

Banking is at a massive crossroads. It is time that we ...

Published: January 13, 2026, 12:31 pm

Janet Yellen has talked about the US government offering a 100% Federal government guarantee to all depositors in smaller US banks, of which there are plenty. And now she she denied that this is being considered in a move that sent shares in such banks down yesterday, which is why I very strongly suspect that this guarantee will happen.

You cannot muse on this issue when in Yellen's position as US Treasury Secretary and then say you have changed your mind and not expect a run on the banks in question. Thinking out loud and then saying you did not mean it is not an option in her position. So my guess is that it is going to happen.

Yellen's motivation is obvious. She wants to make sure money stays in smaller banks. Without a guarantee she knows it is going to flow, pretty rapidly, from such banks to JP Morgan Chase, the Bank of America and the like. If she wants to save the small banking sector she has no choice but offer this guarantee.

But then let's think about what happens next. Doing so, settle in for quite a ride.

First, Yellen cannot offer this guarantee for those in smaller banks without doing so for larger banks as well. That's because unless she does offer that guarantee to larger bank depositors they are going to be moving their funds to small banks. If Credit Suisse can fail despite passing all bank solvency tests depositors are not in the mood to trust anyone now. So, by musing out loud Yellen has in effect opened the door to a 100% deposit guaranteed US banking system. That's the end of US banking as we have known it.

But, before considering that now think about the situation of a large company in the UK not enjoying such a guarantee. How long will it before it shifts its funds out of sterling and into a US bank to get a deposit guarantee? And then ask the same of will German, French, Spanish and other companies. They will do the same.

Of course, it could be argued that they can use repo to simulate a government guarantee on funds deposited but if by holding funds in dollars you can have the real

thing why not take it? I think I can guarantee those flows to the dollar. Five central banks have even created a credit line to enable them at present. The result is obvious. One after the other the governments of countries are going to have to succumb and offer 100% bank deposit guarantees. How long will this take? It is hard to know, but maybe only weeks.

Then just think this through. First, if all bank deposits are 100% guaranteed the whole repo market ceases to have a purpose. That wipes out a whole banking sector, and that would be inevitable. Repo only exists because there is no deposit guarantee for large companies.

Ending repo also removes one way in which the government can influence short term interest rates: effectively one of its so-called 'open market operations' arrangements that are used to communicate bank base rates into the market evaporates, overnight.

But then so too does something else disappear, which is the reason to buy gilts (or in the US, Treasuries). Government bonds are, after all, just 100% secure fixed-term deposit accounts with the government. You can describe them in any other fancy way you like, but the previous sentence tells you all you need to know, excepting the fact that these deposit accounts are arranged so that they can be traded between those wanting to own them. Now offer 100% guaranteed deposits and who would want a gilt or US Treasury bond? You could then get all the security you want by putting the money on deposit instead, and quite probably with a break clause. So that basically eliminates the government bond markets, and the supposed funding mechanism that it provides to governments.

This is not the end of the consequences though. As is now universally acknowledged by central banks, bank deposits are only created by lending. And if those deposits only exist as a bank liability (which is what they are on a bank balance sheet) because there is a matching bank asset, which is a sum advanced as a loan to customer, now ask a simple question. That question is whether it is credible to expect a government to guarantee deposits and have no interest in the quality of the loans creating those deposits? It seems very unlikely that this would remain the case for long: the risk of moral hazard would otherwise be off the scale. So loan regulation has to follow from 100% deposit guarantees: it makes no sense to regulate only one side of the transaction.

But in that case what is the remaining role of the private sector bank? Its capital has ceased to have consequence because it has been replaced by a government guarantee. Its depositors need have no faith in it. They are only concerned with the government guarantee. Its lending will be regulated. Some of its capacity to speculate will have been removed. Its agency with regard to interest rates may well have been curtailed. All that there would be left for it to do would be investment banking, and it would be easy to see how a new Glass Steagall Act, splitting investment banking from deposit taking, could be enacted to ensure that this division, harmfully abandoned by President

Clinton, could be recreated.

No wonder that Janet Yellen has hesitated in that case. Perhaps no wonder too that she has realised the danger of her speculation, which she uttered rather too loudly to ever deny. A 100% deposit guarantee might save small banks but at the same time it would completely change the entire model of banking as we know it. It would simultaneously change the way in which governments pretend that they are financed through borrowing. What would undoubtedly be brought forward is the era of central bank deposits probably through central bank digital accounts.

Maybe Yellen has realised this. Maybe she has realised that this change is inevitable. I think it probably is. Or, unless it is recognised as necessary banking will continue to operate on the basis of the pretense that there is not a 100% deposit guarantee when in reality we all know that there is, because no bank depositor is ever going to be abandoned: the political cost of doing so is too high.

Banking is at a massive crossroads. It is time that we talked about what comes next.