

Economic meltdown: coming our way

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Three weeks ago, I warned that the war involving Iran could trigger a seven-stage economic crisis. Today, I think that risk is much greater than it was then.

The reason is simple. We are no longer looking at a threat to one global trade route. We are potentially looking at threats to two of the most important trade routes in the world at the same time.

Iran is now signalling its intention to close the Strait of Hormuz. At the same time, disruption in the Red Sea could make access to the Suez Canal effectively impossible. Together, these routes are critical to global energy supplies and world trade. A significant proportion of the world's oil passes through Hormuz, whilst the Suez route is one of the key arteries linking Europe, Asia and the Middle East. If both are disrupted, the consequences will be felt everywhere.

In this video, I explain why these situations change everything. As a result, I revisit the seven stages of economic meltdown that I outlined previously and explain why events are now moving in exactly the direction that analysis suggested. Rising oil prices are only the beginning. Fuel shortages, supply chain breakdowns, food price inflation, business failures and a banking crisis could all follow.

I also explain why central banks are likely to make matters worse. Faced with rising prices, they may once again reach for higher interest rates even though inflation would be caused by shortages and disrupted supply chains, not excessive consumer demand. That mistake could deepen the crisis and accelerate the recession we face.

My concern is not simply that a crisis might happen. My concern is that it may already have begun. Markets are reacting. Commodity prices are rising. Diplomatic efforts are failing. The warning signs are becoming harder to ignore by the day.

<https://www.youtube.com/watch?v=xPL3UwWIJF8?si=VIt2GHRaLYnVIOPJ>

This is the audio version:

https://www.podbean.com/player-v2/?i=vm59s-1adb072-pb&from=pb6admin&share=1&download=1&rtl=0&font=Arial&skin=f6f6f6&font-color=auto&logo_link=episode_page&btn-skin=c73a3a

This is the transcript:

I've said we are heading for economic chaos for some time now, but today I think the chance of that is very much higher than before.

New developments over the last day or two in the Middle East are pushing us closer to economic meltdown.

Iran has pulled out of all diplomatic negotiations with the USA and Israel, and Iran took this decision because of continued aggression against it. The US is still attacking Iran despite the ceasefire, and Israel is breaching the ceasefire in Lebanon, making negotiations impossible, according to Iran.

The consequences for the global economy are now serious and accelerating, and this is no longer speculation. The warning signs are all there now.

Iran is now moving to shut the Strait of Hormuz completely.

It's also moving to assist the closure of the Red Sea access via Yemen, and that means the effective closure of the Suez Canal as well. Two of the world's most critical trade choke points are being threatened simultaneously. Global energy supplies and trade flows depend on both these routes. The economic consequences of their closure will be enormous.

Three weeks ago, I set out the seven stages of economic meltdown that this war could create. Nothing has now changed my view that those stages will happen. Every development since then has confirmed the direction of travel, so I am reissuing that analysis now because those stages are more relevant than ever. We need to understand what is coming so we can prepare for the consequences.

Let me then walk through all those seven stages again, starting from the very beginning.

Stage one of this process has already happened. Commodity markets have already

noted what is happening in this war and have already responded to it. Almost certainly, they've got their reaction wrong because they assume the crisis will be over soon, but that's just sweet and deeply naive of them. The fact is that oil, gas, fertiliser, and other raw material prices have all gone up heavily already. Oil is now settling at well over \$100 a barrel, and I stress that these are anticipatory price rises ahead of actual real shortages in the market. Markets are pricing fear right now and not yet reality, but the price signals are real enough and are beginning to feed through, and that leads us into stage two of this crisis.

Stage two of this crisis develops when the raw material price increases seen in stage one begin to flow through to consumers. We are, of course, seeing that this is already happening. The most visible impact so far is at the petrol pump, but food prices are also rising, although not by as much as yet, as they are likely to do. Even the Bank of England admits they will increase by a great deal more as this year progresses, and I think they're understating the risk even then. The key point here is, though, that this stage is also already underway. We are seeing the impact of this war in our pockets right now, but the worst of the supply chain transmission is still ahead. That's the key point to make.

The third stage of the economic crisis that we are in is when central banks begin to make the wrong calls with regard to interest rates. We've already seen all the central banks warning that they might increase interest rates if oil prices remain high, and the likelihood that we're going to see those interest rates rise very soon is very high indeed. It could be as soon as next month. There is a meeting of the Bank of England on 18 June to consider this issue. By then, oil price shortages will be happening, as I will note very soon.

The consequence would be that we would have an increase in the cost of money, which is absolutely the wrong thing for the Bank of England to do at this moment because we do not have an economy that is overheating because of an excess of demand within it, but one that is in crisis because of a shortage of demand within it for most goods and services because people are going to have to reallocate their money towards essentials like fuel, energy, and food, and will not be buying anything else. And therefore, at this moment, an interest rate increase will only make matters worse by reducing demand for all the more peripheral items in life, which are already going to be in crisis because of a supply chain problem. This policy error from our central banks will then make this crisis significantly worse. But it is going to happen, I have no doubt about that, and that is what stage three of this crisis will represent. It is when the central banks move in to make everything worse.

Stage four of this crisis will begin sometime in mid-June, according to all current forecasts, and that is when real shortages of products will begin to hit us. Petrol, diesel, jet fuel, and oil-based energy are the first casualties that we're going to see. Those are likely to happen by mid-June. Reports are already coming through that stock levels are already being reported to be falling rapidly, and they could run out by the middle of

June. That is when the shortages will really begin to hit because there will be no buffer left to provide for the shortfall in absolute supply. Those absolute supplies are running at the moment at around 80% of normal levels. That does not mean there will be no petrol, no diesel, no jet fuel, and no gas. It does mean that these things will suffer an absolute shortage of supply, and that means that rationing will take place.

Rationing can happen in two ways. It can either happen through the price of the product, or it can happen by government intervention to control physical supply. Either way, there is going to be major disruption, and it will become concrete, and it will become unavoidable, and it is going to have a very big real-world impact.

Stage five of this crisis develops when supply chains fracture as a result of fuel shortages. Without physical rationing, that could very easily be by the middle of this summer and with rationing, it's still going to happen, but by early autumn. There simply will be too little fuel by that stage to ensure that everybody gets what they need on time to keep products moving through our economy, and that will create the supply chain disruptions that I'm talking about.

Food supplies will be most vulnerable. They are going to be severely disrupted and quite soon, because, of course, the timescales involved in moving food from field to plate are quite low, but that issue will be exacerbated as well by issues around fertiliser supply. Just getting crops to market might be the big issue with regard to fuel, but whether there are crops at all will be another issue we will have to worry about, and that is going to hit as we move into the autumn.

And, in addition to that, raw material shortages will spread across many sectors of the economy. People will find themselves without essential items, as will businesses, most importantly, and they will not be able to produce. It's quite ridiculous that if you miss a single washer whilst you're building a car and you can't find it anywhere else, then you can't build that car, and that brings the entire supply line to a halt. This may well be the sort of situation that we face. We don't know where supply chains are going to break. That they will break is almost certain, and government intervention will be necessary, but may not come. That's my key point.

That leads us to stage six of this crisis, and I think that this will be something that will be happening by early autumn and stretching on from there towards Christmas, by which time there will be a major issue with regard to businesses failing. Businesses with limited financial reserves will not be able to survive sustained supply chain disruption. That's why businesses had to be supported by the government during the COVID crisis. We will face the same problems again now, and unless businesses are able to meet customer demand, which they will not be able to do if they cannot make or get the products that they need to sell, they will face mounting losses.

The first response might be short-time working. This is what happened in 1973 when we had a crisis with regard to energy supply. But closures will follow as funds run out. If the

government is not willing to provide the scale of support that it did during the COVID crisis to prevent our economy falling apart, we will see large parts of UK business fail during the course of this autumn. Unless action is planned and even taken now, this will happen. No ifs or buts. We will see economic failure, and we are in trouble if we do not anticipate it at this moment.

Finally, there is stage seven of this crisis, and that happens when we get a banking crisis. We are going to have such a banking crisis later this year unless we take action, and it could be on a scale bigger than that of 2008. Business failures and job losses will leave both commercial and mortgage customers unable to service their debts to banks. The resulting financial stress will hit the banks directly. This is the point at which the financial system itself comes under threat. And when we also have potential failures in the \$2.5 trillion private credit or secondary banking system, this might just compound the problem. All of this could happen before the end of this year. It's not scaremongering to say so. It is just an exercise in reasonable anticipation. We are in trouble.

And at this moment, any resolution to the war with Iran will come too late to prevent a lot of this from happening. That's because political pressure on both the USA and Israel to end this war will not, I think, arise until we reach something like stages six and seven of this crisis, and by then the damage will already be done.

Like 2008 and like COVID, our politicians will react too late. We will be in recession and heading towards depression before they even realise the scale of the problem that's going to hit them. And the scale of the global economic impact is hard to overstate.

That is the problem, and that is because we are in a situation where the impasse in the Strait of Hormuz is holding, and Trump has no credible strategy to reopen that waterway.

Iran has every reason to hold onto its position of strength, and European governments, and maybe that of China, are too cautious to impose meaningful pressure on either the USA or Israel at present to end this war. So nothing is likely to shift before the autumn at the earliest.

What might happen then? We may get a break in the deadlock. But that depends entirely upon the political and economic pressure that is brought to bear on Trump and Netanyahu, either internationally or in the elections scheduled in Israel and the USA then. But none of this is likely to arrive soon enough to prevent this crisis being genuinely described as such.

This is the trajectory, then. Seven stages, some already underway, and each of them accelerating as the year progresses, creating more and more chaos and unpredictability as this process advances. It's going to get serious from early autumn, and maybe even earlier with regard to fuel shortages, and the window of opportunity to act is narrowing

with each passing week.

Political and economic pressure must be built now. The cost of inaction will be measured in lost livelihoods, lost opportunity, failed businesses, financial and political crisis, and not just in statistics. We are already inside this crisis and not watching from outside it, and it seems that no one wants to stop it. That is the most worrying thing of all.