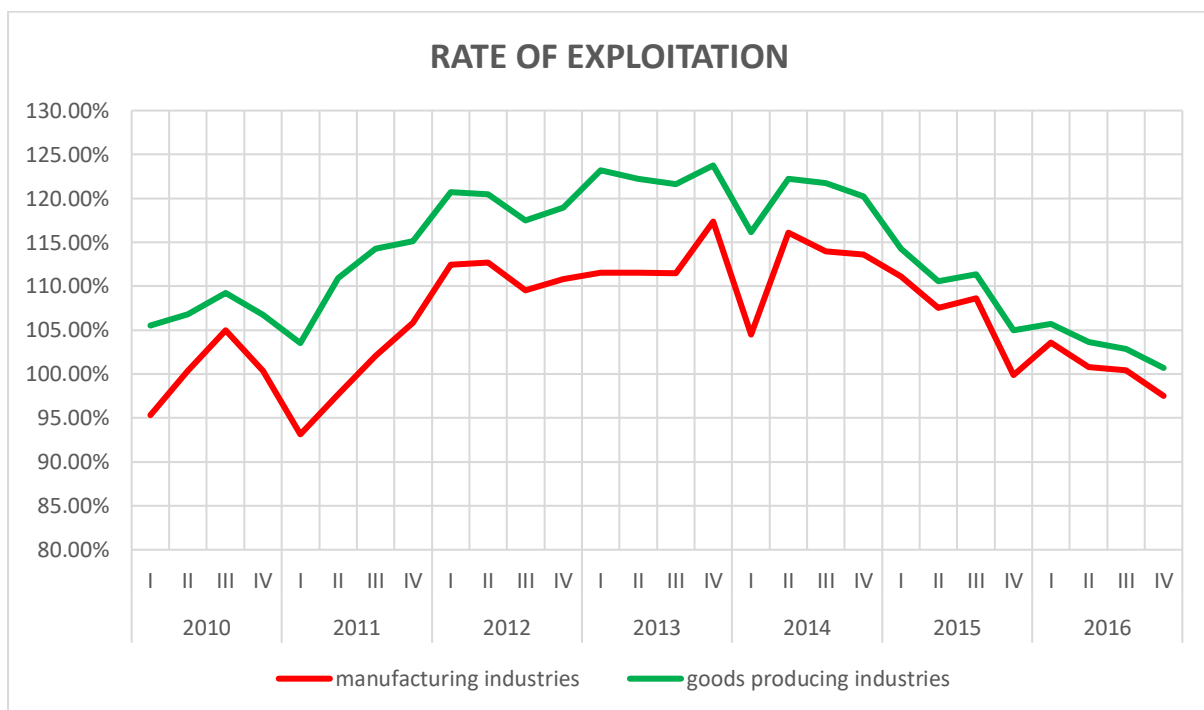


REPORTING THE FOURTH QUARTER (2016) RATE OF SURPLUS VALUE IN THE USA AND THE STATE OF THE WORLD ECONOMY.

The Trump smelling salts had worn off long before his first 100 days in office was over. GDP for the first quarter (first estimate) came in at a three year low of 0.7%. It is likely to be reduced to 0.5% when more data relating to a weak March is factored in. On the other side of the planet, China's GDP beat estimates as all the financial stops were pulled out to prevent the economy overshadowing the CCP Congress to be held later this year where Xi is up for "re-election". Despite the IMF raising its outlook for the world economy, there is evidence that the reflation trade based on Chinese credit expansion and Trump's election is over.

This commentary, primarily on the U.S. economy, is produced every quarter following the release by the BEA of its GDP by Industry Data which enables the preparation of turnovers covering the previous quarter, in this case the fourth quarter of 2016. In line with previous commentaries we begin with the rate of exploitation. The rate of exploitation is obtained by subtracting wages and salaries (Table 2.2B) from net value added (Table 6.1D) to obtain the surplus. This surplus is then divided by wages and salaries. (It is not as accurate as using employee compensation which includes benefits in addition to wages and salaries, but these are not yet available.)

Graph 1.



(Sources: BEA Table 2.2B and 6.1D)

The rate of exploitation continued to fall reaching levels last seen in 2010. This was in part due to tighter labour market conditions together with a reduction in the transfer of value from China to the USA as China moves up the value chain. The tightness of the labour market needs more elaboration. The tightness of the labour market is not simply due to the shortage of workers of whom there are many. Thirty years of neo-liberalism has corroded education and the absence of a safety net has led many workers to degenerate. The result is a shortage of qualified workers fit for work, not the absence of a reserve army of labour. It is but another example of the short-sightedness of neo-liberal politics.

The rate of exploitation is unlikely to be reversed in the first quarter of 2017. Labour costs have continued to increase. The Bureau of Labour Statistics Employment Cost Index released on Friday 28th April 2017,

showed a jump of 0.8% for the quarter, the highest quarterly increase since December 2007. The report also showed the index accelerating towards the end of the quarter.

The rate of exploitation is not to be confused with the all-important rate of surplus value where it forms only one part. It is not the rate of exploitation that determines profitability, but as Marx showed, it is the rate of surplus value. To obtain the rate of surplus value turnover times need to be factored in as well. Turnover times reveals the length of time wages and salaries need to be paid, before they are replenished by new money coming in from the sale of the commodities produced in that period. They also describe how quickly profits are produced. Therefore, the shorter the turnover time, the smaller the outlay on wages, the greater the production of annual profits.

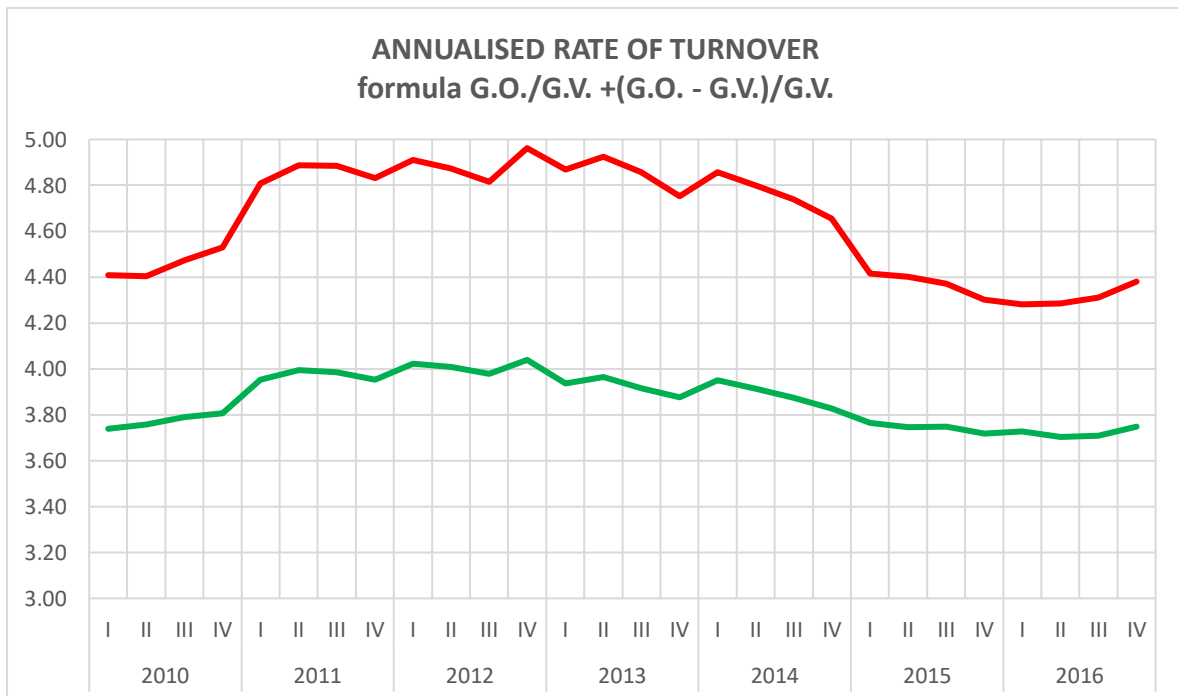
The formula for the turnover of capital is:

$$g.o./g.v. + (g.o.-g.v.)/g.v.$$

where g.o. stands for total sales or gross output and g.v. stands for final sales or net value added,)

In contradistinction to the fall in exploitation, U.S. capital benefited from an improvement in turnover times. Quicker turnovers mean more turnovers can occur during a calendar year, which results in an increase in the annual rate of turnover. An increase in the annual rate of turnover represents shorter turnover times and vice versa. The annualized rate is shown in Graph 2 below. It shows the adjustments to the annual rate on a quarterly basis.

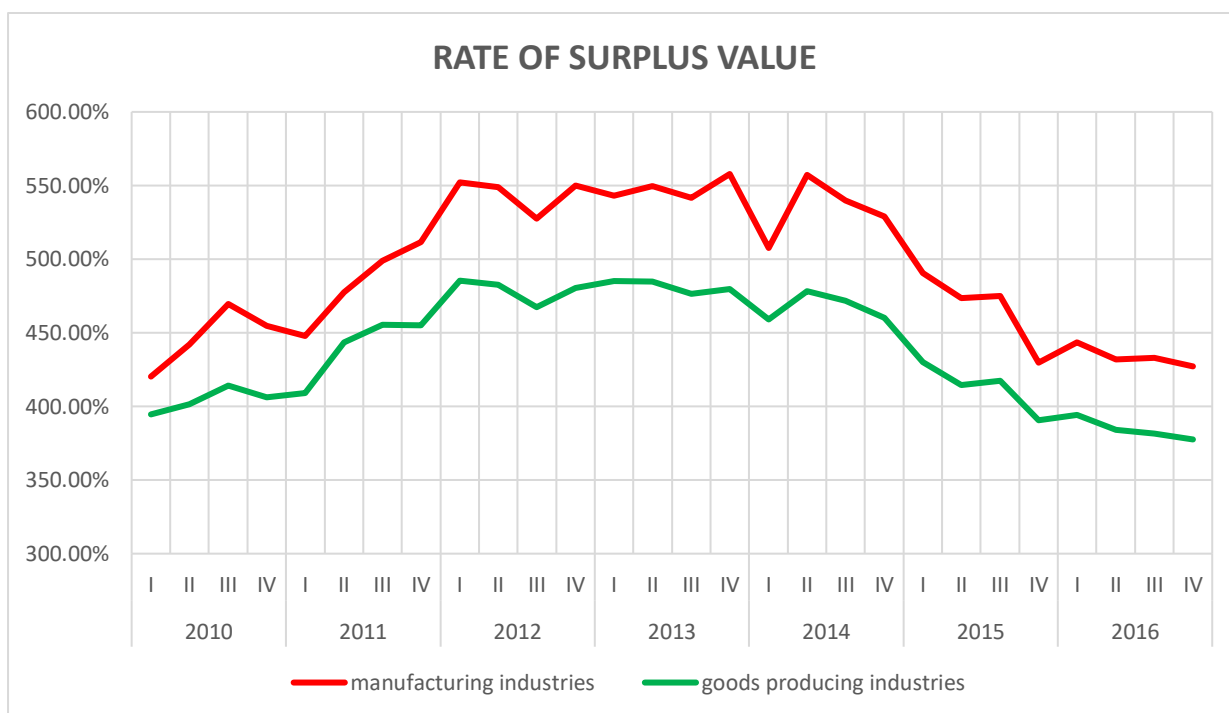
Graph 2.



(Source: BEA Interactive Data, GDP by Industry, Gross Value Added (G.V.) and Gross Output (G.O.)

The rate of turnover lies well below the levels achieved in 2012/2013. Measured in days, turnover times have increased from 73.5 days to 83.3 days currently, an increase of nearly 10 days. Ten more days to pay wages, ten fewer days to produce profits. However, they continue to rise gently from there low point at the beginning of 2016. It is likely, given the current fall in inventories, that they have continued their gentle increase in the first quarter of 2017. Resulting from this marginal increase in turnovers, the rate of surplus value did not fall as steeply as the rate of exploitation. This is demonstrated in Graph 3 below which is arrived at by multiplying the rate of exploitation by the number of annualized turnovers (Graph 2).

Graph 3.



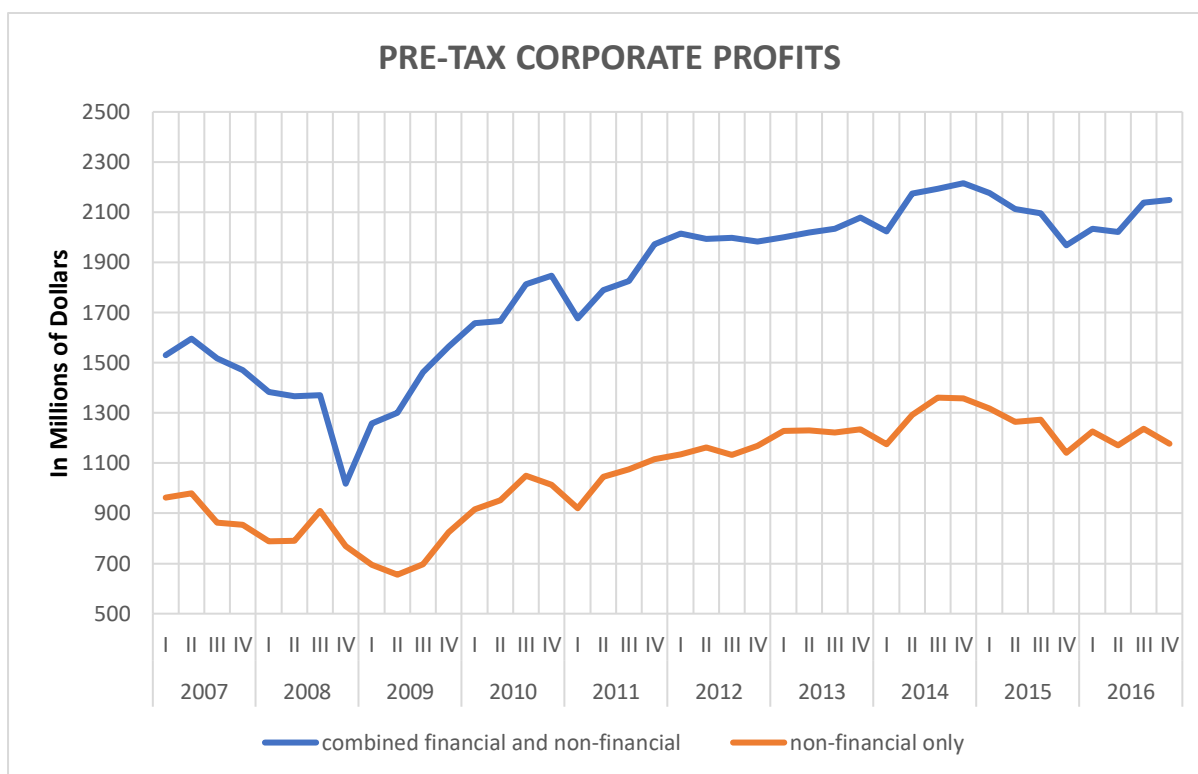
In manufacturing, the fall in the rate of surplus value during the fourth quarter more than wiped out the improvement found in the third quarter, resulting in the rate falling below the rate found in the final quarter of 2015. In the case of goods producing, the rise in the oil price was insufficient to prevent its gentle fall in the fourth quarter. Both rates have now fallen back to their 2010 level when the economy was emerging from the 2008 financial crash.

The fall in the rate of surplus value has stabilised, but it has done so at a level that is 25% below the peak level that obtained in 2014. This means that U.S. capital, despite the hype of Wall Street, has not re-established the conditions of profitability that were encountered nearly three years ago. In 2014, the rate of surplus value was 557% for manufacturing, while it was only 427% at the end of 2016.

Not only does the rate of surplus value provide the best measure for determining the mass of profits, its trend mirrors that of corporate profits. In quarter three the rate of surplus value, unlike the rate of exploitation, increased and this was reflected in a rise of corporate profits for that quarter. In quarter four, both the rate of exploitation and that of surplus value fell. Non-financial corporate profits fell too, reversing their third quarter gains. However, the amount that corporate profits fell was closer to the fall in the rate of surplus value, rather than the much steeper fall in the rate of exploitation. Non-financial corporate profits peaked at \$1361 in 2014 falling to \$1171 in the final quarter of 2016 an inflation adjusted fall of 19%. Fourth quarter non-financial profits (inflation adjusted) were no higher than their nadir in the final quarter of 2015.

If total corporate profits have risen, this is only because financial profits have risen. Indeed, total financial profits are over 10% higher than in 2014. The quality of these profits is however questionable. It is difficult to equate the growth in the mass of financial profits with a low interest and low volatile environment, leaving the assumption that much of this growth owes more to fiction than to the real flows of interest.

Graph 4.



(Sources: BEA Table 1.12 for total corporate profits and Table A463RC1Q027SBEA for non-financial profits)

Current Conditions.

For the whole of 2016, total corporate profits were no higher than in 2015 because of the fall in profits in the last quarter. Average profit for 2014, 2015 and 2016 were \$2152.1 billion, \$2040.2 and \$2085.8 respectively. In inflation adjusted terms, 2016 profits were 6% down on 2014. It therefore can be expected that the rate of profit fell in 2016 because the marginal increase would have been insufficient to offset the growth in the means of production used to produce it.

At the time of writing, FactSet’s blended growth in earnings for the first quarter of 2017 is set at 12.5% for S&P 500 companies (58% of companies having reported). Anything over the 6%-7% level should result in an increase in non-financial earnings. The first 6-7% is noise caused by share buy-backs, inflation, fictitious financial profits, distortions created by non-GAAP reporting and a depressed Q1 in 2016. This is reflected in FactSet’s reporting of profits for the final quarter 2016, where an annual rise of 5.9% in S&P profits was translated into a quarterly fall in the mass of non-financial profits.

The first quarter of 2017 represents the third consecutive increase in profit per share for S&P 500 companies according to FactSet and one of its strongest since the crash of 2008. This significant increase in the mass of profits seems to be incongruous when set against annual GDP growth of only 0.5%-0.7%. As CNBC reported on the 1st May 2017, earnings per share growth compared to GDP growth is at its widest since the third quarter of 2011. It attributes the discrepancy to foreign earnings. “S&P 500 companies that generate more than half their revenue overseas are posting quarterly earnings growth of 19.9 percent on average, double that of companies that conduct most of their business domestically...” Given that 46% of S&P 500 revenue is derived outside the US the contribution from foreign earnings is substantial. A substantial portion of this growth in foreign profits is the jump in the profits of the oil majors resulting from an oil price that averaged over \$50 during the quarter. Companies with local sales are likely to have done less well.

This increase is of course flattered by comparison to the first quarter of 2016 when profitability was at a low point. It is unlikely that the improvement will be so marked when measured against the second half of 2016 when profits picked up. Finally, the increase in profits is uneven being concentrated in handfuls of tech companies and investment banks. At best, even with this quarterly increase in profits, profits will have plateaued, rather than resuming an upward trend.

The outlook for quarter two GDP is subdued based on the slowdown that occurred in March. March may very well turn out to be the pivotal month, not only for the USA, but for the international economy, as it marked the moment when the reflation trade went bust. This is the reason as well, why it is likely that GDP will be revised below its current estimate of 0.7%. Anything under 1%, adjusting for the leap year quarter last year, does not represent real growth as the contribution by I.P. duplication of 0.4%, that of owner occupier rent of 0.3% and finally the widening fiscal deficit of 0.3% adds up to at least 1%.

The weak first quarter of 2017 was predicted by the very weak GDI (Gross Domestic Income) number in the last quarter of 2017. Preliminary GDI figures for the first quarter are looking weak as well though likely to be increased because of the rise in profits. According to the BEA GDP release dated 28th April 2017, total real disposable income, which informs GDI, rose by only 1% during the quarter. In many ways, GDI is a more accurate indicator of economic trends than GDP as it is the direct measure of the value produced in every quarter.

Except for housing and petrol sales, there are no sources of strength in the economy. Initial figures for light vehicle sales show a 4.7% fall in sales in April despite average incentives of \$3,499 approaching those found at the height of the financial crisis. According to Automotive News, the four month fall in light vehicle sales is the longest fall since 2009. As light vehicle sales represent 20% of retail sales, their fall will significantly reduce GDP figures. It will also impact on jobs and production as inventory levels which have spiked to 100 days from under 80 days, will need to be reduced.

US car sales shines a light on the US economy. *"New cars are only bought by the top 5% of the population. Steven Szakaly"*, said the chief economist of the National Automobile Dealers Association who was quoted in Bloomberg (1st May). A more accurate statement would be to say that all top end cars/SUVs are bought by the top 5% which is why this segment of light motor vehicles has been resilient compared to lower priced models and sedans which have not. (It is worth adding that high end car sales are a proxy for the stock market, they rise in proportion to the rise in share values and vice versa.)

The sharp fall in car sales is at the lower end, where car loans predominate. Outside the top 5%, most car buyers need to take out car loans to buy cars or more accurately lease cars. Car loans have become the new sub-prime though in total their aggregate value is only one seventh that of mortgages. The fall in car sales is in part due to banks and finance houses tightening their lending criteria in the face of rising defaults on the one hand, and on the other, collapsing residual values of cars at the end of their term.

The fall in car sales ensured that the level of PCE (Personal Consumption Expenditures) was flat in the month of February and March (Table 5, Personal Income and Outlays: March 2017, released on 1st May 2017). The only growth in outlays was once again the forced rise in health expenditures. Health spending as always remains out of control weighing on the economy.

The retrenchment in lending is across the board. Financiers like Capital One Financial, purveyor of less than perfect credit cards, is the canary in the coal mine. It saw defaults rise by 29% in the first quarter to over 5% for the first time in six years forcing it to tighten its lending criteria. Regional large banks, for the first time in four years, reduced total lending in the first quarter because of increasing indebtedness and the reluctance by borrowers to take on more debt in the face of rising rates (reported in MishTalk 29th April). This contributed to total credit advanced to industry and individuals stalling in the first quarter. This followed the largest quarterly increase in household debt in the previous quarter for three years.

(Household Debt Increases Substantially, Approaching Previous Peak, February 16, 2017. Released by the Federal Reserve Bank of New York.)

What was most interesting about the report by the New York FED was the composition of household debt. It has almost reached its pre-2008 peak despite mortgage debt being lower. Stripping this out, car loans, student loans, credit card loans and unsecured personal loans are all much higher than in 2007. They epitomise an economy based on credit, dependent on credit and thus vulnerable to rate rises.

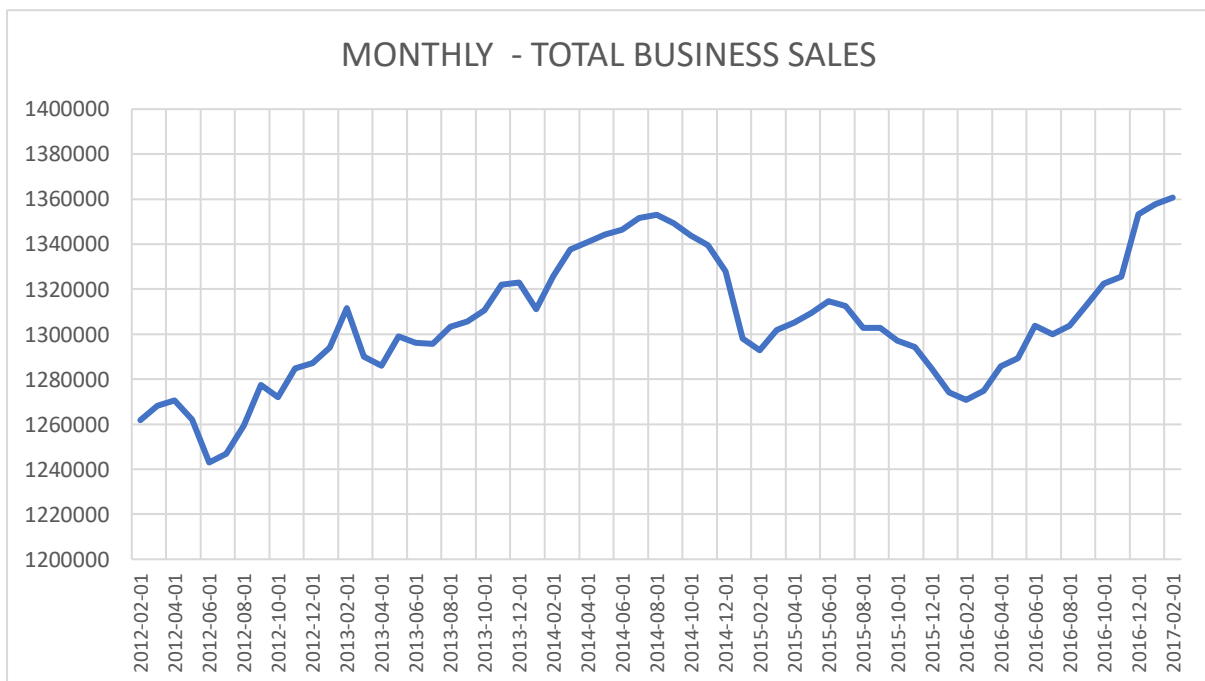
When interest rates began to rise in November, I posed the question: “can the U.S. economy which is based on credit instead of profitable investment, survive the rise in interest rates?” In the language of Marx, can an economy dependent on the cost of capital rather than the rate of return for that capital, grow under conditions where the cost of capital is rising while the rate of return is stagnant. The answer is that it cannot, which is why interest rates have fallen back and the deflation period is over. The same is true of China with its spike in interest rates.

What we have learnt about this long period of expansion, albeit subdued, is how decisive the interaction between the rate of return on capital and the cost of that capital is. This period was nurtured by historically low rates of interest even as the rate of profit fell after 2104. In the usual business cycle, the late stage of the cycle is characterised by a fall in the rate of profit colliding with a rapid rise in the cost of that capital. Less profit coming in, collides with more interest going out.

No collision took place in late 2014. The rate of profit fell together with the cost of capital which buffered the fall in the rate. The business cycle petered out in late 2014 simply because corporations could no longer raise their margins through cost cutting, not because over-investment had overheated the economy and with it the demand for capital. A quite unorthodox state of affairs.

The movement in the cycle is best illustrated by the graph below which tracks combined business sales up to February 2017 (total sales for manufacturing, wholesale and retail equal to between 27% and 55% of the economy.)

Graph 5.



(Source: FRED Total Business Sales TOTBUSSMSA)

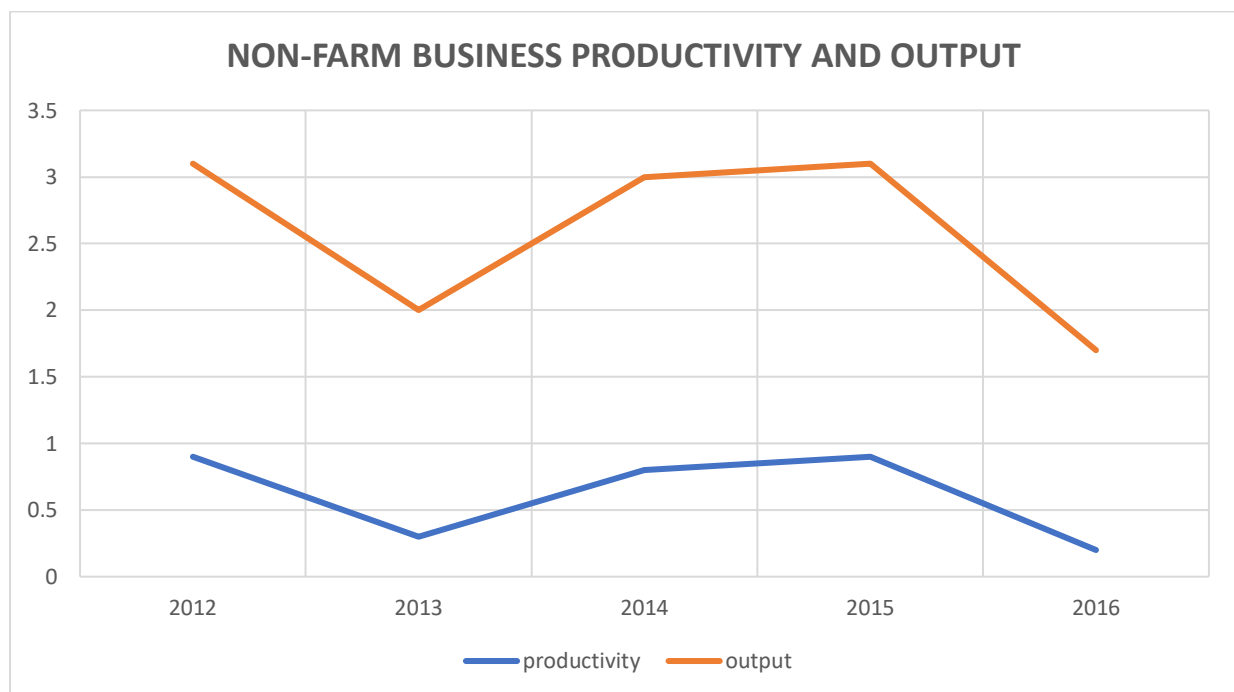
Total Business Sales fell to their low point in early 2016 since when they have risen in nominal terms to a point equivalent to their peak in mid-2014. Adjusted for inflation the February figure is below the figure obtained in 2014. More specifically, the trend moderated in January and February when sales increased in annual terms by only 3%. Given the preliminary data for March including a fall of 4.7% for vehicle sales, total business sales are expected to have fallen quite sharply in March.

In my previous report, I pointed out that the trend in the total sales embraces the typical business cycle, suggesting we may have moved into an expansive phase in the second half of 2016, though at the time it was too early to say so unequivocally. The data coming in over the last two months suggests this trend is reversing. And it is reversing for two reasons. Increasingly indebted consumers and producers are facing rising interest rates. The proof is given by the inability of interest rates to maintain their recent peaks. The key 10-year government bond which peaked at 2.62% in late March now struggles to keep its head above 2.3%. The FED which aimed to raise interest rates three times this year will once again end up with egg on its face. The main reason interest rates have sagged is the sensitivity of loan demand to any rise in interest rates. The propensity for the demand for loans to fall because of rate rises, is extreme. This was amply demonstrated by the collapse in mortgage applications when the 10-year rate approached 2.6%.

Flatlining productivity.

At the heart of the stagnation of the US economy lies flatlining productivity. The reasons for this are manifold including stagnant net investment even adjusted for price falls. Graph 6 plots the anaemic economy wide growth in both (real) output and productivity for the five years up to 2016.

Graph 6.



(Source: PRODUCTIVITY AND COSTS Fourth Quarter and Annual Averages 2016, Revised. BLS 8 March 2017)

Both productivity and output fell to their lowest point in 2016. In only the third and fourth quarters, what I have dubbed the Hillary Clinton quarters or if you like, the soya bean quarters, did productivity perk up. However, this rebound was quickly snuffed out by the 0.6% fall in productivity during the first quarter of 2017 (BLS report 4 May 2017). The crisis in both productivity and output is well known. In January 2017, the BLS released a report by *Shawn Sprague* titled: *Below trend: the U.S. productivity*

slowdown since the Great Recession. This report showed output growth during this business cycle to be the weakest since the second world war. This anemic growth in output which normally results in falling numbers of workers, was instead accompanied by rising numbers of workers, hence the flatlining of productivity. Intoxicated by historically low interest rates, the capitalist economy is acting in a most un-capitalistic manner.

The latest projection by the FED sees future productivity stagnating. Stagnant productivity puts a lid on the mass of profits. Stagnant productivity means the mass of profits can only grow through cutting wages or by increasing employment, conditions that is making the US economy resemble that of the USSR during its dying days. Much of the cause for moribund productivity is placed at the door of weak net investment, or what is the same thing, the slow-motion renewal of the means of production. This is only part of the story. What little investment there is, is wasted on luxury production. The rise in inequality has seen the surge in the production and consumption of luxury goods. But the investment in luxury goods production does not improve productivity. Wasting \$250 billion on a fleet of personal/business jets instead of on the roads, may make the rich feel better about themselves, but it does not fill in one pothole.

An alternative explanation for flatlining productivity which is gaining traction amongst economists is “deflationary progress”. In the words of David Eiwert: *“To automate is to collapse the steps in a process...Technologies are invented and intersected in a way that deflates the market.”* (Financial Times. 4 May 2017). By default, Mr. Eiwert is merely confirming the labour theory of value, or what is the same thing, machines do not add value to production, only labour does, which means the displacement of labour by automated machines ends up devaluing production. In sum, *deflationary progress* is the theory that as automation cheapens (devalues) production it reduces nominal output and it is this reduction which leads to flatlining productivity because productivity is measured by this reduced output.

This theory is a superficial insight into a developing phenomenon which is not unique to the history of capitalism and its periodic revolutionizing of production. Statisticians find it difficult to measure productivity, which is first measured in monetary terms before being translated into physical terms. This is due to money being an inexact measuring rod because it is variable. Unlike a metre which is a fixed measure, defined as: “the length of the path travelled by light in vacuum during a time interval of 1/299792458 of a second” (Wikipedia), money shrinks (depreciates) with each passing day. If money were a substitute for the metre, and because it gets shorter, the distance between two points would be x metres on day 1 and $x+$ metres on day 100, even though the distance between the two points had not changed. All that has changed is that using a shorter metre requires more metres to measure the same distance. The same applies to money, when it shrinks in value, prices go up because more money is needed to circulate goods.

Statisticians try their best to compensate for money’s variable nature. This would not present a problem if prices rose at the same rate throughout the economy. But the price of a cup of coffee behaves differently to a computer because the production of the computer lends itself to automation, while that of coffee does not. Statisticians thus develop specific deflators for specific industries. If real output is to be made real, then nominal output needs to be deflated accurately, otherwise real output would be too low or too high, depending on the direction of error.

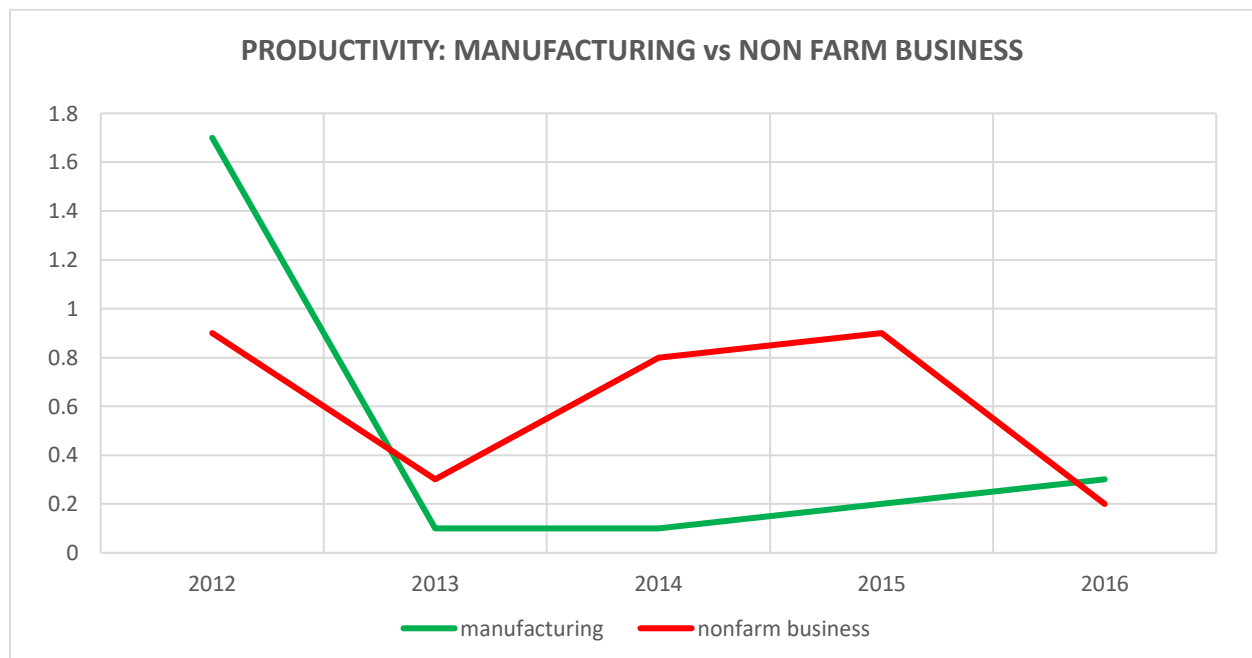
Assuming the deflator is set at the right level real output may still fall because of the cheapening process. The common example used by Mr. Eiwert is where music streaming replaces CDs. The physical increase of streaming cannot compensate for the loss of CDs because the unit cost is so different. However, what is

true for total output is not true for the output per worker. Output per worker should not fall, but rise, because automation should reduce the number of workers significantly. If output per labour hour is falling, that is either due to the workforce increasing, unlikely as automation would then not pay for itself, or it is due to something entirely different.

If overall output and output per hour both fall simultaneously, under conditions where production is expanding, then we are dealing with a realization problem. The two are different. One is driven by changes in production (automation=cheapening) while the other is driven by changes in circulation (a fall in demand). The former increases profits while the latter diminishes profits. To distinguish the one from the other we turn to manufacturing. Manufacturing is chosen deliberately because it is the sector most prone to automation and one where productivity per labour hour should be increased by automation. In Graph 7 below manufacturing productivity is compared to that of the whole economy.

In this graph, as expected, manufacturing productivity at first is significantly higher than the whole economy which is more labour intensive. But then in 2013 productivity in manufacturing collapses confirming that we are dealing with a realization problem which has continued to this day.

Graph 7.



(Sources: see graph 6.)

This realization problem has beset the world economy since 2008. World demand has been deficient. It is the reason I have concentrated on the gap between corporate cash flow and investment as a guide to the build-up of idle capital, unconsumed capital of which the growth of corporate cash piles is but one example. When part of the annual surplus is not consumed by the capitalist class either productively or unproductively, then total demand in the world economy falls and a generalized realization problem emerges. Workers produce unpaid labour as before, but less of this unpaid labour is converted into profits because selling prices are depressed. And if selling prices are depressed then so too is nominal output and with it productivity. As nominal (monetary) output is the starting point for determining productivity this presents a statistical problem. Any depression of nominal output will tend to depress productivity as it tends to produce a deflator which is itself understated. The net result is that productivity is understated.

To confirm this view it is useful to compare the third and fourth quarters of 2016. In the third quarter, GDP rose by 3.3% and the fourth by only 2.1%. Overall productivity in the third quarter went up by 3.3% but only 1.3% in the fourth quarter. It is highly unlikely that the quarterly change in productivity was different by 2% in such short a period. More likely the effect was due to changes in demand. This can be confirmed by examining GDI (Gross Domestic Income) in the preceding quarter. In the quarter that preceded the third quarter, GDI went up by \$295 billion and in the quarter which preceded the fourth quarter, it went up by less than half or \$146 billion. This meant there was an additional \$149 billion of revenue to be spent in the third quarter compared to the fourth.

Capitalism has great difficulty measuring productivity despite all its statistical tools and methods. Only when prices are tied to actual costs of production, and money becomes invariable, can productivity changes be measured directly by the price mechanism. But that requires a different society, a socialist society free of exploitation. In the mean-time, capitalism will manipulate the value of money to defraud the working class making it difficult to measure productivity accurately. However, despite the murky productivity figures, the fact that nominal rates of productivity are also flat-lining, suggests capitalism's footing remains precarious.

My prediction of a possible correction to the US markets in October was not whimsical. Retrospective data proved how vulnerable the real economy was at the time. The mass of profits did fall. However, this market additionally runs on psychological factors fueled by benign interest rates. There is always a ruse to sustain the market: either Donald Trump will come good in the end or the FED will come to the rescue again or the Chinese will reflate.

What is true is that the brief reflation period is over. Its barometer, commodity prices, are tumbling once again. Bell-weather commodities like oil and copper have fallen below their pre-Trump and China reflationary levels. Raw materials are always a forward-looking indicator, because raw materials mark the start of the production process and their sharp fall indicates a slow-down in the process of production itself.

China, the year of the re-election of Xi.

CCP chloroform replaces the Trump smelling salts. 2017 is the year during which the Chinese Coputalist Party (CCP) holds its Congress at which time the pre-ordained re-election of Xi will take place. Nothing will be allowed to compromise this Congress or overshadow Xi's second coronation. So, any downward movements are smothered at source. Whereas the S&P has risen 7% the Shanghai Composite has fallen by 3% this year and is now 6% below its peak in 2016. The downward steps have been gentle with only one intra-day fall of 1% that was quickly pounced on and reversed by state backed investors. It is of course incongruous that an economy which grew 6.9% in the first quarter should manifest a fall in its stock exchanges, whereas the U.S. economy which grew at only 0.7%, should see a sharp rise in its share prices.

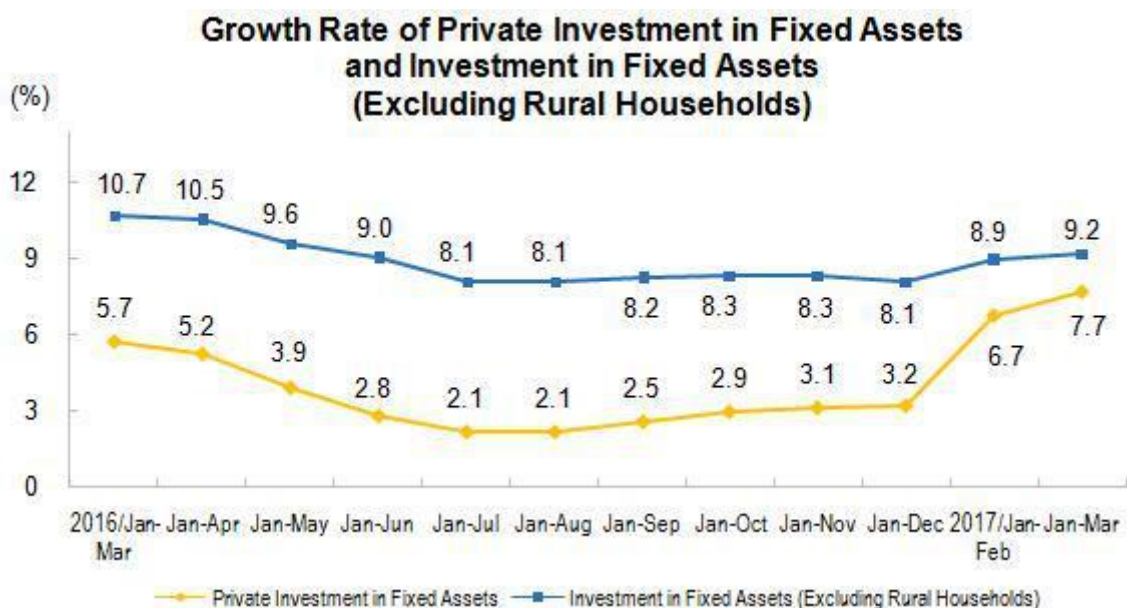
The same is true of Chinese house prices. The 35% annualized house price increases in Chinese Tier 1 cities has been reduced to single figure rises over the last two months and the volume of sales have been reduced to a trickle. This is not due so much to the efforts of city governments to curb the speculative bubble as it is to the absolute level of prices and rising interest rates. In addition, car sales have slowed down. In March car sales were up less than 4% on the corresponding month the previous year. (ChinaAutoWeb) This rate was less than half that of January and February.

Profits rebounded by 23.8% during the first quarter, once again flattered by depressed profits in the first half of 2016. The rise in profits would have been even higher had March's profits not fallen 3.2% month on month. Just as the price of oil boosted S&P, so higher commodity prices boosted profits in the primary sector by 32% thereby inflating SOE profits by 75%. Private profits increased by much less at 14%. More ominously this rebound in profits was not replicated in the high-tech industries. *"The manufacture of electrical machinery and equipment increased by 4.7 percent, that of manufacture of computer, communication equipment and other electronic equipment increased by 6.9 percent."* (Industrial Profits Increased in the First Three Months of 2017, National Bureau of Statistics of China, 2017-04-27.) In other words, the sectors of industry that the CCP is prioritising, and which are most exposed to the world economy, showed little improvement in profit even when set against a lacklustre first half last year. Finally, the upward movement in profits appeared to have stalled in March underlining once again how pivotal this month may turn out to be.

The upward movement in profits may also have reduced the reliance on debt. In the first quarter, banks increased loans by \$613 billion compared to over \$700 billion for the same period last year. Within this aggregate, the rate of increase for mortgages (real estate loans) was 26.1% - unchanged. Credit expansion by the shadow banking system for the first quarter is not available. Overall debt grew by 12.5% (CHINADAILY.COM 2017-04-15) which adjusted for nominal GDP growth, meant a growth rate of only 2.5%. It is likely that this reduction in credit expansion adding to that of the USA will squeeze future world growth. It may be an indication that with interest rates rising around the world, except in Europe and Japan, credit expansion has run its course leaving Chinese corporations the most indebted in the world.

Turning to investment, investment increased as well. However, as the graph below shows, the rate of increase did not return to levels seen in early 2016. (Source: National Bureau of Statistics of China, 18 April 2017)

Graph 8.



The pick-up in the growth rate of investment was primarily due to a rise in private investment. Private investment doubled the rate of its investment during the first quarter. This contradicts the view that the rise in investment was primarily driven by SOE (State Organised Enterprises) investment. Within these figures, the bulk of investment took place in the service sector where private companies predominate. This

quarter also marked the moment when total investment in the service sector overtook investment in industry. As it takes half the investment in the service sector to produce one job, this change in the destination of investment may explain the reasons why employment is rising while productivity is falling.

Two specific industries stand out. Though the computer and electrical equipment sector increased its profits by only 4.9%, investment there surged by 26.8%, while investment in the critical construction industry fell by 20.7%. It could be argued that this is a rebalancing of the economy away from housing or it could be argued that one of the growth props of the economy has been kicked away.

It also reflects the tightening of credit conditions in China. For the first time interest rates are rising sharply. This is not only due to measures taken by the PBOC (Rich People's Bank of China) but corresponds to actual risk. While most commentators are sanguine about the prospects for the Chinese economy, insisting that its current robustness can absorb tighter credit conditions, a reduction in credit growth is bound to impact on the economy. Just as the expansion of credit has a multiplier effect, so too has contracting credit, only more so.

In many ways, speculation has taken over from corruption in China, and its collapse could impact the economy severely. The three key ingredients for speculation are excess profits/savings, leverage and low interest rates. With two of the three - leverage and low interest rates - subsiding, the whole economy can unwind as has been the case with raw material prices. The fall out will impact the world economy and will not be limited to China even though it is Chinese capital which is most at risk.

Britain.

The little tale that Theresa Mayfly tells, that she decided to call an election while walking in Snowdonia, is the fairy tale told to children and indicative of the contempt with which she and her Tories hold the electorate. It was not the need to increase her majority to strengthen her hand in the Brexit negotiations that changed her mind, it was her fear that she would lose her majority after the CPS (Criminal Prosecution Services) said it had come to a determination whether or not to prosecute the electoral fraud committed by the Tories during the last election, wot did it,. It was not the need to appear tough that changed her mind, but the realisation that soon Britain would be shown up as isolated and weak in the Brexit negotiations. It was not the need to build on economic success wot did it, but the realisation that from now on bad economic news would come streaming in undermining the Tory claim to be good economic managers. The fact that she had such a large lead in the opinion polls was the least of her concerns. Living on borrowed time was.

In the first quarter the Brexit effect finally made itself felt. Up to then the effect was subterranean impacting mainly on the poorer section of society. On the surface, the weak Pound drew in the rich tourists to feast in the various emporiums London offers. But in March, this effect was insufficient to offset the underlying trend. Retail sales in March fell 1.84% (ONS) month on month while private car sales fell a staggering 28% in April, stalling annual growth to 1.1% in what had been the hottest car market in Europe.

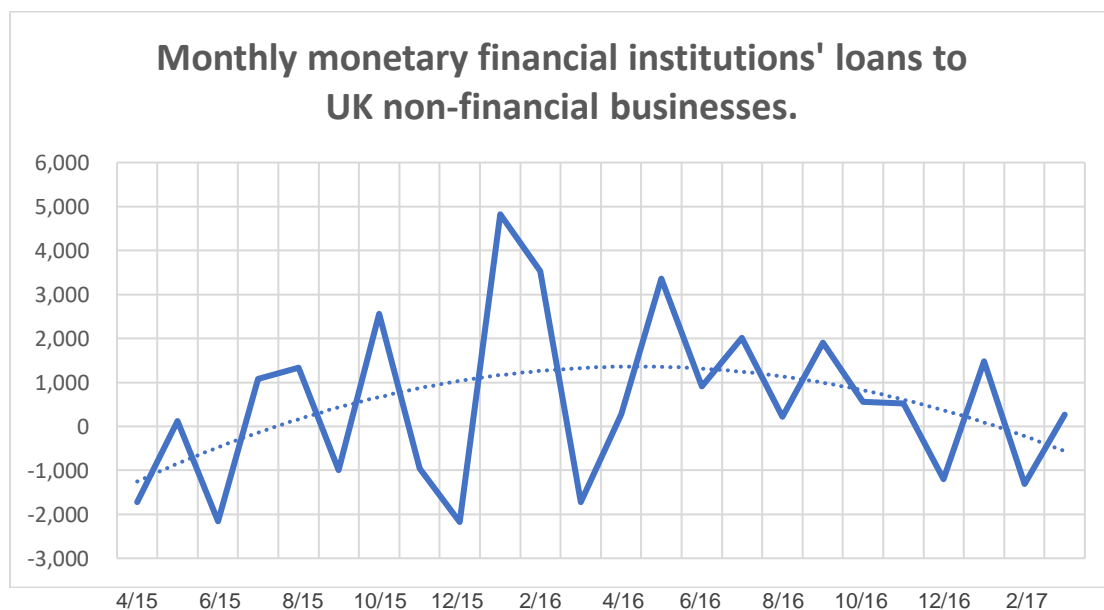
Even sacred house prices were not immune. House price falls in March and April brought house price inflation down to 2.6% with the expectation that it would fall further to 2.0% for the year (Nationwide). This will mean that for the first time since 2011, house price inflation is expected to fall below consumer inflation. Rents followed suit especially in London. Average rents in the capital fell from £1,297 a year ago to £1,203 in March 2017, with rents falling by 6% in March alone (Your Move). The RICS Q1 survey of commercial property showed prime and secondary locations in London covering office and retail space, softening. The Bank of England *Agent's summary of business conditions* showed a cautious outlook for commercial property in the city of London against a background of falling rents.

It has to be recognised that this softening process is in its early stages and that the impact on the balance of payments of a shrinking City of London has yet to be felt.

Consumer Credit went up by 8% in the year to March 2017 or by £539 per household. Average credit card debt exceeded £2500 for the first time. Total personal debt is \$1.529 trillion with interest payments exceeding £50 billion. Over the last year debt enquiries with the CAB went up 12%. (All figures from The Money Charity themoneycharity.org.uk/money-statistics) In March the percentage of households in rent arrears in London was 9.05%. (Your Move) As in the US, sub-prime auto loans are a ticking time bomb. Nine out of ten private car buyers use car loans which added up to £31.6 billion in 2016, an increase of 12% from the year before. (Guardian 10 February 2017) As in 2007, lenders remain sanguine, arguing that at £150 billion, car loans are a small fraction of mortgage loans. However, personal debt is sufficient to wipe out the capital of UK banks should there be a spike in defaults.

In the mean-time non-financial corporations repaid their debt at an accelerated rate, which means they are not investing in the future. (Bankstats [Monetary & Financial Statistics] - March 2017 – Bank of England) This trend is shown in graph 9 below with data taken from Table A8.1. covering the period April 2015 (4/15) up to March 2017 (3/17).

Graph 9.



The trend in net lending begins its fall after the referendum results are announced at the end of June 2016. Over the last six months, the average net loans made per month was below £50 million, an insignificant amount. This adds to the credit contraction mentioned earlier for both China and the USA, leaving only the EU and Japan adding to credit via their respective central banks.

In conclusion.

It is incontestable that profitability rebounded in the first quarter, the height of the reflationary interregnum. This upsurge in profits has not translated into increased investment. One of the primary reasons is the slowdown in globalization. Investment remains entangled in the under-growth of

national legislation. Donald Tusk the EU commissioner, continued his weight bearing exercises, by waving the 2000+ page trade treaty between the EU and Canada in the face of Theresa May. This is testament to the size and degree that national peculiarities abound in the world economy, and the myriad of local interests that must be placated in any negotiation.

If capitalism is to continue growing it needs to expand its investment, but it cannot do so if economic autarky deepens, driven by the growing national resentment against the results of globalization. The election of “my country first” politicians or at least their rising popularity, testifies to the direction of the political tide. In the end, when prime ministers and presidents are faced by the contradiction between my country first or profits first, they will end up supporting the latter. Even the president of the most powerful country in the world, Humpty Trumpty, is starting to do a U-turn on his promises of putting America First (surely North America First as America includes every country from Chile to Canada).

China remains at the center of the world economy. Nothing will be allowed to dampen the (rich) People’s Congress later this year or the competency of Xi’s economic management. If the monetary authorities are tightening up to avert leverage bringing down the economy, the side effect will be slower growth for the world economy. The increasingly erratic nature of the Chinese economy, where the alternating phases of deflation and tightening are increasingly compressed speaks to the increasing difficulty the state has in managing the economy and steering its direction. The Chinese economy’s speed wobble is intensifying.

China and the US are the alpha and omega in the spectrum of international capitalism. Whereas the Chinese state is wrestling with the law of value, the new US Republican administration wants to give free reign to the law of value by further reducing the role of the state. In the former case the battle is futile and in the latter catastrophic. March and April can be seen in two different ways. Firstly that the decline was merely a pause in the upward reflationary cycle, or alternatively, that the upward inflationary cycle could not be sustained. If it is the latter, then at best the world economy will return to its comfortable low interest rate bed there to lie comatose, or at worst a correction remains probable.

Brian Green 7 May 2017.