

What happens if 50% of government backed loans fail, as...

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This blog is a day or so late, but I had to spend much of yesterday setting up a new computer because my main old one, bought in 2014, was showing real signs of collapse. Pyrotechnic screen displays were making it impossible to use, and repairs were, I was assured, not guaranteed to work at a cost less than a replacement. The message remains relevant despite that fact.

The [Financial Times](#) noted in a report yesterday that the state of UK banking is perilous. As they put it:

For the smallest and weakest [banks] still struggling to recover from the cataclysm 12 years ago, coronavirus could prove fatal. For the biggest, it portends a period of hand-to-mouth survival – weak profits, no dividends and much lower, or no, bonuses – at a time when most investors had already turned bearish.

They continued:

Vast credit losses are the primary concern. Six months into Covid-19, the numbers are already staggering. The 15-largest US banks have set aside \$76bn to cover projected bad debts and their 32-biggest European cousins – \$56bn, Citigroup data shows. The combined total of \$139bn in loan-loss provisions is the highest since the \$186bn reached in the second half of 2009, the nadir of the financial crisis that brought down Bear Stearns and Lehman Brothers. Using a wider sample of banks, consultants at Accenture warn that the estimated losses from bad debts could rise to \$880bn by the end of 2022.

And then added that:

Banks will not bear the full brunt of escalating defaults. The UK government's emergency small-business lending programme – where as many as half of the “bounce back” loans, with a combined cost of at least £34bn, are not expected to be repaid – puts taxpayers on the line for losses.

However, they note:

Payment holidays on credit cards, mortgages and rents are also masking the current stress on loan books. JPMorgan wrote off just \$1.6bn of loans in its \$998bn lending portfolio in its second-quarter results. The UK's largest mortgage lender, Lloyds, has so far written off just £10.5m of its £38.4bn small business loan book.

In other words, despite new accounting rules that require earlier recognition of losses, this does not appear to be happening.

Their overall conclusions were bleak:

As government support schemes are withdrawn and borrowers start to come up short on their loans, banks may have to sacrifice their prized role as the good guys. So far, they have been willing conduits for trillions of government support and largely sympathetic to customers in distress, but that will change.

"There is still massive guilt over the last crisis, we used to be the pillars of society and then we became pilloried," says the chief executive of a big UK bank, who asked not to be named. "Now we want to be the heroes, save the economy and be knighted when it's over. However, we will reach a point where the debt has to be collected and then the tough choices will start," he adds. "A lot of these companies are going to go bankrupt, we'll have to write the debt off and that will be painful. It'll be difficult to be the heroes then."

Quite so, but that is simply a very micro, bank driven, perspective. In my opinion, much more important is the macro perspective. From that viewpoint, these opinions do, of course, accord with my own argument that there will be overall unemployment in the UK of a much higher figure than that which has been forecast by the Bank of England, who think that total will be little more than 3 million.

This figure is, of course, utterly implausible if, as the Financial Times suggests, up to 50% of the companies now enjoying government-backed loan facilities default upon them. Some 1.1 million companies have had those loans, meaning that more than half a million are at risk of defaulting. That's around a third of all SMEs in the UK economy. Since that sector employs about 16 million people in this country (most of them in relatively low paid and what are usually described as low productivity jobs) and given that the sample size being considered is so high, the likelihood is that it follows that about one-third of all employment in that sector is at risk, meaning that up to 5 million jobs could be in doubt, over and above those that will be lost from larger companies and amongst the self-employed.

Of course, we can hope that not all these jobs are lost simultaneously. And we can also hope that some of the enterprises that will go into liquidation because of inability to service their government-backed loan, will be resurrected, Phoenix-like, to commence trading again, with maybe fewer job losses than the simple extrapolation suggest likely

as a consequence. Indeed, I sincerely hope so, because unless this is the case the number of job losses will be absolutely appalling. But, as it stands this FT report simply provides further evidence to support my hypothesis that the Bank of England's projection for unemployment is utterly unrealistic, almost certainly a work of political fantasy.

There is, of course, a way around this, and that is to convert the loans provided into equity. The government should take stakes of more than 25% as a result, without exception, and require a worker employee be appointed. Conditions on accounting transparency, green transitions and tax should be imposed. But that way jobs could be protected. It's not rocket science. But it is not what the government says it wants to do. And that is foolhardy.