

Is this what July 1914 felt like?

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Whilst the UK obsesses with phone hacking, Murdoch and idiots with shaving foam I have a strong suspicion that right now is just what July 1914 felt like. The world and its scandals seemed to be going on as normal, but around the corner untold trauma awaited then, and may do now.

Almost unnoticed it seems in the UK the US is moving towards defaulting on its debt. That's the result of acts of the utmost and craven irresponsibility on the part of the Republican Party, but it seems like it's going to happen nonetheless unless something little short of a miracle happens. Hundreds of billions will be wiped off the value of the world's banks as the value of US bonds falls. And tens of millions of Americans will have their lives thrown into turmoil, at least temporarily.

In Europe leaders, in an act of craven irresponsibility, are refusing to compromise on a deal on European debt. Merkel is simply refusing to recognise that her country's currency is causing a crisis within Europe that requires her country to make compromise if resolution is to be found. The result is that there will at the very least be massive market turmoil as contagion spreads on sovereign debt in much of Europe, risk of default rises and the burden of financing becomes unaffordable for many countries.

In both cases politicians, acting in the interests of small sections of the community whose interests they serve are refusing to act in the common interest. The consequences will be profound. It is likely that serious sovereign debt defaults might happen in August. The impact will be enormous: we simply do not know how far the consequences will spread or in what amount, but given the enormous capacity of markets to turn molehills into mountains contagion is highly likely once this process starts.

The risk of bank insolvencies - including in the UK - is very, very high. We are facing a situation where once again we have the prospect of cash not being available in cash point machines sometime soon.

I keep wishing that this feeling on my part was just melodrama, but I last felt this way

in the weeks running up to the crash in 2008, and I was right then, and unless something dramatically changes over the next couple of days, I fear I am right now.

There are, however, some differences. First of all, this crash will be much more significant, of wider scale, and long-lasting. We're not seeing the collapse of one investment bank this time triggering a crisis, we're seeing the collapse of confidence in the two major currencies in the world, and the inability of the government of the largest country in the world to pay its debts and of maybe five European countries to do likewise. Last time was, in comparison, a minor crisis.

That is the first downside, and that it is enormous. There is a second outside. This time we seem to have politicians, whether they be Merkel, Cameron, Obama or others who do not have the political capital to now deal with this situation. That is extraordinarily worrying.

On the upside, there is just a chance that someone will rise to the challenge and address the fundamental issues that are going to arise. There are two of them. The first is that we will have insolvent countries. This can be remedied by them defaulting: that will be inevitable. That however leaves banks with a second, dual crisis. The first is of solvency, and the second is of liquidity. Solvency is a long-term issue: many of these banks will not be able in the long-term settle to their liabilities as they fall due. Liquidity is a short-term issue: simple shortage of cash, and that's not the same thing solvency. However, in this case because a crisis of confidence in the Euro may arise they may coincide.

That means that we need to have a massive disaster management plan in place to get us through the potential crisis that August represents. I admit that I don't have time to write that whole plan this morning, but here's an outline of what is needed.

First we have to accept that this time there is no prospect of banks of surviving as independent entities: in most cases their capital is going to be wiped out. If that happens nationalisation is the only course of option we have available to us. And it is also the only way we can go forward to reform banking for ever. That is a silver lining, although maybe a while in coming.

Second, there is absolutely no way round the fact that governments are going to have to, in effect, print vast amounts of money. Quantitative easing is going to be on the agenda again, and very rapidly. Short-term cash injections will be necessary, partly through recapitalising the banks with new taxpayer funds which will have to be raised through the issue of bonds, and those bonds will have to be purchased by central governments is no one else will have the capacity to do so. That is printing money, by any other name. The process of issuing that cash through banks will on this occasion have to be ignored: there is no point in pretending that governments can't borrow from their central banks when commercial banks will at that time have to be under state control.

Third, once that round of what will in effect be crisis driven quantitative easing is complete I strongly recommend that governments must move towards [green quantitative easing](#). This is the way forward once the immediate crisis is over because major capital injections into the broader economy will also be required to assist recovery from this crisis which will result in a significant risk of a massive increase in unemployment throughout Europe, the USA, and elsewhere. Saving the banks will not be enough this time, rebuilding our economies is what is required, and what was not happened to date, to our cost.

Fourth, what happens after this? Well, banking will have to be restored: I make no pretence that banking should remain a state-owned activity for ever, but wise countries will ensure that banking is returned to the private sector on a very different basis to that on which it is operated to date. Mutualisation is essential for some parts of banking. The splitting of investment banking from plain vanilla banking is vital: nothing else will do. Significant control over speculation is essential: banks continue to threaten our well-being because of that speculation, and the contagion which may precipitate this crisis is the consequence of it. And yes, we will need financial transaction taxes to make sure that there is sand in the mechanism of speculation, as we will also have to take action against the world's tax havens to ensure that banking is not moved offshore and beyond this regulatory environment: we can no longer afford the risk.

Such a programme will require enormous courage on the part of governments. I have no idea if that courage is available. I really rather hope it won't be necessary, but in my heart I have this deep fear that we are on the edge of a precipice. This can still be averted. European leaders may take bold action this week to avert crisis, and give breathing space for a negotiated way forward on debt. Obama might find a way around the Tea Party. I can hope. But realistically, the possibility of catastrophic failure of the financial system has to now be recognised to exist and to fail to plan for that right now would be negligence on the part of any government, anywhere.

Perhaps my greatest fear is that planning is not happening either; that too many will be complacent about this being a crisis that will be 'over by Christmas'. That is what they thought in July 1914. Heaven forbid that people will look back and say that is what was thought in July 2011. But unless some very serious action is being taken now that could be the case. And whilst I have no fear of war arising from this, at least as yet, my fear that what might happen in the next month will have untold consequences in terms of turmoil, disruption, anguish, and simple despair for hundreds of millions, if not billions of people, is very real whilst I still cling to the hope that it is misplaced.