

Are banks a nuclear threat?

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John Vickers, author of the post 2008 banking review in the UK started a skew of comments on banking in the FT that has spread all over its pages this morning. To summarise his argument, [using an FT headline](#):

The Bank of England must think again on systemic risk: volatility in bank stocks underlines the importance of strong capital buffers

Martin Wolf [is not so sure, saying](#):

The world economy is not necessarily heading for a crisis, it is probably just heading for a slowdown – but risks abound. Moreover, such risks are bound to affect banks, particularly those of bank-dependent Europe. The weakened banks will then damage economies.

But adds the caveat:

Policymakers must remain aware of these downside risks and do what they can to avoid adding to them. One thing remains clear: banks are still the weak links in the global economic chain. People worry about the health of these huge, highly leveraged, extremely complex and opaque behemoths. They are undoubtedly right to do so.

Which makes his opinion look like an each way bet.

John Kay is specifically concerned about such bets in the form of derivatives. [His argument is that](#):

Accounting practices provide an appearance of precision that may be a poor guide to a world characterised by multiple risks and radical uncertainty. The superficial information we have from balance sheets and capital adequacy calculations understates the scale of complexity and interdependence in the global financial system. Market participants are right to be sceptical, and nervous, about banks.

Or, to put it another way; in 2008 we did not know about the risk in mortgage based

lending and now accounting is failing us on derivatives. I very strongly suspect that is true.

For good measure John Plender's [doubts relate to central banks](#):

What are the limits to the power of central banks? That is arguably now the most important question in global finance. Since 2009 investors have staked their all on the notion of central bank potency. Last week the doubts set in seriously, contributing not a little to the market turmoil. The remarkable thing is that scepticism did not dawn earlier, given a charge sheet that looks challenging, to say the least.

There is justification in his argument: if John Kay is right then central banks are as in the dark as ever they were, except that as Plender says:

The rout in the markets is, among other things, a belated recognition of what ought to have been obvious - namely, that the retreat from unconventional central banking measures was always going to be exceptionally tricky. The most difficult trick is to manage an orderly decline in the price of assets that had first been puffed up by the world's leading central banks.

The obvious is, of course, always anything but to most people most of the time, and so it was with QE. [I'll exempt myself: I wrote of these dangers and the need to address them in 2010.](#)

So what does a central banker say? Neel Kashyap, a Fed insider in 2008 and now the new head of the Minneapolis Federal Reserve is reported by [the FT to have said](#):

the largest US lenders remain "too big too fail"

and that:

that efforts to regulate the big banks since the financial crisis had not gone far enough.

For good measure they also note this:

A break-up should be on the table, alongside a plan to turn the largest into public utilities by "forcing them to hold so much capital that they virtually can't fail", he said. Taxing leverage throughout the financial system to "reduce systemic risks wherever they lie" should be considered as well, he added.

The risk, he reckoned, was equivalent to a nuclear reactor meltdown, saying:

We know markets make mistakes; that is unavoidable in an innovative economy. But these mistakes cannot be allowed to endanger the rest of the country

He clearly thinks banking does that. So do I.

In that context it was good to hear John McDonnell speaking last night about the review he has set up of the Bank of England mandate, headed by Danny Blanchflower. I have no idea whether this review fell out of [the furore I caused](#) last summer on the issue of Bank of England independence in the context of People's Quantitative Easing: if it did I do not regret it.

Banking remains out of control. I think it entirely rational for markets to realise that. And it is also rational for them to realise that as a consequence there are serious risks for the real economy flowing from that lack of control?

Is Martin Wolf right that this will result in a soft landing? I can hope so. I can worry otherwise as well. What I do know is that there is a job of reform to do and George Osborne is moving in all the wrong directions with his pro-banker, weakening of reform programme and that John McDonnell is moving in the right direction. But we have a long way to go still. And Neel Kaskaria may have the right goals in mind.