

It looks as if the can has run out of road for euro ban...

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The [FT has reported tonight](#) that:

Italy has moved to shore up confidence in its fragile banking system after agreeing to pump €5bn of taxpayers' money into two failed mid-sized banks while handing their good assets to Intesa Sanpaolo, the country's strongest lender. Veneto Banca and Banca Popolare di Vicenza, based in the country's prosperous industrial north-eastern Veneto region, will be wound down by Italian authorities after the European Central Bank said they were failing.

Pier Carlo Padoan, Italy's economy minister, said on Sunday that the state would offer additional guarantees of up to €12bn - meaning a possible total of €17bn - to cover losses from the two banks' bad loans.

Two weeks ago [I noted the failure of Banco Popular](#) in Spain at a cost of at least €8bn. I wrote:

With luck a Spanish banking crisis can be contained. But a wary eye is required on what might be a fast developing situation precisely because banking risk is contagious. And if there is a crisis coming we need to be ready.

Three things. First, the probability that there will be contagion looks to be considerably higher now.

Second, we are not ready for it. I explained why in the post on Banco Popular.

Third, if contagion happens it changes everything. I stress the 'if' but it is absurd to ignore the possibility, so I won't. What might contagion mean?

It will reveal that the decisions banks take are not independent of each other. All banks are part of a system and to pretend that banks can in these situations be treated as if they are distinct from each other is simply wrong: they are not. Banks have to trade with each other and are dependent upon each other to settle their liabilities on time. If one cannot do so the counter-party risk is what creates contagion: its limit cannot be

known, and changes in systems since 2008 have not as yet changed that.

The action of the Italian authorities in this case reveals another usually ignored fact. It is claimed that banks create money by lending, and it is undoubtedly true that lending does create money, but the risk of their doing so always rests with the state via central banking authorities. This is why I argue that all money is created by governments: if they carry the can when it all goes wrong then it is their guarantee that gives money its worth.

In that case the question now is whether the collective governments of Europe (and maybe beyond) can persuade the world that their guarantee can still give money the worth that sustains economies without inflation resulting. Let me be clear, that the money creation is possible: there is no limit to the amount of money central banks can create. But if there is serious contagion we have no idea how much money central banks will need to create to deal with this issue and what the inflation consequences will be.

But we know that those consequences are likely. And last time the inflation was almost entirely in asset prices and the result was the rich got richer and everyone else was left even more behind than before. And that too would be the unacceptable outcome this time.

Banks will have to be bailed if necessary.

But this time real reform will have to be imposed. I wrote so much on this in 2008, but this time the banks' entreaties must be ignored: the farce that we have still not put in place all the measures thought necessary then cannot be repeated.

And we have to make sure that the new money benefits the economy. And that can only happen with stringent taxation measures as well as active fiscal intervention. So this time there has to be a wealth tax. And this time, if there is a this time, there has to be a Green New Deal to direct money to where it is needed.

I know it's a touch crass to say it, but if we're going to have another banking crisis then this time it has to be different.