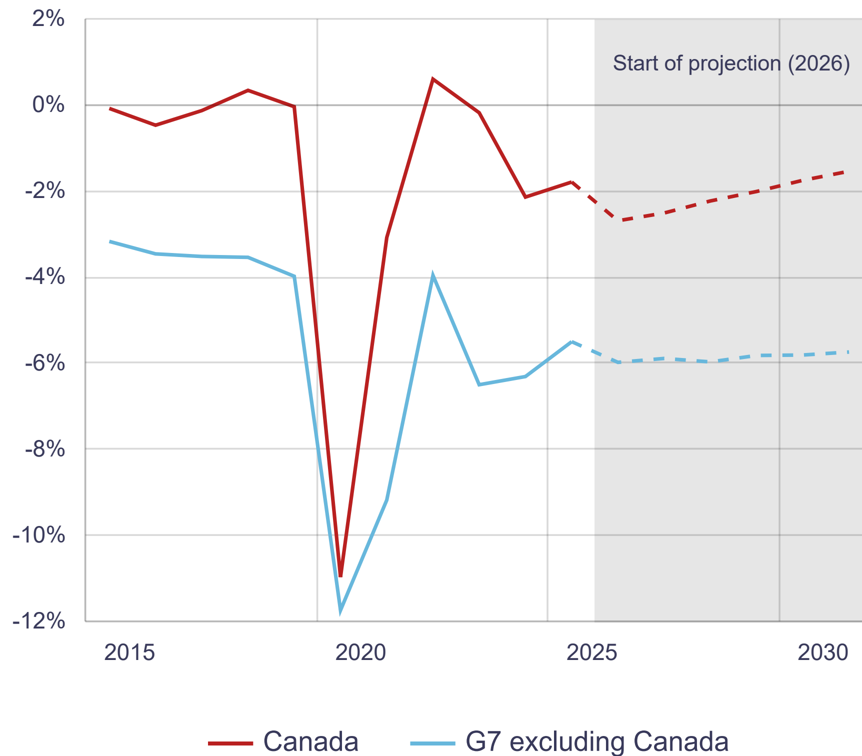
Because large technology firms increasingly rely on borrowing to finance data centres, corporate debt issuance is also becoming more concentrated in the IT sector. Over 18% of US investment-grade bond issuance in 2026 has been in the technology sector—its highest level in at least 16 years. This concentration means that a decline in earnings or earnings expectations for this sector could have a significant impact on the broader market.

Sovereign debt term premiums continue to increase

Globally, government deficits have grown in recent years, and in some countries net debt is already larger than gross domestic product (**Chart 3**). A range of factors—including aging populations and increased defence spending—suggest that government debt loads will continue to expand. In some countries, those debt loads will have to be serviced by a shrinking population.

Chart 3: Sustained fiscal deficits are expected in many jurisdictions

General government fiscal balances as a percentage of GDP, annual data

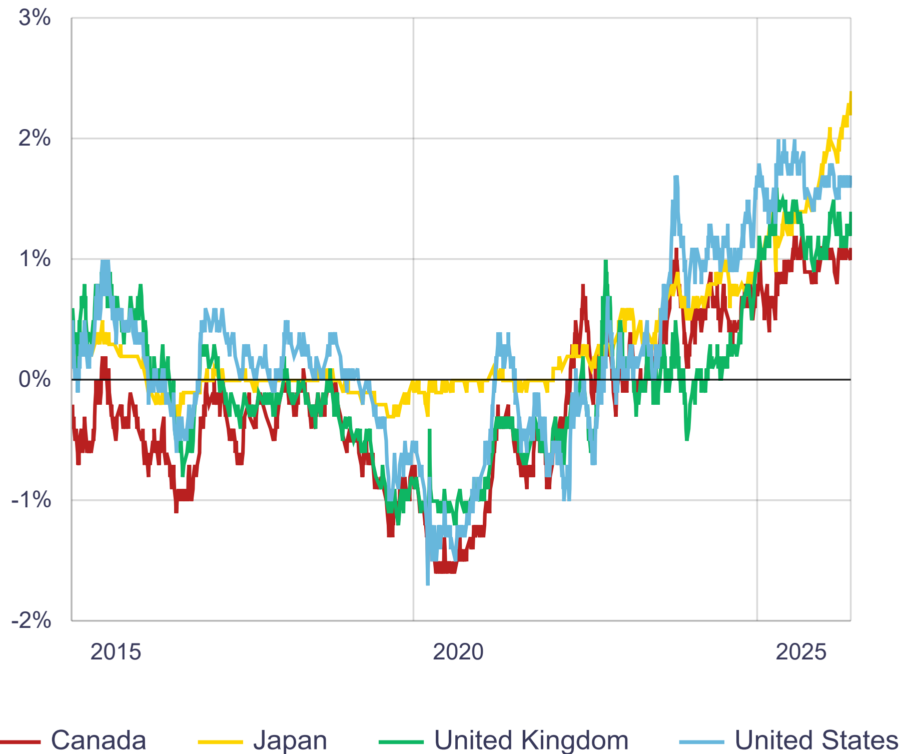


Note: General government fiscal balances are the net lending or borrowing of a jurisdiction's entire government sector (this includes governments at the federal, state/provincial/territorial/regional, and local/municipal levels).
Source: International Monetary Fund via Haver Analytics
Last data plotted: 2031

Because government deficits have grown, investors have had to absorb more debt issuance. These investors face funding and balance sheet constraints, so they have demanded increased compensation, pushing interest rates higher. This has been one driver of the rise in long-term bond yields in recent years (**Chart 4**).[4]

Chart 4: Term premiums have risen in recent years

ACM 10-year term premiums, by country, daily data



Note: Term premiums are calculated using the model developed by Adrian, Crump and Moench (ACM) in T. Adrian, R. K. Crump and E. Moench, "Pricing the Term Structure with Linear Regressions," Federal Reserve Bank of New York Staff Report No. 340 (August 2008, revised April 2013).
Source: Bank of Canada calculations
Last observation: May 15, 2026

Hedge funds have played an important role in absorbing this rising issuance of sovereign debt. Hedge funds tend to use short-term borrowing, which increases the risk that they could pull back abruptly, particularly if liquidity deteriorates or they are forced to reduce leverage. Because sovereign bonds underpin financial markets—as key benchmarks, sources of high-quality collateral and safe assets—any disruption can quickly spill over, reducing liquidity, straining funding markets and pushing up borrowing costs.

In the extreme, a sudden increase in government yields could trigger a liquidity spiral or the type of market turmoil seen in some government bond markets in recent years[5] (see **In focus: A resilient repo market is important for financial stability**).

Some sectors have been affected by recent bouts of volatility

Recent events have led to strains in some markets. These include:

- The stocks of some software companies, as well as broader software equity indexes, have been negatively affected by concerns around potential disruptions from AI. These concerns have also led to a substantial widening of the spreads on leveraged loans to the software sector, and there have been outflows from private credit funds exposed to that sector (see **In focus: Rapid growth in private credit has created vulnerabilities**).
- Traditional safe-haven assets have not behaved as reliably as they have in the past. Government bonds have traditionally been seen as safe-haven assets, with demand rising during periods of market stress. But recently, bond and equity prices have become increasingly positively correlated, which has reduced the risk-mitigation benefits of portfolio diversification.[6] During market corrections, this could lead to greater portfolio volatility and forced deleveraging.
- At the start of the war in the Middle East, significant volatility led some globally active hedge funds to rapidly reduce their leverage and sell government bonds. At the same time, the potential inflationary impact of higher energy prices led to an increase in market expectations for central bank policy interest rates. This caused liquidity in bond markets to deteriorate, leading to short-lived periods of strained market functioning.

Nevertheless, markets displayed resilience and, after volatility subsided, liquidity quickly returned to normal levels.

Endnotes

1. See International Monetary Fund, "**Chapter 1: Shifting Ground beneath the Calm: Stability Challenges amid Changes in Financial Markets**," *Global Financial Stability Report: Shifting Ground beneath the Calm* (October 2025).[←]
2. For more details on this model, see J.-S. Fontaine, G. Ouellet Leblanc and R. Shotlander, "**Canadian stock market since COVID-19: Why a V-shaped price recovery?**" Bank of Canada Staff Analytical Note No. 2020-22 (October 2020).[←]
3. The data for both the TSX and S&P 500 come from London Stock Exchange Group's Refinitiv Workspace and Bank of Canada calculations.[←]
4. For more details, see E. Trostin, J. Ketcheson and A. Diez de los Rios, "**The rise in the Canadian term premium in a global context**," *Sparks at Bank*, Bank of Canada (March 2026). [←]
5. Some examples include the market for US Treasury bonds in April 2025, Japanese government bond markets in January 2026, and UK gilt markets in September 2022.[←]
6. For more details, see T. Adrian, J. Kramer and S. Malik, "**Stock-Bond Diversification Offers Less Protection From Market Selloffs**," International Monetary Fund *IMFBlog* (February 18, 2026).[←]

Households

Overall, Canadian households have proven resilient. But debt levels are elevated, and some pockets of stress remain. The potential impact on employment from ongoing trade uncertainty and geopolitical conflicts is a key concern.

The financial health of Canadian households has changed little since the previous Report. Household indebtedness remains high but below its peak in 2022. The share of borrowers falling behind on debt payments stabilized over the past 12 months after having increased over the previous four years. But this overall picture hides important differences between households, and some face greater financial pressure than others.

Risks to household finances have increased. Trade-related risks remain, while the war in the Middle East has added to economic uncertainty. The main risk to households is that economic or geopolitical developments could lead to a downturn and a sharp rise in unemployment.

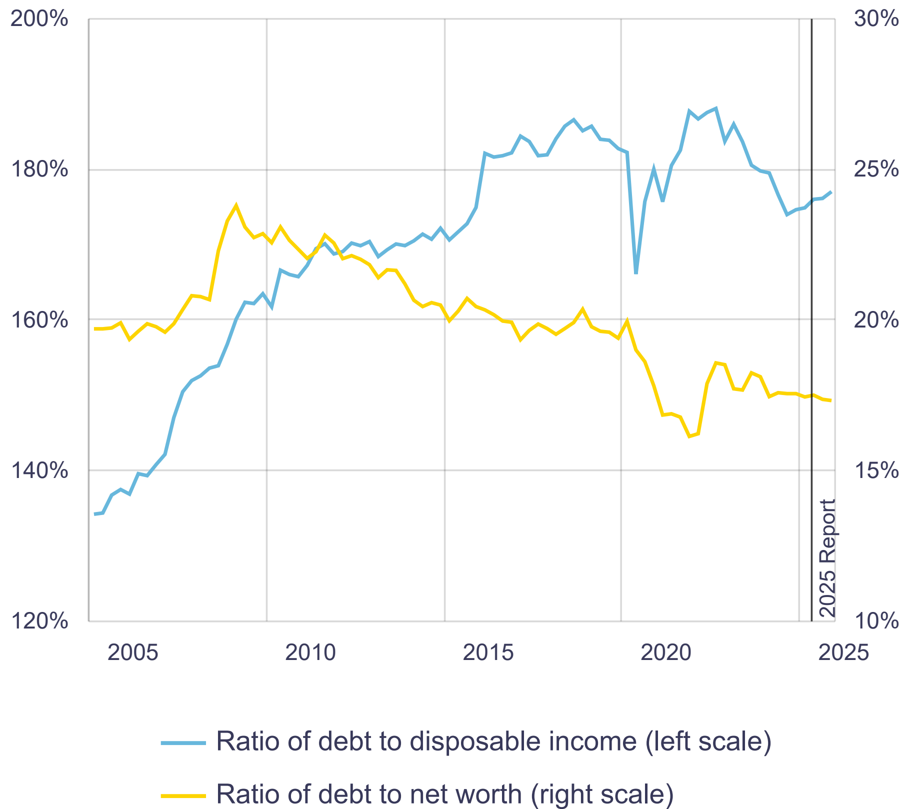
Household financial health

Debt levels remain elevated, but wealth is rising

Canadian households continue to carry high levels of debt relative to their income, making them vulnerable in the event of a job loss or a large, unexpected expense. The ratio of household debt to disposable income has increased slightly over the past 12 months but remains below the peak level observed in 2022 (**Chart 5**).

Chart 5: High indebtedness remains a vulnerabilty, somewhat offset by rising net worth

Household debt ratios, quarterly data



Ratio of debt to disposable income (left scale)

Ratio of debt to net worth (right scale)

Source: Statistics Canada
Last observation: 2025Q4

On average, households appear better off when wealth is taken into account. Debt relative to household net worth has edged down and is well below its pre-pandemic average. This indicates that, overall, household finances have improved, even though debt levels remain high.

Rising house prices have helped drive up household net worth over time. However, housing markets have softened over the past 12 months. Increases in net worth over this period have come mainly from higher values for financial assets, reflecting strong stock market gains (see the **Financial markets** section).

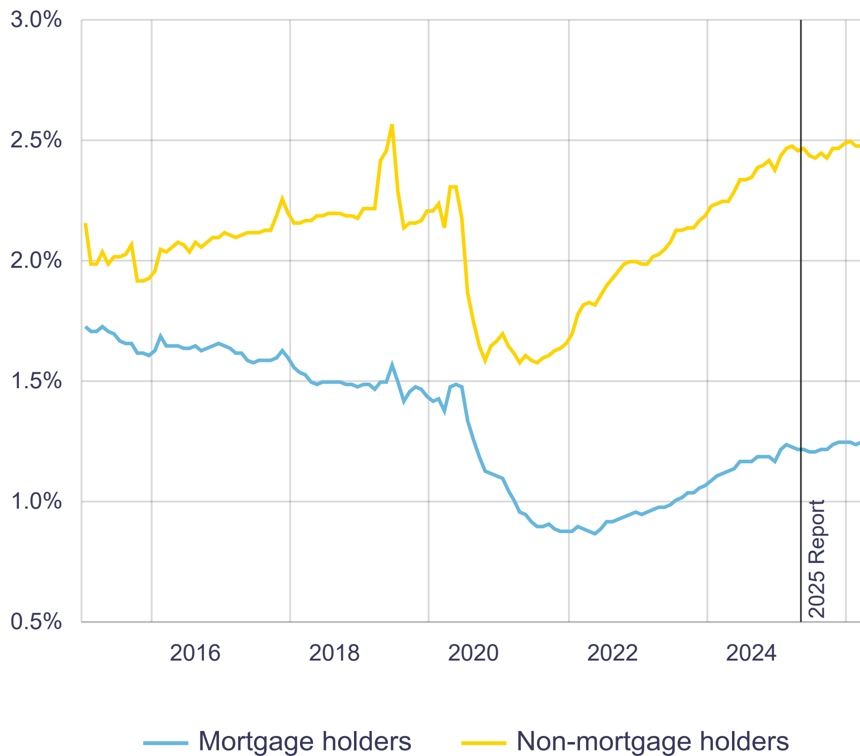
But wealth gains are not evenly distributed among Canadians, and some highly indebted households have very little savings or financial flexibility to cope with an unexpected life event.[1]

Household stress remains broadly unchanged

Overall, financial stress among households is at roughly the same level as in the previous Report, with stress substantially higher among those without a mortgage. The share of borrowers who are late by more than 60 days on at least one account has been broadly stable at about 2.5% for people without a mortgage and 1.3% for mortgage holders (**Chart 6**).

Chart 6: Financial stress has largely stabilized for both mortgage holders and non-mortgage holders

Share of borrowers in arrears by 60 days or more on at least one credit product, seasonally adjusted, monthly data



Note: To protect the privacy of Canadians, TransUnion did not provide any personal information to the Bank of Canada. The TransUnion dataset was anonymized, meaning it does not include information that identifies individual Canadians, such as names, social insurance numbers or addresses.

Sources: TransUnion and Bank of Canada calculations
Last observation: April 2026

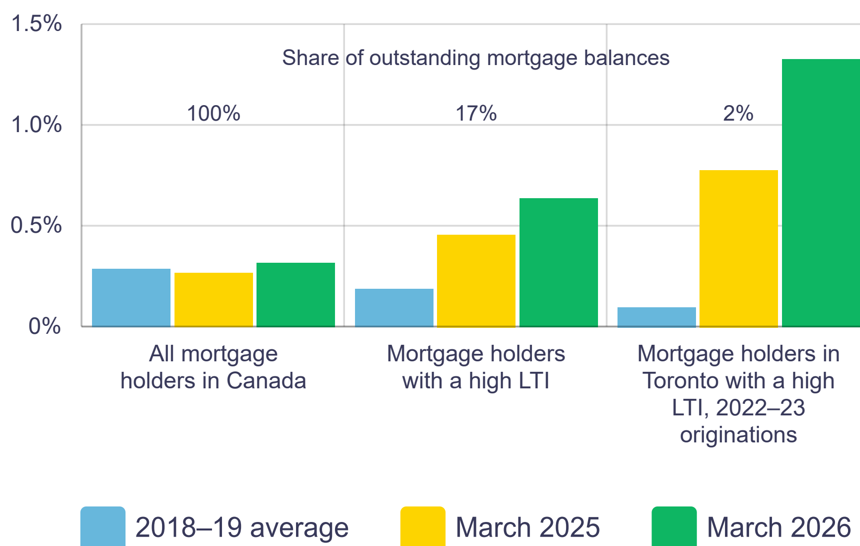
Over the past 12 months, borrowers who took out a mortgage at very low interest rates during the pandemic have been renewing at higher rates. Many mortgage holders faced higher payments at renewal in 2025 and in the first half of 2026, but most have been able to manage the increase. As a result, lenders have not seen a broad rise in loan losses.

The mortgage stress test provided some cushioning, since more than 90% of borrowers who renewed in the past 12 months did so at rates below their qualifying rates.[2] Some borrowers also lessened the increase in their payments by extending the amortization period on their mortgage.

Mortgage arrears remain low overall, with the share of mortgage accounts more than 60 days behind on payments only slightly above the 2018–19 average (**Chart 7**). However, arrears have risen more among borrowers with large mortgage balances relative to their income. These borrowers represent about 17% of outstanding mortgage balances. Stress is most acute among Toronto area borrowers who took out a mortgage in 2022–23. These borrowers represent only about 2% of outstanding balances.[3]

Chart 7: Mortgage arrears remain low but have increased among borrowers with large balances relative to income

Share of mortgage accounts in arrears by 60 days or more



Note: Toronto refers to Statistics Canada's census metropolitan area. High LTI means a loan-to-income ratio higher than 450%. Percentages shown above each group indicate that group's share of outstanding mortgage balances in Canada. To protect the privacy of Canadians, TransUnion did not provide any personal information to the Bank of Canada. The TransUnion dataset was anonymized, meaning it does not include information that identifies individual Canadians, such as names, social insurance numbers or addresses.
Sources: TransUnion, regulatory filings of Canadian banks and Bank of Canada calculations
Last observation: March 2026

Falling home prices can limit financial flexibility

The price of a typical home in Canada has fallen by about 5% in the past 12 months, and by 20% since prices peaked in 2022. Price declines have been most pronounced in Ontario and British Columbia, where new listings are outpacing sales by a growing margin.

Pressures are greatest in condominium markets, particularly in Toronto and Vancouver, and have created challenges for both homeowners and investors. Some buyers have struggled to close on pre-construction purchases because price declines have made it harder to secure financing.[4]

Lower home prices are not necessarily a problem for households that can keep making their mortgage payments. But households that need to refinance to manage their payments may not qualify if they have too little equity to meet lenders' requirements. In this way, lower home prices increase the risk that some households could fall behind on their payments.

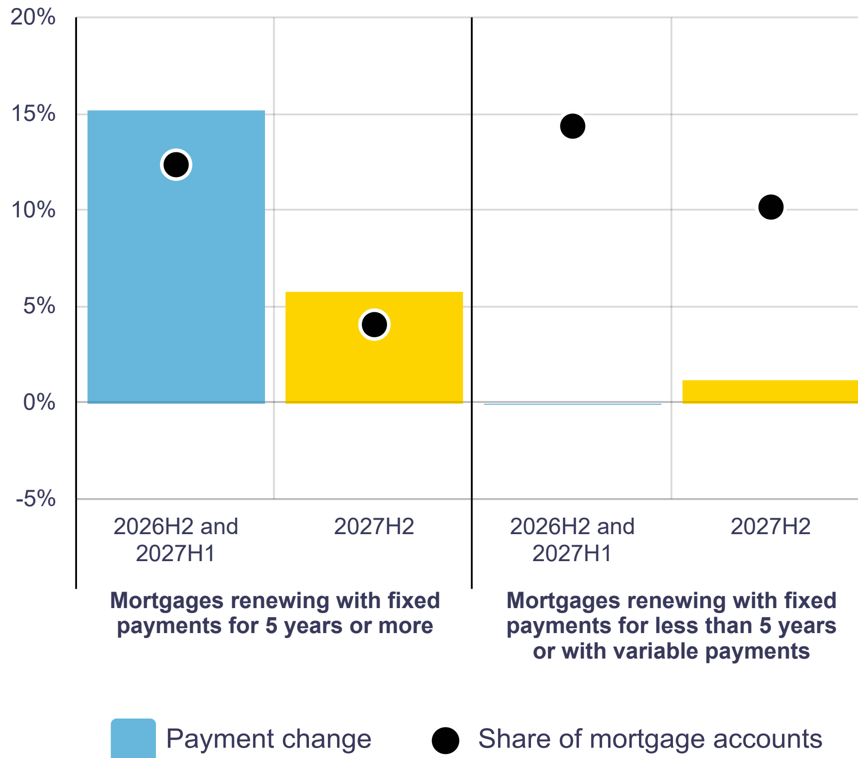
Risks to household finances

Some mortgage holders will face higher renewal rates

Over the next 12 months, the last of the five-year, fixed-payment mortgages taken out during the pandemic will renew. This group represents about 12% of all outstanding mortgages in Canada. On average, these borrowers will see their payments increase by about 15%, broadly in line with increases similar borrowers have faced over the past 12 months (**Chart 8**).

Chart 8: Holders of fixed-payment mortgages with terms of five years or more will see large payment increases at renewal over the next 12 months

Average change in mortgage payments at renewal (in percent, compared with December 2025 payments) and share of mortgage accounts, by mortgage term and payment type



Payment change ● Share of mortgage accounts

Note: The mortgage interest rates used in calculations are based on market expectations for interest rates as at May 19, 2026.

Sources: Regulatory filings of Canadian banks and Bank of Canada calculations

The remaining renewals over the same period, which represent about 14% of outstanding mortgages, are variable-payment mortgages and shorter-term, fixed-payment mortgages that were taken out after rates rose in 2022 and 2023. These borrowers, on average, will not see their payments change at renewal. By the second half of 2027, nearly all mortgage holders facing large payment increases will have renewed.

Strong income growth over the past five years should allow most borrowers to manage payment increases.[5] But those with weaker income growth may have less flexibility because the decline in home prices has reduced equity buffers and made refinancing more difficult.[6]

At current home prices, only a small share of borrowers would not be able to refinance at renewal—an estimated 4% in 2027, or about 9% of borrowers in the Toronto area.[7] If home prices were to fall by another 10%, that share would rise modestly to about 7% nationally and 12% in the Toronto area.

Global developments could weaken economic activity and employment

The Canadian economy has been resilient in the face of multiple shocks, and the unemployment rate has remained in the range of about 6½% to 7% over the past 12 months. However, ongoing trade uncertainty and the war in the Middle East could cause economic conditions to deteriorate.

Households would feel the effects of a weaker economy largely through the labour market. If job losses were to rise, households without sufficient savings could fall behind on mortgage and consumer credit payments.

Endnotes

1. For more details, see T. M. Pugh, S. Sheikh and T. Webley, "**Household balance sheets and mortgage payment shocks**," Bank of Canada Staff Analytical Note No. 2025-23 (October 2025). [←]

2. For more details, see J. Hartley and N. Paixão, "**Mortgage stress tests and household financial resilience under monetary policy tightening**," Bank of Canada Staff Analytical Note No. 2024-25 (November 2024).[←]

3. Toronto refers to the Toronto census metropolitan area. For more details, please see Statistics Canada's **website**.[←]

4. See B. Straus and N. Rao, "**What's behind the slowdown in Toronto's condo market**," *Sparks at Bank*, Bank of Canada (February 2026).[←]

5. Average nominal household disposable income grew by about 16% between 2021 and 2025. [←]

6. Bank of Canada staff estimate that about 10% of the borrowers who had a mortgage in 2022 have since refinanced. About 70% of those who refinanced extended their amortization by an average of six years.[←]

7. This estimate refers to borrowers renewing a mortgage in 2027 with a current loan-to-value ratio above 80%, a gross debt service ratio above 39% and a total debt service ratio above 44%, after fully exhausting the maximum amortization period of 25 years available for insured mortgages.[←]

Non-financial businesses

Canadian businesses remain in good financial shape overall, but risks are building. Trade uncertainty and geopolitical tensions could create new stress for some firms.

The vulnerabilities of non-financial businesses in Canada have remained largely unchanged over the past 12 months. Financial health has remained broadly stable even in sectors that are the most vulnerable to US tariffs and trade policy uncertainty, such as manufacturing. Indicators of financial stress among businesses plateaued in the second half of 2025 after increasing for several years.

However, risks to Canadian businesses are rising. Both ongoing trade uncertainty and the war in the Middle East could put significant financial pressures on businesses.

Business financial health

Vulnerabilities remain unchanged

Canadian businesses have remained in good financial health overall since the previous Report.

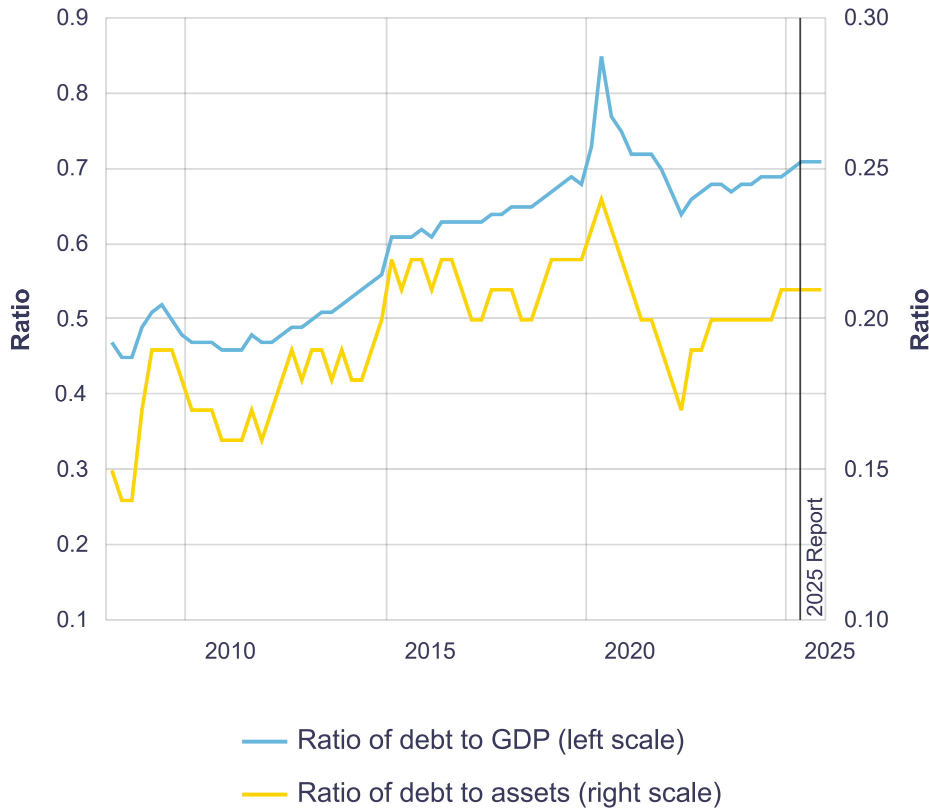
Despite ongoing trade tensions, businesses continue to hold more cash and liquid assets, on average, than was typical before the pandemic. Profitability also remains solid. The combination of these two factors gives businesses a buffer to absorb negative shocks and cover unexpected costs.

Even in sectors most vulnerable to US tariffs—such as manufacturing—financial health has remained broadly stable.

Overall, business debt has risen relative to gross domestic product over the past two years, partly reflecting favourable borrowing conditions for large businesses. At the same time, the ratio of debt to assets is still below pre-pandemic levels and has remained largely stable over the past year (**Chart 9**).

Chart 9: Business leverage has been stable since the previous Report

Measures of business leverage



Ratio of debt to GDP (left scale)

Ratio of debt to assets (right scale)

Sources: Statistics Canada and Bank of Canada calculations
Last observation: 2025Q4

In recent years, large firms have issued bonds to take advantage of low borrowing costs. This has been a key reason for the rise in business debt. Small and medium-sized businesses are generally not able to issue bonds and therefore rely primarily on banks and credit unions for financing.

Additionally, while overall business lending conditions have remained stable in recent quarters, responses to the Bank of Canada's Senior Loan Officer Survey suggest that conditions are somewhat tighter for small businesses than for large borrowers.

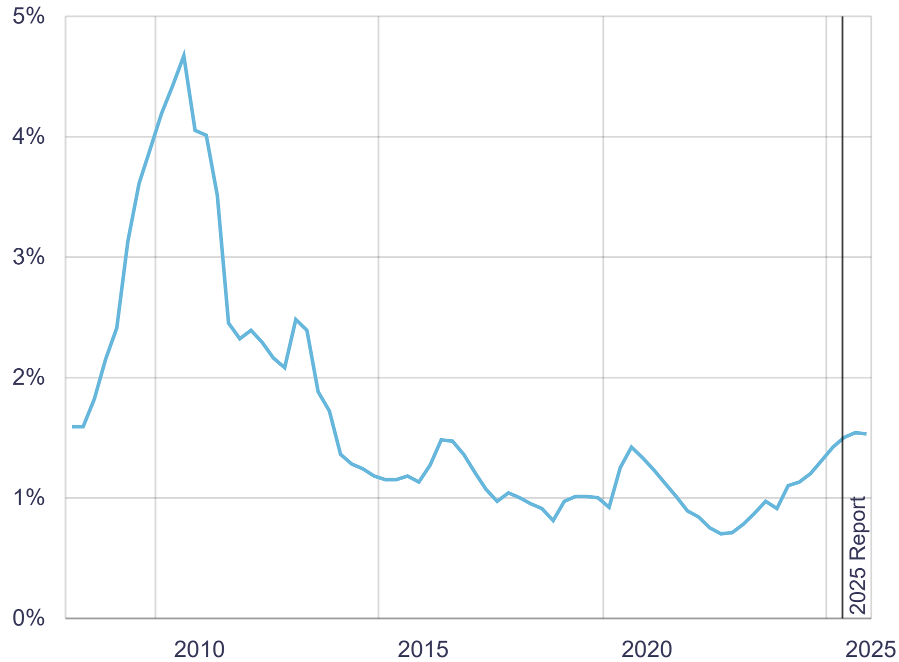
Indicators of financial stress among businesses have stabilized

After increasing over the previous three years, the share of business loans that are past due stabilized in the second half of 2025. It remains low compared with previous periods of significant stress, such as the 2008–09 global financial crisis (**Chart 10**).

Impairments on loans to small businesses have continued to increase in recent months, while they have decreased for loans to large businesses (**Chart 11**).

Chart 10: Impairment rates on business loans have plateaued in recent quarters

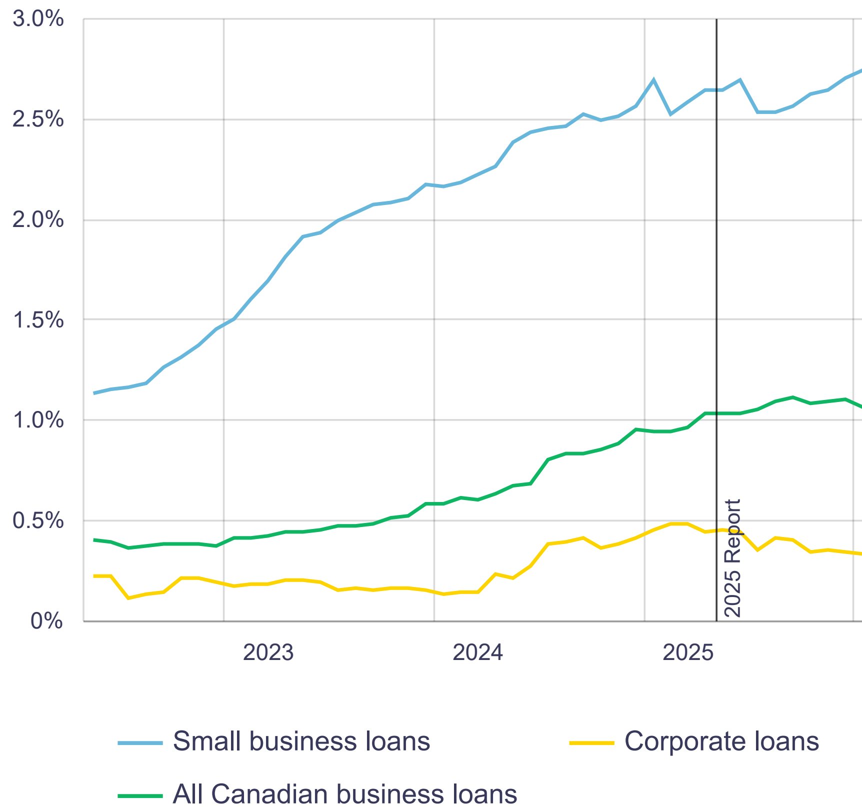
Gross impaired loans from banks to Canadian and foreign businesses, as a share of total business loans



Note: A lender deems a loan impaired when full repayment according to the original terms is no longer expected (e.g., default, bankruptcy or severe delinquency).
Sources: Regulatory filings of Canadian banks and Bank of Canada calculations
Last observation: 2025Q4

Chart 11: Loan impairments for small businesses continue to edge up

Gross impaired loans from large banks to Canadian businesses, as a share of loans per category



Note: *Small business loans* can be up to $1.5 million and are managed by banks as retail exposures. *Corporate loans* are for large companies that typically have at least $500 million in annual revenue; banks manage these loans as corporate exposures. These groupings represent 6% and 17% of Canadian business loans, respectively, at large Canadian banks.

Sources: Regulatory filings of Canadian banks and Bank of Canada calculations
Last observation: January 2026

Banks

Canada’s large banks have grown more resilient. They remain well positioned to support the economy and the financial system even if conditions deteriorate.

Canada’s large banks remain in solid financial health. Since the previous Report, the economic environment has become more challenging amid ongoing trade tensions and increasing geopolitical conflicts.

For banks, these developments could eventually lead to higher credit losses or make it more difficult and costly to raise funding from investors. Accordingly, banks have set aside additional funds to cover potential loan losses. These provisions, combined with robust earnings and high levels of capital, leave banks well placed to absorb shocks.

Even in a stress test where an escalation of the war in the Middle East leads to a prolonged period of high oil prices and acute financial system stress, Canada’s large banks are expected to remain resilient and able to support the economy (see **In focus: How a financial market correction could worsen the effects of an oil shock**).

Financial health of the banking sector

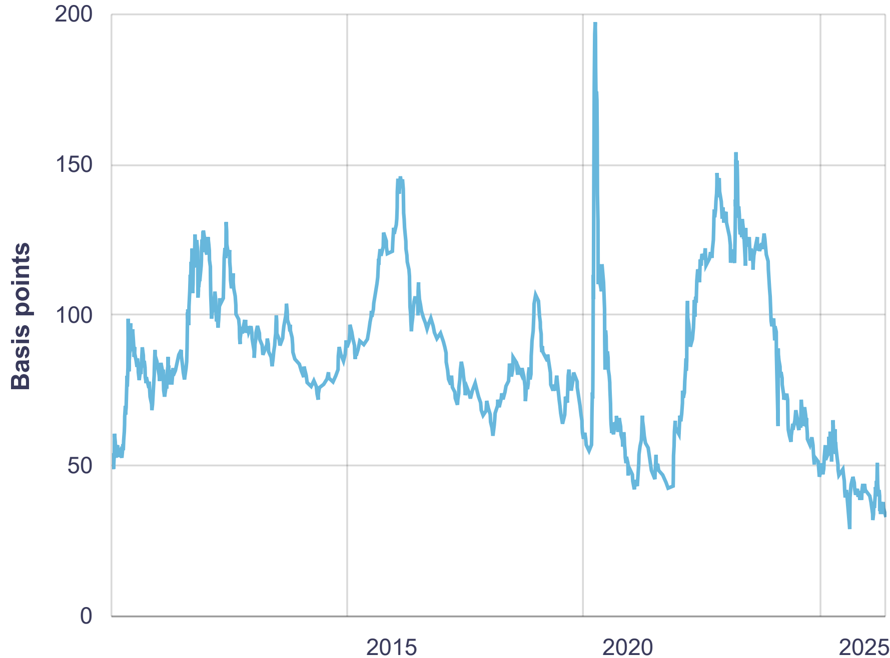
Improved profitability and good access to funding are supporting resilience

The financial health of Canada’s large banks has improved over the past 12 months. Bank profitability has increased, supported by higher revenues from capital market activities. The deterioration in credit performance noted in the previous Report has stabilized, particularly for corporate lending.

Banks have continued to benefit from narrow funding spreads and strong investor appetite for their debt. As a result, they have maintained good access to funding despite temporary market stress following the outbreak of the war in the Middle East (**Chart 12**). As market conditions stabilized, Canadian banks were among the first to issue bonds again, signalling continued confidence from global investors.

Chart 12: Funding spreads of systemically important banks are at historical lows

Yield spread between 5-year senior deposit notes and 5-year Goverment of Canada benchmark bonds



Sources: BMO Sapphire and Bank of Canada calculations
Last observation: May 20, 2026

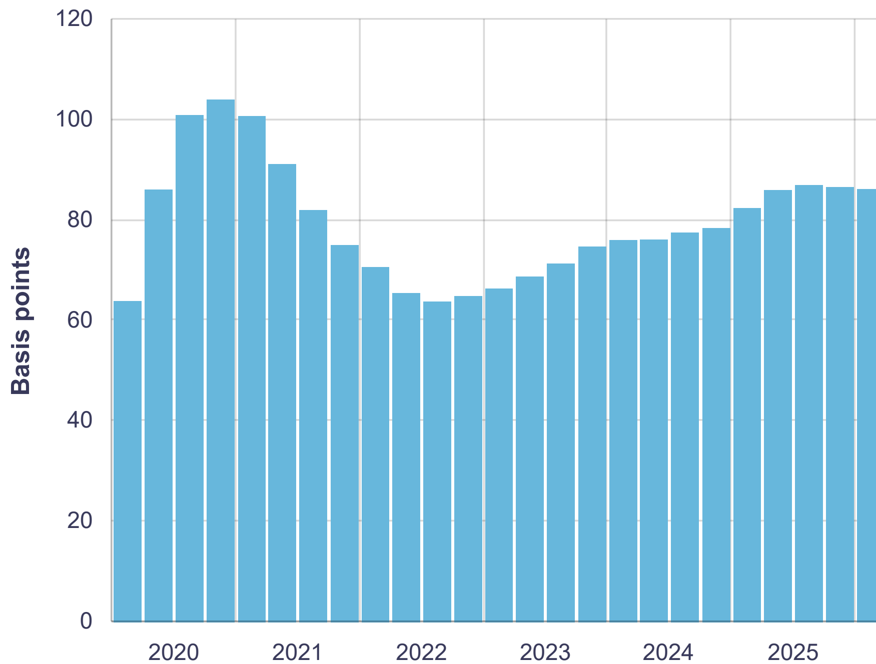
Canada's big banks have taken steps to protect themselves against potential shocks

Canada's major banks remain well positioned to withstand economic shocks and continue lending to the broader economy. They have set aside additional funds to cover potential loan losses, reflecting increased risks to the Canadian economy from US tariffs and trade policy uncertainty. The accumulated stock of loan loss provisions as a share of total lending is now about 30% larger than it was three years ago (**Chart 13**).

These provisions are intended to absorb anticipated credit losses, and banks would rely on capital if losses were to exceed expectations. Large banks continue to maintain high levels of capital. Their common equity Tier 1 capital ratio averaged 13.7% in the first quarter of 2026, about 2 percentage points higher than before the pandemic and well above regulatory minimums.[1]

Chart 13: Systemically important banks have increased their allowances for credit losses

Allowances for credit losses as a share of total loans



Sources: Public financial reports of Canadian banks and Bank of Canada calculations
Last observation: 2026Q1

Risks to the banking sector

Disruptions to funding markets could limit banks' capacity to support capital markets

Canada's large banks rely not only on deposits but also on funding from wholesale markets. As a result, they are sensitive to shifts in global funding conditions. A further geopolitical shock could disrupt these markets, raising borrowing costs or making it harder to issue new debt. The impact would depend on which markets are affected and how long the disruption lasts.

Long-term funding, such as bonds, is less affected by short-term disruptions. In contrast, stress in short-term markets—such as repo and commercial paper—matters more for banks' day-to-day market intermediation. Stress in these markets could limit the ability of banks to finance securities and support trading. This would make it harder for other market participants to trade or raise cash (see the **Non-bank financial intermediaries** section).

A severe and prolonged disruption in funding markets would be challenging for Canadian banks, given their reliance on wholesale funding and the growing contribution of capital market activities to revenues in recent years.

Geopolitical and trade tensions could have implications for credit losses

Credit losses could exceed banks' current expectations if an escalation in US trade frictions or the war in the Middle East significantly weakens employment and economic activity. Trade tensions could create targeted pressures, especially for small and medium-sized banks and credit unions that are highly exposed to regions or industries affected by increased tariffs.

Canada's large banks are well diversified, which reduces their exposure to any single source of stress. Even under a severe stress-test scenario, large banks would remain resilient, though credit losses would rise as economic conditions deteriorate (see **In focus: How a financial market correction could worsen the effects of an oil shock**).

Endnotes

1. The common equity Tier 1 ratio is the highest quality of regulatory capital because it absorbs losses immediately when they occur. In this ratio, the numerator includes the sum of common shares and stock surplus, retained earnings, other comprehensive income, qualifying minority interest and regulatory adjustments. The denominator is risk-weighted assets.[←]

Non-bank financial intermediaries

Hedge funds have continued to increase their repo borrowing. While their activity supports market efficiency and liquidity, it could leave fixed-income markets more vulnerable to the risk of a sudden sell-off.

Non-bank financial intermediaries—including pension funds, insurance companies, hedge funds, mutual funds and other asset managers—are important investors in financial markets. However, their activities may create vulnerabilities for the financial system if not properly managed.

Over the past 12 months, hedge funds have further increased their use of repurchase-agreement (repo) borrowing to fund trading positions in government bonds. This supports market liquidity and price efficiency in normal times.

But if hedge funds were forced to quickly unwind their positions—for example, due to a loss of access to repo funding—it could amplify price movements and lead to dysfunction in government bond markets. It could also contribute to broader liquidity strains. These risks have increased since the previous Report because of heightened economic and geopolitical uncertainty.

Another area of non-bank financial intermediation that warrants attention is private credit. This market has expanded rapidly at the global level and has recently shown signs of strain (see **In focus: Rapid growth in private credit has created vulnerabilities**).

Asset manager vulnerabilities

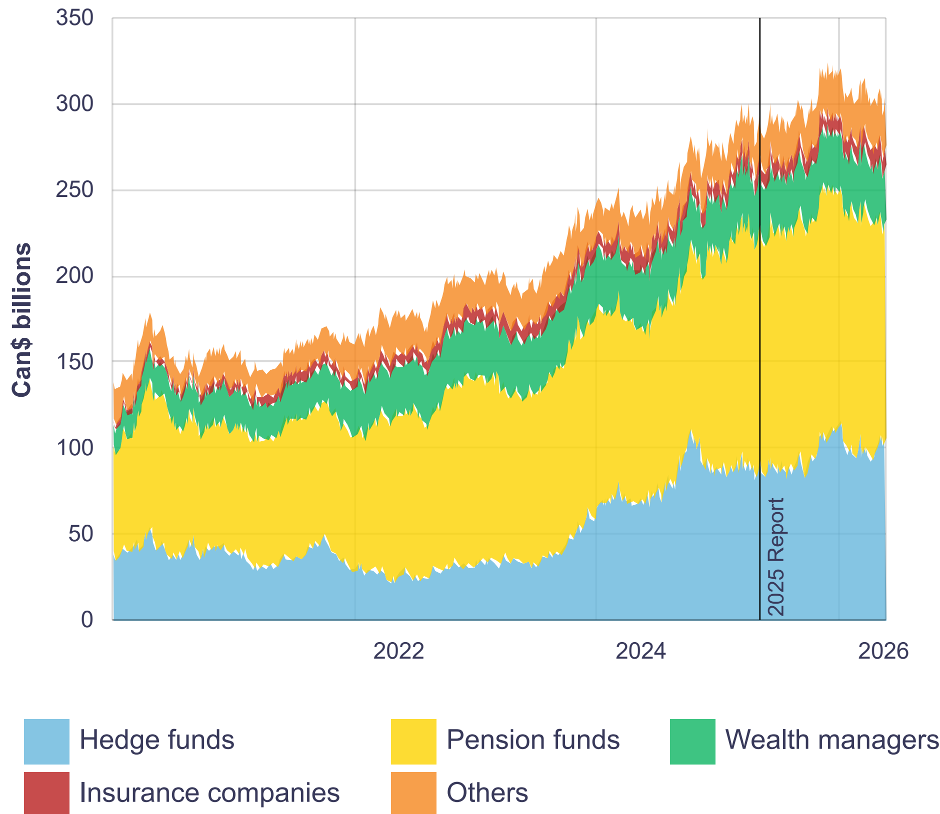
Asset managers' repo leverage has continued to increase

Over the past five years, total repo borrowing by asset managers has roughly doubled to around $300 billion (**Chart 14**). Because repos are widely used to finance the purchase of government debt securities, this increase partly reflects higher issuance and, more generally, the overall growth of the Government of Canada bond market in recent years.

Over the past 12 months, repo borrowing by asset managers has increased by about 8%, or $22 billion.[1] Hedge funds account for most of the growth, while repo borrowing by pension funds—the largest users of repos overall—has declined slightly. Pension funds tend to borrow for longer terms and at lower levels of leverage than hedge funds.

Chart 14: Gross repo borrowing by asset managers remains elevated

Estimates of Canadian-dollar repurchase agreement (repo) positions outstanding



Hedge funds | Pension funds | Wealth managers | Insurance companies | Others

Note: *Others* includes other clients of dealers, such as foreign central banks and sub-sovereigns.

Sources: Canadian Investment Regulatory Organization and Bank of Canada calculations

Last observation: May 20, 2026

A sudden unwinding of repo leverage could affect market liquidity and functioning

Leveraged asset managers typically have robust risk management practices to meet sudden liquidity demands. However, these safeguards can come under strain during periods of severe market stress.

The risk of sudden liquidity demand has increased over the past 12 months. Volatility in fixed-income markets has risen, and the stock of sovereign debt continues to grow globally. Episodes of market stress, such as the start of the war in the Middle East, have already led some hedge funds to scale back their repo positions in certain markets. This highlights the vulnerability of core markets to sudden changes in asset managers' behaviour.

If asset managers need to suddenly raise liquidity or reduce their leverage, it could have significant implications for financial markets. A sharp pullback in hedge fund activity in government debt markets, for example, could negatively affect the liquidity and functioning of these and other fixed-income markets. This, in turn, could generate broader financial system stress.

Endnotes

1. Despite higher repo borrowing by asset managers since the previous Report, dealer repo balance sheets remain stable. This reflects an increase in transactions that can be netted—where repos and reverse repos offset one another—while repo exposures that cannot be netted are at similar levels.[←]

How a financial market correction could worsen the effects of an oil shock

The war in the Middle East has pushed up oil prices, putting pressure on inflation. In a situation where geopolitical tensions trigger a severe tightening in financial conditions, the resilience of the financial system could be tested.

This section assesses how a persistent oil market disruption, combined with a sharp tightening in financial conditions, could affect the Canadian economy and the resilience of the financial system.

The stress-test scenario is constructed by taking the illustrative scenario in the April 2026 *Monetary Policy Report* and adding a severe increase in financial stress.[1]

The stress-test scenario assumes:

- Crude oil prices remain around US$100 a barrel for at least three years, and supply bottlenecks persist.
- Cost pressures are passed through to a broad set of goods and services, leading to higher prices.
- Financial market stress across asset classes in both Canada and the United States spikes quickly and remains elevated for several months. It then gradually dissipates, in line with historical stress events such as the 2008–09 global financial crisis.[2]
- Because inflation is high and persistent, monetary policy remains tight.

As a result, economic activity deteriorates, unemployment rises and housing prices fall. This leads to significant challenges for Canadian households and businesses. Canada's major banks face a material increase in credit losses but remain resilient.

Financial stress amid high inflation could test resilience

As financial pressures increase in the stress-test scenario, the Canadian economy becomes more sensitive to financial shocks, and economic conditions deteriorate further.[3] This reflects past episodes of heightened financial stress, which have led to severe recessions, high unemployment and large declines in housing prices.

Financial stress also pushes up risk and term premiums, resulting in higher borrowing costs for households and businesses. At the same time, weakening equity prices reduce household wealth. This puts households and businesses under strain, which could lead financial institutions to reduce their lending.

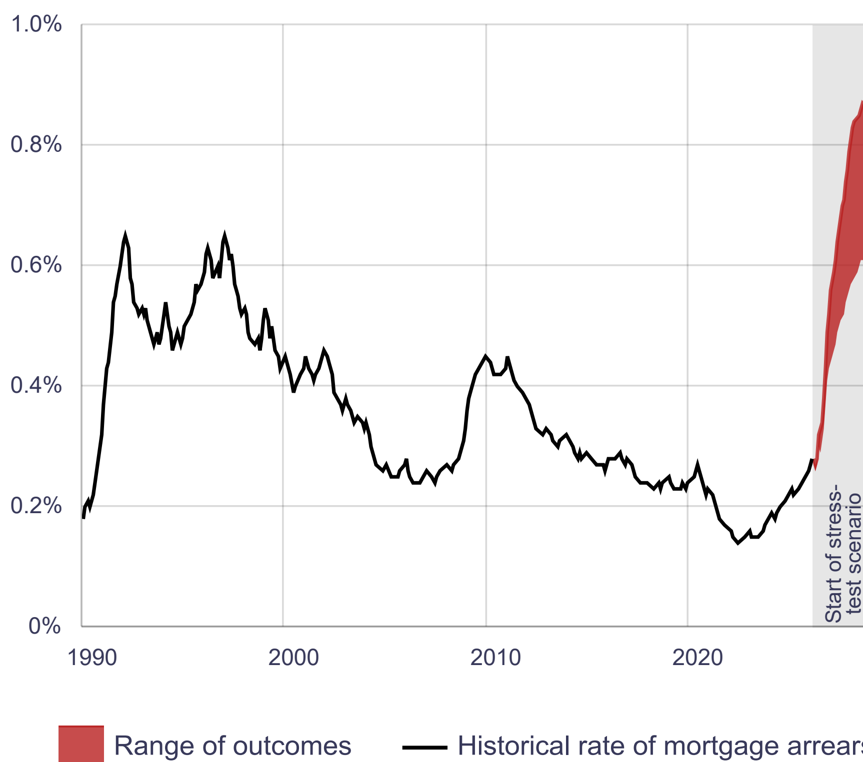
As a result, in the stress-test scenario, the real economy softens broadly: gross domestic product declines by about 1%, unemployment rises to around 10%, and housing prices fall by about 25%.

Households and businesses would face significant stress

In the stress-test scenario, as unemployment rises and housing prices fall, households and businesses come under significant stress. Rates of mortgage arrears increase and reach a multi-decade high (**Chart 15**). Businesses face increased costs and a decline in demand, which pushes corporate default rates close to levels seen during the global financial crisis (**Chart 16**).

Chart 15: In the stress-test scenario, a repricing of risk assets could push household mortgage arrears to multi-decade highs

Share of mortgages in arrears by 90 days or more

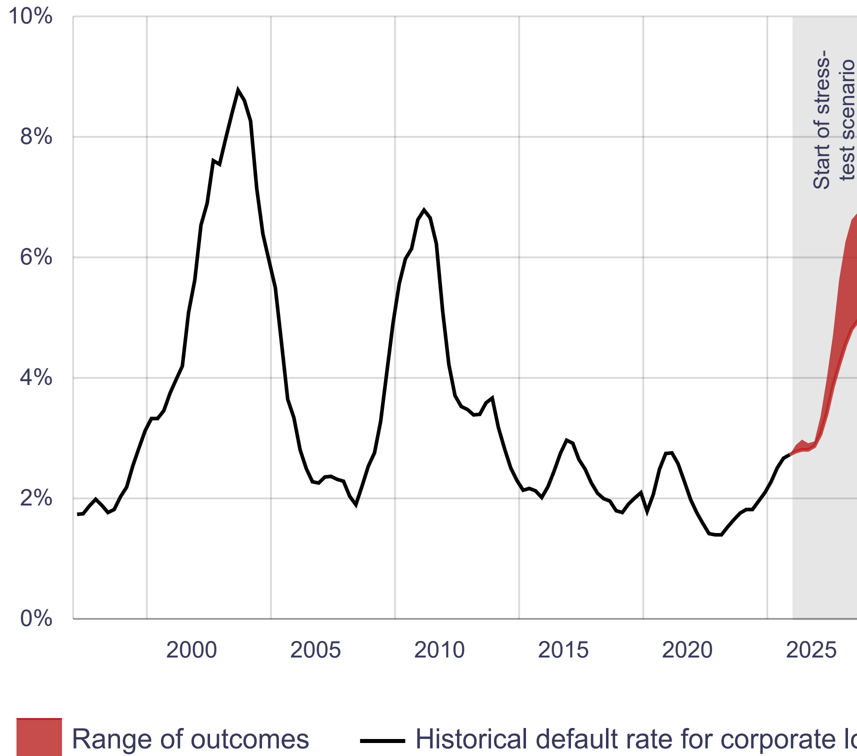


Range of outcomes — Historical rate of mortgage arrears

Note: The Bank of Canada constructed a stress-test scenario that takes the illustrative scenario in the April 2026 *Monetary Policy Report* and adds a severe increase in financial stress.
Sources: Statistics Canada, Canadian Bankers Association, Canadian Real Estate Association and Bank of Canada calculations, estimates and projections
Last data plotted: December 2028

Chart 16: In the stress-test scenario, a repricing of risk assets could cause corporate default rates to return to 2008–09 global financial crisis levels

Annual default rate for corporate loans



Range of outcomes — Historical default rate for corporate loans

Note: The Bank of Canada constructed a stress-test scenario that takes the illustrative scenario in the April 2026 *Monetary Policy Report* and adds a severe increase in financial stress.

Sources: Regulatory filings of Canadian banks and Bank of Canada calculations, estimates and projections

Last data plotted: 2028Q4

Despite the heightened economic and financial stress faced by households and businesses in the stress-test scenario, Canada's major banks remain resilient. Credit losses rise to slightly more than 1% of loan balances. These losses are greater than those experienced during the global financial crisis but not as significant as those experienced during the recessions of the late 1980s and early 1990s. Credit losses deplete allowances and a portion of pre-provision net revenue but are not large enough to reduce bank regulatory capital.

While major banks remain in sound financial condition in this stress-test scenario, they could slow their lending because of loan losses.

Liquidity stress could be amplified

The stress-test scenario does not explicitly model the effects of liquidity spirals. However, these could develop if defensive actions by market participants during periods of stress reinforce one another and further reduce market liquidity.

For example, businesses could draw on credit lines, banks could increase liquidity buffers, and investors could sell assets to raise cash. While these actions might be prudent individually, together they could put additional pressure on core funding markets.

In the extreme, this could lead to market dysfunction and make the actual impacts more severe for Canada's banks and the broader financial system than the stress-test scenario suggests.

Endnotes

1. See Bank of Canada, "**In focus: The war in the Middle East—Transmission channels and risks to inflation**," *Monetary Policy Report* (April 2026).[←]

2. Systemic financial stress occurs when sharp corrections take place simultaneously across several major markets: equity markets, government debt, foreign exchange rates, money markets, the banking system, corporate bonds and the housing market. For more details, see T. Duprey, "**Canadian Financial Stress and Macroeconomic Conditions**," Bank of Canada Staff Discussion Paper No. 2020-4 (June 2020) or the Bank of Canada's **Financial Stability Indicators dashboard**.[←]

3. This scenario uses the Bank of Canada's Risk Amplification Macro Model (RAMM), a nonlinear model that can be used to simulate the amplification of shocks that may occur during episodes of heightened financial stress. For more details on RAMM, see K. Tuzcuoglu, "**Risk Amplification Macro Model (RAMM)**," Bank of Canada Technical Report No. 123 (January 2023).[←]

A resilient repo market is important for financial stability

Repo markets are crucial for the functioning of government bond markets. They are also an important source of short-term funding. But their size and widespread use mean they can transmit financial stress if conditions deteriorate.

Repurchase agreement (repo) markets are a key part of the plumbing of the financial system. They support liquidity in government bond markets by allowing market participants to borrow or lend cash or securities, and they play a vital role in transmitting monetary policy.

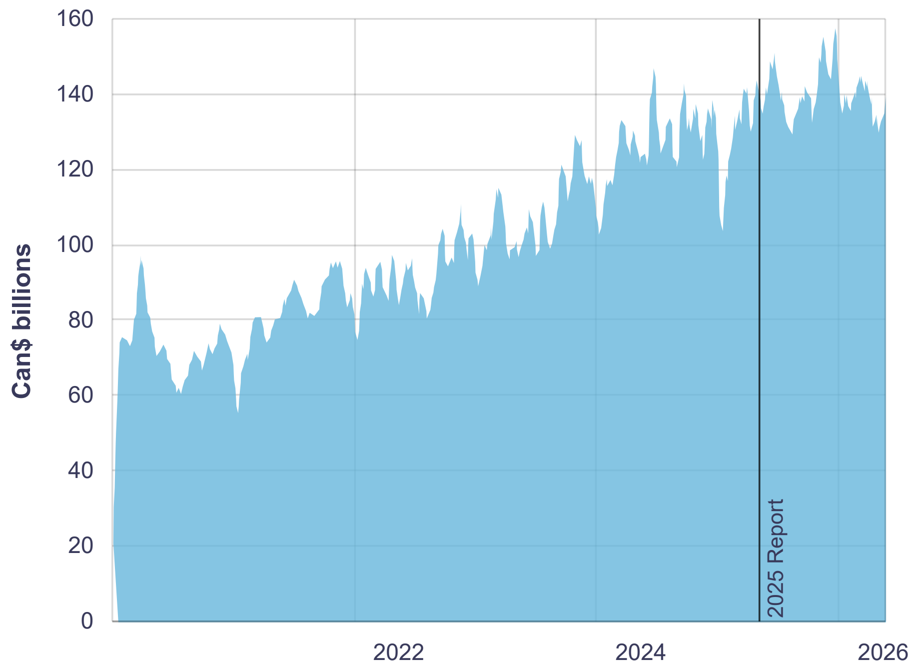
Because repo markets play such a central role, stress in them can spread quickly to other parts of the financial system. A disruption to repo markets could, for example, cause hedge funds to suddenly sell off their holdings of government bonds, reducing market liquidity and potentially leading to liquidity spirals. For this reason, governments, central banks and market participants are focused on strengthening the resilience of these markets.

Disruptions in repo markets could affect government bond markets

Repo markets have grown steadily in recent years, which has further increased their importance in Canada's financial system (**Chart 17**). More than $130 billion in repo transactions now take place in Canada each day, about double the amount from five years ago. A wide range of market participants use repos to obtain leverage, borrow and lend securities, earn returns on extra cash and manage funding liquidity.

Chart 17: The volume of repo transactions has climbed steadily over the past five years

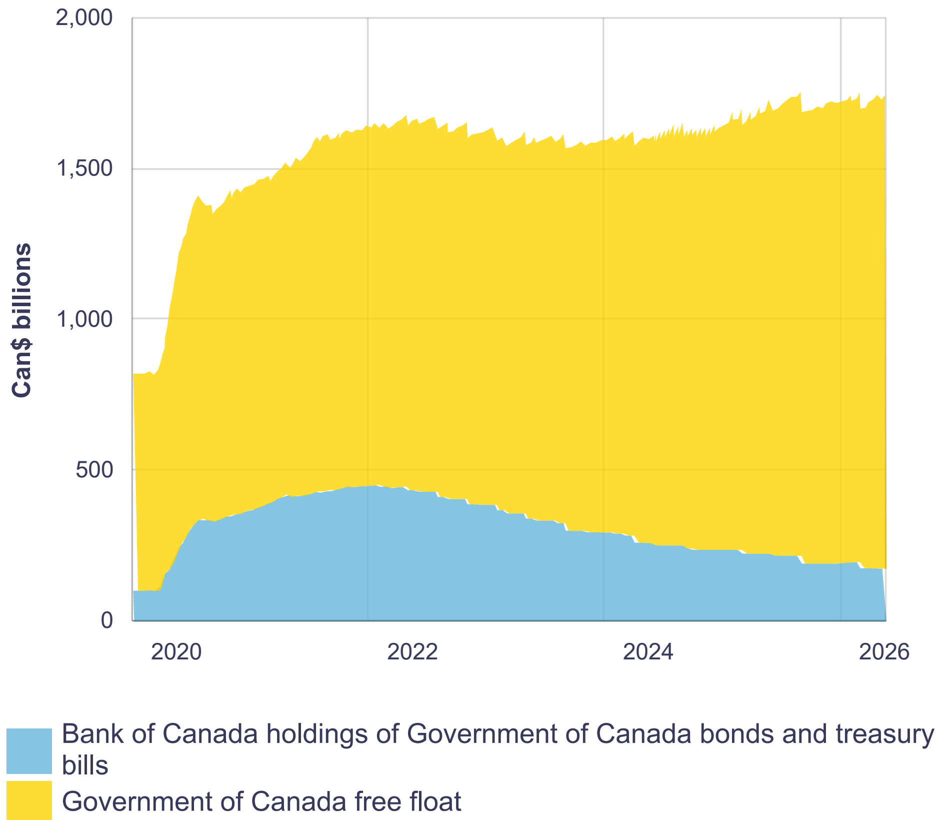
Repurchase agreement (repo) volume, 15-day moving average



Sources: Canadian Investment Regulatory Organization and Bank of Canada calculations
Last observation: May 20, 2026

Repo activity is rising in part because more Government of Canada bonds are being issued and traded (**Chart 18**). Repos are a flexible and cost-effective way to finance trading in government bonds and therefore play an important role in facilitating dealers' market-making activities. They also allow hedge funds to finance their activities, including basis trades in government bonds and futures. These activities, in turn, support liquidity and efficiency in the markets for government securities.[1]

Chart 18: The volume of Government of Canada bonds and treasury bills available to the market has increased since 2022



Bank of Canada holdings of Government of Canada bonds and treasury bills

Government of Canada free float

Note: The *Government of Canada free float* is calculated as the total stock of Government of Canada bonds and treasury bills minus the Bank of Canada's holdings of Government of Canada bonds and treasury bills.

Sources: Bank of Canada and Bank of Canada calculations

Last observation: May 21, 2026

Government bonds are widely used as collateral and liquid assets to manage risks. They are also used as pricing benchmarks for other securities. Because of this, a disruption in repo markets would have broad implications for the financial system. These include:

- **A sudden deleveraging by asset managers**. For example, if hedge funds or other asset managers cannot obtain repo funding, they may need to quickly sell government bonds, further reducing market liquidity.
- **A reduction in overall market liquidity**. Wider bid-ask spreads and higher trading costs in government bond markets could spill over into other fixed-income and derivative markets. If this led to significant margin calls, it could result in a liquidity spiral as market participants are forced to sell liquid assets to raise cash.
- **Sharp movements in the Canadian Overnight Repo Rate Average (CORRA)**. This would affect the large numbers of financial instruments that use CORRA as a risk-free rate, such as interest rate derivatives and floating rate notes.[2]

If any of these situations were to occur, borrowing costs across the economy would go up, leading to potential second-round effects.[3]

Efforts are underway to improve the resilience of repo markets

The Bank of Canada has been working for years with industry and other stakeholders to improve the resilience of repo markets by:

- **Providing a robust and reliable pricing benchmark**. In 2020, the Bank became the administrator of CORRA—the main pricing benchmark for repo markets—and improved its calculation methodology.[4]
- **Working with the private sector to improve Canada's repo market infrastructure**. The Bank proposed and now sponsors the Collateral Infrastructure and Market Practices Advisory Group (CIMPA). This group seeks ways to modernize Canada's fixed-income market to support uninterrupted, efficient functioning of cash trading, securities lending and financing markets. As a result of CIMPA's work, the Bank has announced that it will join the:
    - Canadian Collateral Management Service's triparty repo platform. Triparty repos allow market participants to manage risks and liquidity more efficiently than traditional bilateral repos.[5]
    - Canadian Derivatives Clearing Corporation (CDCC), a central counterparty for repo and derivatives transactions. After the 2008–09 global financial crisis, the CDCC expanded to include repo transactions to strengthen the operation of core repo markets during periods of financial stress. The Bank's participation in the CDCC will help make central clearing more attractive for market participants and, through netting, increase the ability of dealers to provide repo market funding through a more efficient use of balance sheet capacity.
- **Contributing to international work on repo markets**. The Bank contributed to the Financial Stability Board's recent report on vulnerabilities in government bond-backed repo markets.[6] This work is important because hedge funds and other asset managers operate across borders, interconnecting global bond markets.
- **Working to improve transparency in repo markets**. The Bank regularly publishes research on Canada's repo markets, including a fact sheet that outlines their size and composition.[7] This work helps make stakeholders aware of the structure of and vulnerabilities in these markets.
- **Ensuring the Bank's liquidity facilities adapt to changes in market structure**. For example, the Bank widened eligibility for its Contingent Term Repo Facility to include certain non-bank financial intermediaries because of their increasing role in fixed-income markets and the financial system.[8] This facility can be used to provide liquidity during periods of severe market stress.

The Bank's work to improve the resilience of repo markets is ongoing. The Bank will continue to monitor repo markets and contribute both to CIMPA's efforts to improve the resilience of Canadian fixed-income markets and to global efforts to monitor and address emerging vulnerabilities.

Endnotes

1. For more details, see Bank of Canada, "**Box 3: Cash-futures basis trade**," *Financial Stability Report—2024* and Bank of Canada, "**Box 3: Recent developments in swap spreads**," *Financial Stability Report—2025*.[←]

2. For more details on CORRA, see the Bank of Canada's **website**.[←]

3. These second-round effects could manifest themselves by pushing up borrowing costs, increasing stress on households and businesses that weighs further on economic growth.[←]

4. See Bank of Canada, "**Bank of Canada becomes administrator of Canadian Overnight Repo Rate Average**" (press release, June 15, 2020).[←]

5. For more details, see P. Muller and M. Padalko, "**The new repo tri-party Canadian Collateral Management Service: Benefits to the financial system and to the Bank of Canada**," Bank of Canada Staff Analytical Note No. 2025-6 (February 2025).[←]

6. See Financial Stability Board, "**Vulnerabilities in Government Bond-backed Repo Markets**" (February 2026).[←]

7. See Bank of Canada, "**Financial markets**" and M. Fisher, M. Padalko and A. Walton, "**Canadian Repo Market Fact Sheet**" (Bank of Canada, September 2024).[←]

8. See Bank of Canada, "**Bank of Canada announces planned changes to its Contingent Term Repo Facility**" (market notice, March 17, 2025).[←]

Rapid growth in private credit has created vulnerabilities

Globally, private credit lending has expanded rapidly and become increasingly connected to the broader financial system. Complex structures, limited transparency and the fact that private credit is untested in a downturn make it difficult to predict how the sector might amplify shocks.

Private credit is lending by non-banks through privately negotiated loans. Globally, it has helped fill financing gaps for medium-sized businesses not well served by banks or public markets. It has also increased competition in credit markets. Strong investor demand has allowed private credit to expand into larger loans and a wider set of borrowers.

But limited transparency makes it difficult to see where vulnerabilities are building and how losses could spread. And signs of strain have emerged internationally. For example, the high-profile bankruptcies of several US firms financed by private credit have raised questions about underwriting standards. Growing links between private credit funds and banks could allow stress in the sector to spread to the broader financial system.

Because private credit is still largely untested in a downturn, these dynamics could amplify shocks in ways that are difficult to predict.

In Canada, private credit lending to businesses remains limited, and exposures of Canadian institutional investors appear manageable. But the potential for spillovers through global markets and financial institutions reinforces the need for continued monitoring.

Complex structures and a lack of transparency make risks hard to assess

When the private credit market was expanding rapidly, funds were under pressure to invest the large amounts of money that were flowing into the asset class. This may have led to lower lending standards than would otherwise be expected.

The quality of underwriting is difficult to assess because private credit is much less transparent than public markets, particularly when investments are made through funds. Information on the underlying loans is often limited, and because these loans do not trade regularly, verifying their actual value can be challenging—especially during periods of stress. This makes it hard for investors and authorities to distinguish isolated credit losses from signs of widespread weakness.

Complex structures can add to these challenges. Private credit loans can lead to a buildup of debt at several levels—the borrower, the fund and the investor. These structures can also link private credit funds to banks and other parts of the financial system in ways that are difficult to trace. This complexity can make it hard to see where risks are growing and how losses could spread if economic conditions were to worsen.

Limited transparency can also amplify market reactions when sentiment shifts. If investors cannot clearly assess where losses are concentrated, they may assume that problems in one segment exist more broadly. This could lead to a more widespread decline in risk appetite, tighter financing conditions and reduced credit availability for businesses that rely on private credit or related debt markets.

Private credit is becoming more connected to the banking sector

Banks provide loans to private credit funds for both liquidity and funding. The most common form is subscription loans, which are secured by the financial strength of a fund's investors.[1] These loans are used by private credit funds to bridge the period between lending and raising capital from investors. In contrast, when a bank's lending is secured only by underlying loans from private credit funds, the bank's exposure to risk increases. This is because the bank's potential gains or losses depend directly on how those underlying loans perform.

Nonetheless, banks are typically protected from losses because funds hold large equity cushions.[2] This means fund investors would absorb losses before banks do. Defaults would likely need to be severe before banks are affected. Still, complex structures and limited transparency can make it difficult to assess which banks are most exposed and the extent of their exposures. In periods of stress, markets could penalize banks perceived to have material exposures to the sector even if actual losses remain contained.[3]

Stress in global private credit could spill over to Canada

Most private lending happens outside Canada, so domestic vulnerabilities are limited. But Canadian institutional investors, such as pension funds and life insurance companies, do engage in a form of private credit by lending directly to businesses in Canada and abroad. Because these direct loans offer a clear line of sight into the businesses and a high degree of control, they are less risky than investments in opaque private credit funds.

In addition, institutional investors have long investment horizons and tend not to rely on short-term funding. This means they are less likely than other investors to face pressure to sell assets quickly during periods of stress.

More broadly, losses or uncertainty in private credit markets could lead global investors to pull back from related debt markets and exposed financial institutions. This could result in a tightening of global financing conditions. While direct risks to Canada appear manageable, these potential spillovers warrant continued monitoring of the sector.

Endnotes

1. See Financial Stability Board, ***Report on Vulnerabilities in Private Credit*** (May 2026).[←]

2. Equity typically accounts for about 65% to 80% of the total assets of private credit funds, providing a substantial cushion for creditors to the fund. See G. Matvos, T. Piskorski and A.Seru, "**Private Credit, Balance Sheets and Financial Stability**," National Bureau of Economic Research Working Paper No. 34991 (March 2026, revised April 2026).[←]

3. Recent analysis by Liberty Street Economics suggests this channel can be important. Banks with greater exposure to non-bank financial intermediaries (NBFIs) had worse equity returns during the recent period of NBFI-sector stress, even though the mechanism of spillover remains uncertain. See V. V. Acharya, N. Cetorelli and B. Tuckman, "**Stress and Strain from NBFIs to Banks**," *Liberty Street Economics*, Federal Reserve Bank of New York (May 2026).[←]