

Funding the Future

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The Guardian [ran a feature yesterday](#) on economic comment from Davos concerning world share market sell offs. One union leader apart the vast majority of those who reported seemed to wholly miss the point. They seemed to be suggesting that the concern was simply with what was happening in share exchanges. Most argued these were suffering a 'necessary correction' and once that had happened then all would be OK.

Larry Elliott in the same paper [may be at least in part guilty](#) of the same mistake: he says the sell off is serious but unless there is a transmission mechanism to real markets then it is hard to be sure that a recession will follow. So let me offer explanation as to at least three such transmission mechanisms, whilst noting that there are more.

First, oil and other commodity price falls will deliver real bad debts to global markets for three reasons. First stocks will, for many companies, have fallen heavily in value creating liquidity crises. Second, falling margins will create long term profit concerns and so solvency issues. And third, banks in a great many countries, including the UK, have already failed to address the real scale of the bad debts they face and so are much weaker than their balance sheets suggest. This accounting weakness has to only begin a ripple effect of bad debt provisioning leading to doubts as to bank solvency for the contagion mechanism to be created.

Second, the contagion can come from currency wars as many states with a shortfall of domestic demand seek to inflate short term earnings all at the same time: China is the obvious start point for this but the rapidly developing downward pressure on prices that might result will be deeply disruptive for employment in many states, including the UK as local producers are undercut. Steel is a powerful first example. That is a powerful contagion mechanism.

Third there will be a flight to safety amongst investors. That may be to property but is much more likely to be to gilts. This is rational in the face of massive doubt about future business earnings and in particular extractive industry valuations, where current reserves are hopelessly inflated in value terms as a large proportion of the reserves on which value has been placed will have to stay in the ground if we are as a race to survive here in earth. There is, then, no short term price correction is going on: a

fundamental reappraisal of value may instead, wittingly or unwittingly, be happening. That's the real explanation for market decline and the impact feeds into the first two processes and so delivers contagion.

If banking, the extractive sector and manufacturing are all under fundamental threat at the same time then we are not seeing a blip, this is what I [described as a disruptive event](#) yesterday.

And such events are not inconsequential. They require fundamental reappraisal if market risks, operations and functions if recovery is to be possible in a reasonable time period. Failure to recognise the significance of the event only extends the pain. And that's the prospect that the reported view from Davos suggests we will face.