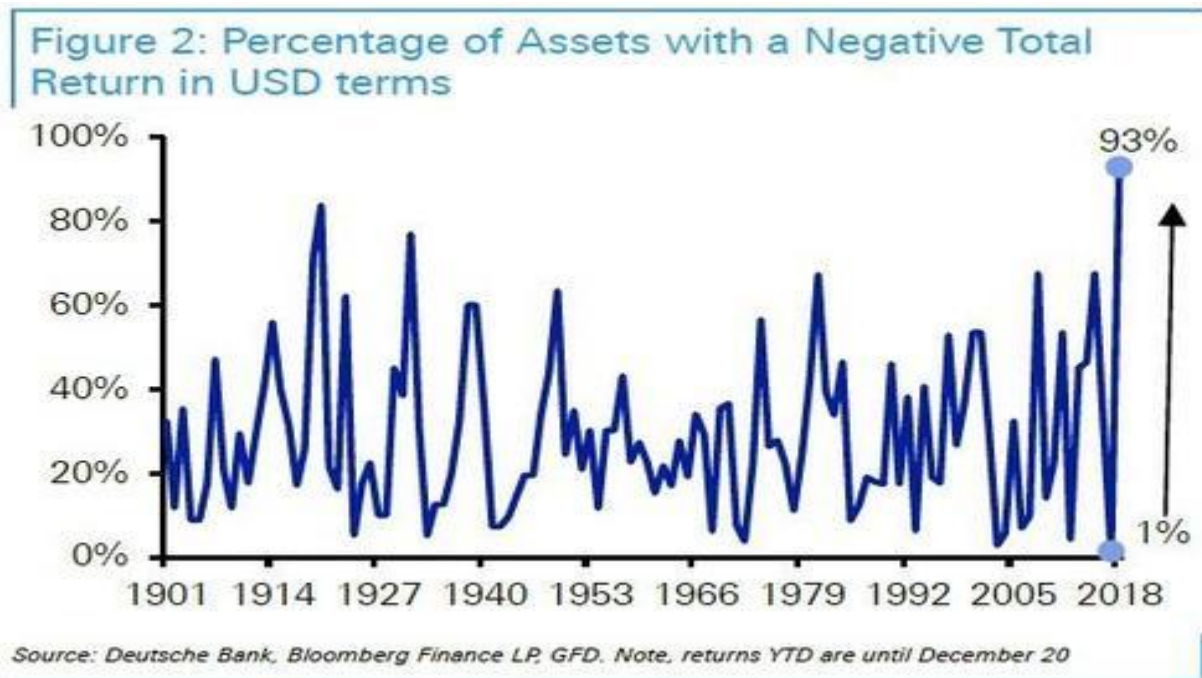


THE NEW YEAR: 2019 OR 1929 OR 1937?

Santa's present to the capitalist class was a loss of over 18 Trillion Dollars globally as asset markets deflated, an amount exceeded only in 2008. What we have seen thus far is only the first phase of the Bear Market. Phase 2 will only occur when it becomes clear how vulnerable this unequal world has become to collapsing asset bubbles. Phase 2 will not only be driven by corporate insolvency, but, will be compounded by the collapse in spending by the top 10%, whose consumer habits are formed from the "capital gains" provided by these asset bubbles.

In my previous posting I presumed that the FED was unlikely to raise interest rates in December. They were unwise to have done so. The result was the worst December for stock exchanges since 1931. Shares in China are down 25% year on year, Germany is down 18%, Japan is down 14%, the "Footsie" is down 13% and the US is down on average around 6%. As Graph 1 below shows, 2018 and 2017 could not be more different. In 2017, when the talk was of a synchronised world recovery captained by the masterful Trump, only 1% of asset markets fell for the year, a record low. Fast forward to the 20th December 2018 and the reverse is the case, a record 93% of asset markets are down. This compares to around 70% in 2008 and higher than at the outbreak of both world wars as well as 2009.

Graph 1.



<https://www.zerohedge.com/news/2018-12-21/2018-officially-worst-year-record-93-all-assets-down>

The 93% fall in asset markets has a hidden significance. It demonstrates that the unfolding crash does not have an epicentre as in 2008, when it was focused on sub-prime mortgages in the USA. It demonstrates that it is global and that it is affecting all the major economies and regions simultaneously including the USA. The world may not have benefited from a synchronised global expansion in 2017 but it is certainly imperilled by a synchronised global crash in 2019.

Will it elicit a global response, a synchronised stimulus by global central banks and governments? That is the key question at a time when the world economy is being fractured by trade wars and national autarchic economic policies. This fracturing makes a concerted response more problematic and

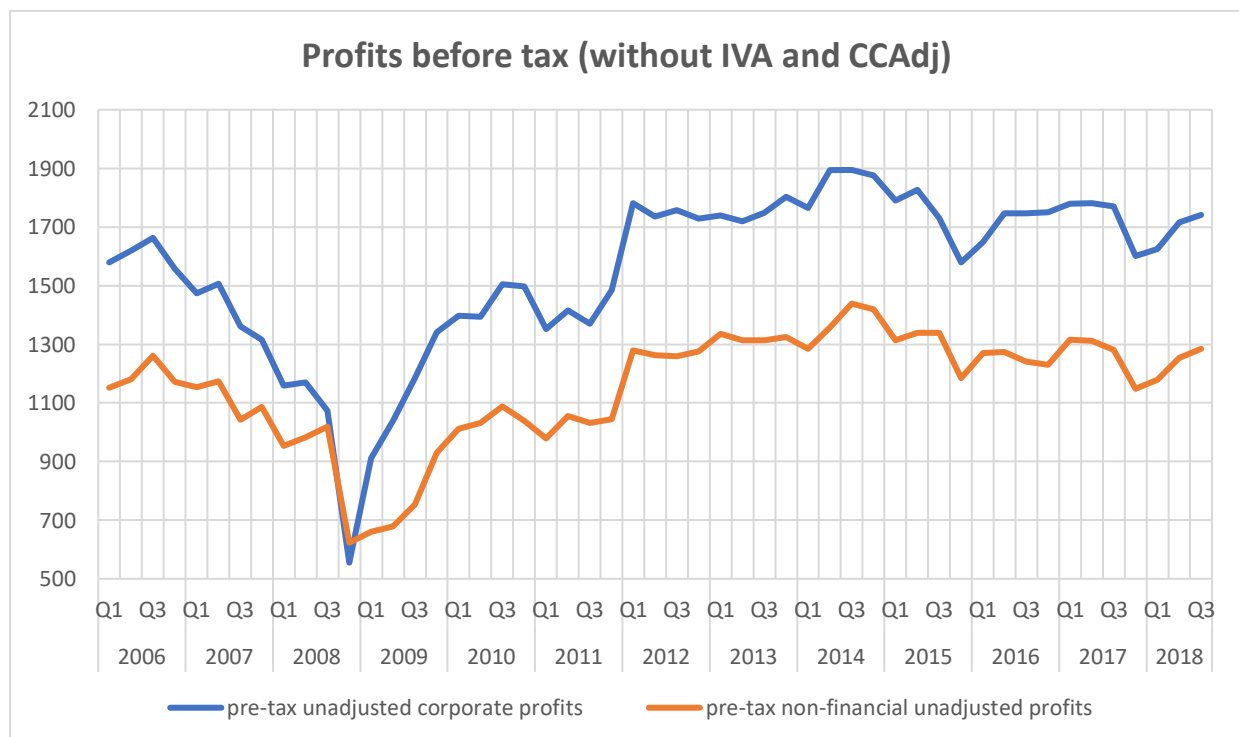
therefore unlikely, as it will be predicated on ending the trade war. This is a concession the Trump administration will be unlikely to concede as its foreign policy imperative is to restrain Chinese technological development at all cost.

There are three elements to the unfolding financial crash. The first is corporate debt exposed by falling global profitability. Secondly the housing pandemic in China. Thirdly, as has been mentioned in previous posts, the spending behaviour of those dependent on the paper fortunes generated by asset bubbles. These three ribs will form the shape of any future financial emergency. The reason for the tumble by Wall Street immediately before Xmas was the announcement by Mnuchin, the treasury secretary, that he had held a conference call with the heads of the top six banks who assured him they had sufficient liquidity to operate normally. As all financial crashes begin with a liquidity crisis, the revelation of this call had the opposite effect, it spooked the markets.

The latest earnings insight by FactSet revises earnings per share for the current quarter from an original 16.8% to 12.4%. Most of this 25% downward revision has occurred in the last fortnight and a further revision of this magnitude can be expected shortly because of the collapse of oil and banking profits. Of this 12.4% increase, FactSet estimates 7.3% is due to changes in tax. This is a much lower percentage than the one provided by the more authoritative BEA reporting of corporate profits. If we factor in inflation and share buy backs then FactSet is in fact reporting no real profit improvement.

FactSet’s analysis relates to the largest public corporations only, which tends to overstate profitability in the US economy as a whole. By the end of this year, the total fall in underlying corporate profits for this quarter is likely to reverse the growth in corporate profits during 2018/2 and 2018/3. In other words, it will take only a 6% fall in corporate profits this quarter, which is highly likely, to reverse any profit growth for the entire year. This can be determined from Graph 3. Despite the rise in profits in quarter 2 and 3, pre-tax corporate profits in nominal terms is still down 8% from its peak in 2014 and in real terms 14%. For the non-financial sector, the figures are 11% and 16%.

Graph 2.



(Source: Table 1.14, released 21st December 2018, line 32 for corporate and line 37 for non-financial.)

In September, FactSet originally predicted earnings growth for 2019/1 of 7.2% and for 2019/2 of 7.5%. This fall represents the elimination of the boost of “7.3%” contributed by the tax changes since 2017/1. In their latest report the expected rise in profits has now been halved to 3.5% and 4.1%. In other words, at best no underlying growth in profits. Based on FactSet’s projections, even without a financial crash, underlying corporate profits over the next 6 months are on the decline. The same is true of China, Japan and Germany. In Japan third quarter profits fell 30% back to levels of a year ago.

Graph 2.



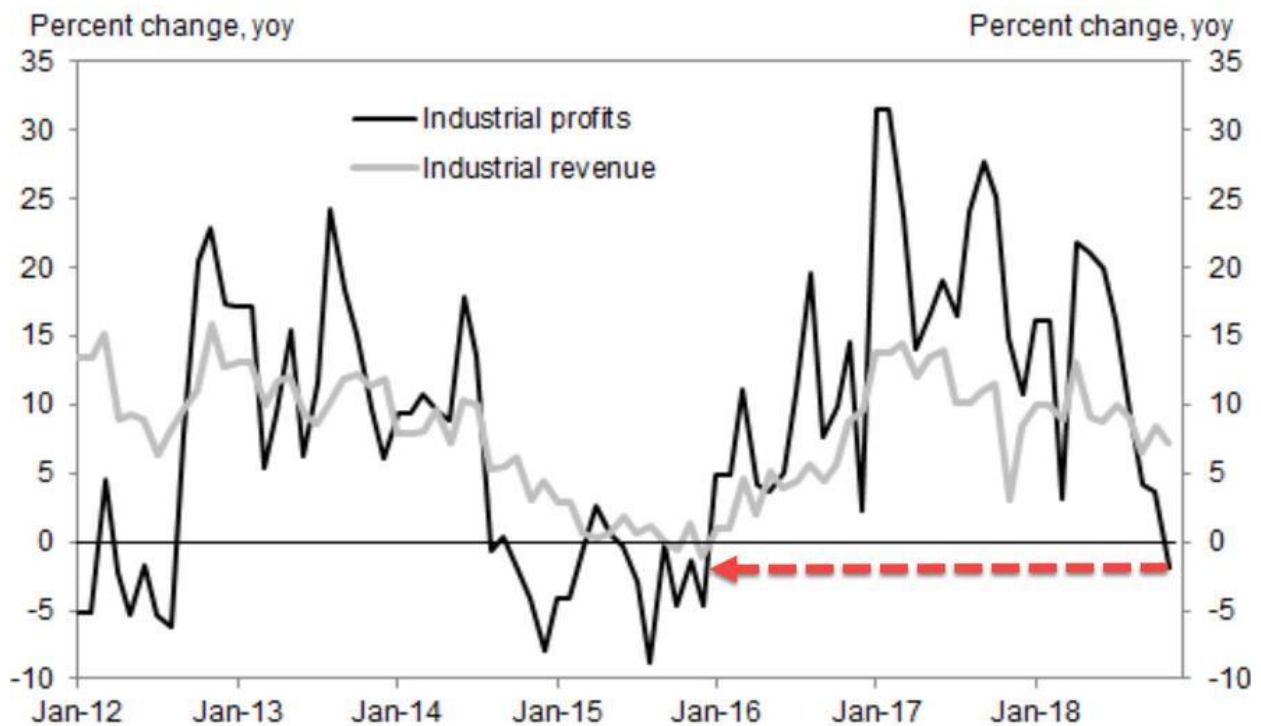
The same trend is apparent for Germany as Graph 3 shows.

Graph 3.



Chinese Industrial profits, according to the Goldman Sachs’ recent analysis, fell for the first time, year on year. Profits growth which had been slowing throughout the second half of the year finally turned negative in November, falling by 1.8% This has not happened since the pseudo recession in early 2016. Rebased on nominal figures, the article concludes Chinese profit growth throughout 2018 was illusory. Finally, Goldman’s predicts an accelerating fall in Chinese Profits.

Graph 4.



(Source: <https://con.klee24.de/2018/12/27/china-industrial-profits-collapse-in-november-set-to-worsen/>)

In summation, beginning in the third quarter, and extending into the fourth, there is now a global contraction in the mass of profits resulting in an absolute fall in the rate of profit. This is of decisive importance as an absolute fall in the rate of profit, acting on investments, is the harbinger of recession.

The Chinese housing-market.

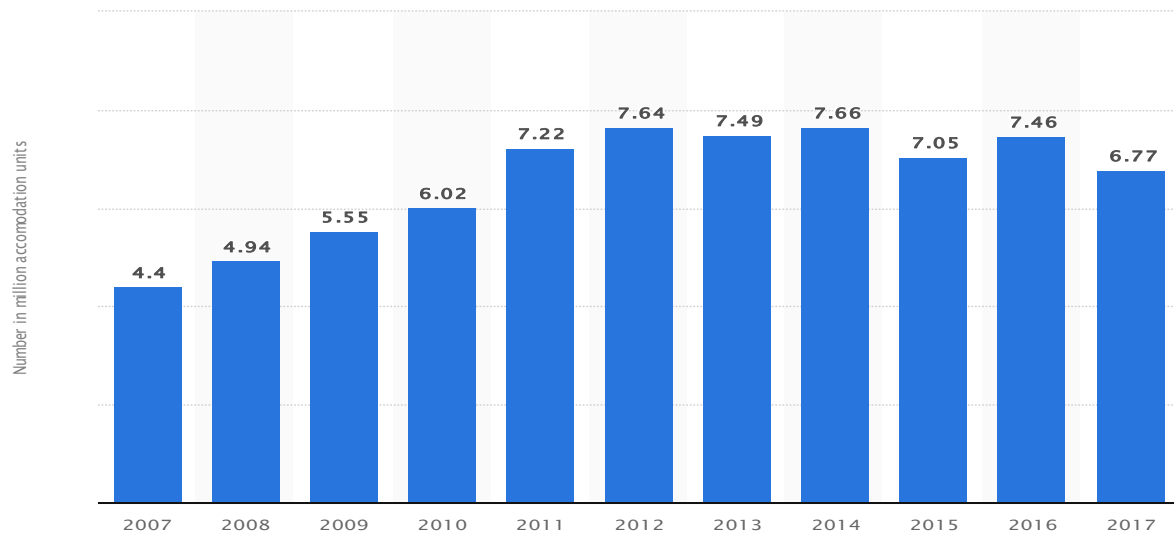
Turning to the Chinese Housing Market. The following quote was taken from Zerohedge, which, despite its libertarian politics, has had a number of interesting articles on China. *“Meanwhile, the latest China household finance survey conducted by the Southwest University of Finance and Economics, which was published last week, found that the number of vacant urban homes in China has risen to 65 million units in 2017 from 42 million units in 2011, with the vacancy ratio rising to 21.4 per cent from 18.4 per cent in the period.”* <https://www.zerohedge.com/news/2018-12-25/top-chinese-banker-warns-against-buying-property-because-theres-no-more-money-be> This is double the vacancy rate found in the USA.

The article goes on to discuss the role of the Chinese state’s response to the overbuilding of residential properties. For three years the government has been buying up increasing numbers of properties from private developers or subsidising their rental. The result is that 50% of public housing had been sourced from the private sector at inflated prices by 2016, resulting in local government debt more than doubling between 2014 and 2016.

Of course, an impending housing crisis has been expected in China from at least 2011. Almost as many predictions have been made for such an event as houses built. The result in fact has been subtler. Instead of an outright crash, there has been a significant deceleration in the rate of construction. Whereas the number of new dwellings increased by 73% (unadjusted for floor space differences) between 2008 and 2012, since then the number of homes built has fallen by 11% (see Graph 4 below prepared by Statista). The latest data for the first 9 months of 2018 by the National Bureau of Statistics

of China shows no improvement on 2017. Had the earlier pace continued, China would have built over 10 million units in 2017, an increase of 50% over the figure actually built in 2017.

Graph 5.



This reduction in residential construction affects the global industrial economy. To put the volumes of this construction in perspective a few metrics need to be explored. China built 6.77 million residential properties while the US built 1.15 million (2017). China built 6 times more properties but the average size of a US property at 193 square meters was 3.5 times the size of Chinese property. Thus, adjusted for floor space China was building 1.7 times more properties not 6.0 times. (Sources: for Chinese Property statistics <http://data.stats.gov.cn/english/easyquery.htm?cn=B01> and for US property statistics <https://www.census.gov/construction/chars/highlights.html>)

However, figures that adjust for floor space do not complete the comparison. Most Chinese developments are high rise, while in the US 69% of new construction are single family homes usually limited to two stories. The rule of thumb for adding each additional floor to a building is an additional 5% per floor because of the need to use additional materials together with services like lifts, sewerage, water pipes and so on. Thus, it is likely that the material used in Chinese residential construction per unit is double that of the USA, meaning that the Chinese use of building and ancillary materials is 3 to 4 times greater in China compared to the USA when adjusted for floor space as well as floors.

This is confirmed by the raw consumption of key materials like cement, steel and copper. Typically, China produces and consumes five times as much of these materials as does the US. The higher figure of five takes account of the larger and more numerous infrastructural projects being built in China as well as commercial building. For example, of the 144 skyscrapers over 200 metres, China built 76, the US only 10. Accounting for nearly half of global construction, any changes to construction in China reverberates throughout the world economy in a way changes in the US does not. This is why the recent slowdown in construction in China has prevented the repeat of the commodity-boom which occurred in the period up to 2014, and, why consequently shares in the global miners trade at reduced multiples.

Given the fall in every asset class in China, from the stock exchange to commodities, it is likely that housing will not be immune. Traditionally, the money ball in China, valiantly chased by the financial authorities, has rolled from one asset class to another deflating and inflating them in turn. What is

unique today is that this ball is no longer rolling. All asset classes are deflating simultaneously and that has not happened before. More ominously for China this is happening despite the tax cuts and more accommodative financial posture of the Peoples Bank of China.

It is this unique situation which for the first time puts Chinese financial institutions in harm's way. Of course, it can be argued, as it has been, that most of the debts emanate from state bodies. Bad debts can simply be written off. After all, does this not happen in recessions in capitalist economies where capital is destroyed by insolvencies? The only difference being that there it is individual capitalists who pay the price. Indeed, these insolvencies play a vital role in unclogging profitability by devaluing the stock of capital (Marx).

Can't the same be said of China. Why not replicate the events at the turn of the century when the Chinese state did just that, and, when it used the opportunity to simultaneously restructure industry? This fails to understand the role played by the rate of profit in directing investment both in terms of direction and in terms of quantity. In China, the role of profit is mediated by state-based investment. The result is over-investment and duplicated investment. The consequence of which is the build-up of debt, because these investments cannot be cleared by future income.

Under such circumstances this should lead to a devaluation of that investment in line with its future income stream. However, the purpose of capitalism is not to continuously devalue its capital, that is waste it, but to up-value it in terms of a rising income stream, or in the words of Marx, with a rising rate of profit. If China continues to operate on the basis of devaluing its investments, the result will be a sustained depression in the rate of profit and with it an economy losing its vitality. China may avoid breaking a leg and stumbling as happens in most capitalist economy, but it will do so at the expense of becoming increasingly anaemic, which means China will no longer serve as the driver of global industry.

Luxury spending.

The surplus of society is owned by the capitalist class who can do one of three things with it, firstly invest it, secondly, consume it unproductively (luxury spending) and finally speculate with it. All three streams are regulated by the rate of profit. A rising rate of profit encourages investment which expands production and with it, generally, the mass of profits. In turn a rising mass of profits lifts the valuation (multiple) of primary fictitious paper (shares and property primarily) buffering speculation. The rich feel richer and they then increase their unproductive consumption. The opposite happens when the rate of profit falls absolutely. This discourages investment, profits fall and valuations contract as the outlook dims. The capitalist class feel less rich and spend less on themselves.

Now it is sometimes argued by Marxist that a relative fall in the rate of profit in some sectors of the economy encourages capitalists trapped there to speculate in order to supplement their industrial profits. This may be the case, but it is not significant. A low rate of interest rather than of profit, is the main cause for speculation. Low interest rates imply that money is cheap and freely available to people of property creating an orgy of speculation. In the words of Marx: *"The cheapness of capital gives facilities to speculation, just in the same way as the cheapness of beef and beer gives facilities to gluttony and drunkenness."* (Chapter 25, Volume 3)

What concerns us in this article is the element of luxury spending. The top 10% spend as much as the bottom 80% on retail and services. Over the course of 2018 wages rose a paltry 2.6% in the USA, barely covering inflation if at all. On the other hand, financial wealth until recently was rising at a rate close to \$5 trillion p.a. (Credit Suisse *Global Wealth Report 2018*, page 5. <https://publications.credit-suisse.com/tasks/render/file/index.cfm?fileid=B4A3FC6E-942D-C103-3D14B98BA7FD0BCC>) That was

until the 4th Quarter when asset markets fell. Already the fall in global wealth this year exceeds the \$14 trillion wealth fictitiously generated in 2017.

The same is true in the USA. From a gain of 12%, stocks are looking to have fallen by 6-7% this year. The key question is; will this fall impact spending by the capitalist class and their rich entourage. In January these legal thieves will be receiving a summary of their portfolios for 2018 which makes the first quarter decisive. An examination of BEA Table 1.2.2. *Contributions to Percent Change in Real Gross Domestic Product by Major Type of Product* reveals that already in the third quarter personal consumption expenditures had fallen 4% from the previous quarter. In fact, strip out the contribution made by inventories and the growing fiscal deficit, and this reversal in sales would have yielded a GDP rise of only 0.5% rather than 3.4%.

There are two current sources of data for recent holiday sales, a barometer measuring the confidence of the US consumer. Master Card's "Spending Pulse", puts total US sales (excluding auto sales) up 5.1% compared to the previous year (sales up to 24th December). On the other hand, First Data with their excellent holiday spending dashboard based on 45% of card sales in the US in real time, puts sales up only 3.4% for the period ending 26th December and 3% for the 31st December itself. (It is worth visiting this dashboard to obtain up to date sales data. It is a real tribute to the internet. <https://analytics.firstdata.com/holidayinsights/2018/tps/index.html#/>) Much of this increase originated during "Black Friday" and "Cyber Monday" when sales rose by 6.1% and 5.0%. For the whole of December, sales seem to be trending in line with or just below 2017 levels.

There has thus been only a deceleration in the pace of spending. If this marks a reversal in trend, and sales fall in the first quarter of 2017, then the US economy will have entered the second phase of the unfolding crisis. Just as in 2016, the first quarter of 2019 has added significance.

Discussion.

Beginning in 2014, after the FED announced the ending of quantitative easing, a discussion debating whether this move was premature. Thoughts turned to the Great Depression in the 1930s. What had been forgotten about the Depression was now brought to light, namely the recession in the USA in 1937. No recession in history has been surrounded by so many myths. Three causes have been popularly ascribed for precipitating this recession, firstly, the sterilisation of inflows of gold, the ending of the fiscal stimuli and finally the tightening of bank reserve requirements. As each of these causes individually seems to be insufficient to have provoked such a deep recession, a combination of all of them, or their cumulative damage has become accepted wisdom.

What concerned the anxious authors of 2014, was the withdrawal of liquidity that occurred with the ending of quantitative easing. The feeling was that it was premature as in 1937 and that it would spark a repeat of 1937. Many Marxists were drawn to analogies with 1937, including myself. In his recent article: *Forecast for 2019* (<https://wordpress.com/read/feeds/313842/posts/2116702459>) Michael Roberts repeats his view that 1937 is the likely outcome during 2019: "*If the Fed continues with its policy hikes, just as in 1937 during the Great Depression of the 1930s, it threatens to provoke a sharp downturn, not just in the price of fictitious capital but also in the so-called 'real' economy.*"

On deeper reflection I am dissuaded that what is coming is another 1937. The only two similarities I find with 1937 is monetary policy and Roosevelt feeling beleaguered by the success of the statist policies of Hitler and Stalin, particularly the industrial rise of the USSR. He felt that "liberal democracy" was threatened by the industrial successes found in Europe and Asia. By implication, this need to be economically assertive represented the awakening of US imperialism to a perspective which recognised that the fortunes of US capital were now tied to remaking the world economy in its own

image. Today the same worldview prevails with regard to China, namely the need to strangle Chinese technological developments in order to prevent the mightiest industrial economy on the planet becoming its hegemonic economic power. On a more chilling note, the 1937 recession broke out three years before World War erupted.

But there the similarity ends. In shape the 1937 recession is more reminiscent of 2008 than is 1929. 1937 has little to do with the conditions found today. Currently “real” US GDP is 15.5% higher than 2008 whereas in 1937, GDP was only 5.5% higher than in 1929. Secondly, whereas there had been only two years of upturn prior to 1937, there has been eight years including 2018 currently. Of course, there were dissimilarities as well, particularly fiscal policy. Whereas fiscal policy was stimulatory up to 1937, when it was withdrawn, the opposite was the case leading up to 2008 when the federal deficit fell from \$413 billion to only \$161 billion between 2004 and 2007. (FRED table FYFSD).

The recession of 1937, which broke out 8 years after the 1929 crash, has been ignored, not because it resided in the shadow of 1929, but because unlike 1929 which endured, the 1937 recession was short and sharp. Nevertheless, it was as severe as the initial period of the 1929 crash. *The contraction’s dimensions certainly qualify it as a major bust. Real annual GDP fell by more than 5 percent between 1937 and 1938. Real gross business product declined by almost 7 percent; real gross private domestic investment by 21 percent; real private investment in producers’ durable equipment by more than 31 percent; and real private investment in new industrial structures by more than 50 percent. The Federal Reserve’s index of industrial production dropped from 8.3 in the spring of 1937 to 5.6 in May 1938—a plunge of 33 percent...* Foundation for Economic Education. <https://fee.org/articles/americas-depression-within-a-depression-193739/>

It is the shape of the 1937 recession as well as the US government’s response to it that is so similar to 2008. It took just two years after 1937 for the US economy to recover lost ground compared to the three years in 2008. In both cases it took a reversal in monetary posture by the central bank as well as state support to accelerate the recovery.

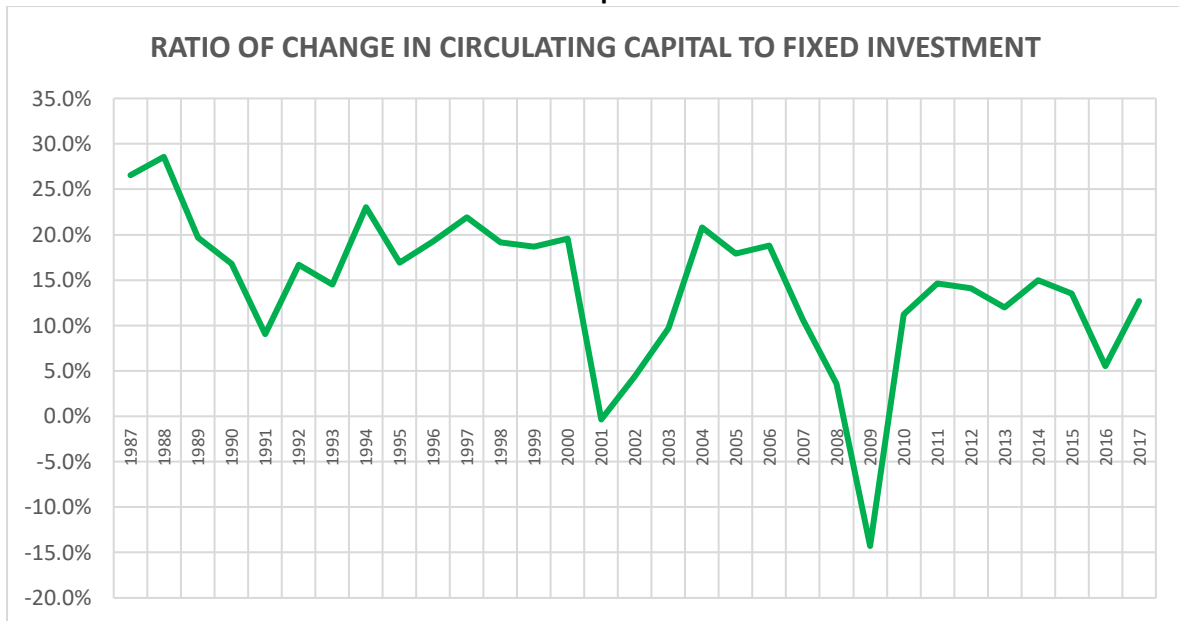
It follows that if 2008 was closer to 1937 could it be the case the next recession which is unfolding will be closer in scope and duration to 1929. This conclusion cannot be dismissed despite the fact that every recession is concrete, it contains its own unique DNA. The reason that this conclusion cannot be dismissed is that the conditions prevailing in the world economy are now more acute than in 2008 and have built up over ten years. Thus, the depression that Michael Roberts talks about post-2008 may in fact only occur after 2019.

There are a number of reasons to support this view. Firstly, the mass of profits globally has not recovered from their peak in 2014. This has primarily been due to the deceleration in the annual rate of turnovers which has undermined the rate of surplus value. The rate of surplus value differs from the rate of exploitation because the former contains turnover as a multiplier, whereas the latter does not. It is simply wrong to substitute the rate of exploitation for that of surplus value. I have written extensively on this subject on this website. This distinction has been ignored by most Marxists simply because they believed turnover could not be estimated.

This is exemplified by an otherwise excellent article found in the compilation entitled *WORLD IN CRISIS, A GLOBAL ANALYSIS OF MARX’S LAW OF PROFITABILITY* edited by G Carchedi and M Roberts. In Chapter 3, Jose A Tapia reviews the history of the relationship between profit and investment and he provides data on the volatility between profits, investment and wages. His conclusion: as profitability is the most volatile of these three factors, this helps explain why it is a leading indicator and why investment is a lagging indicator.

He is partially correct. Compared to fixed investment, profits are more volatile. But there are two aspects to investment, fixed and fluid, and by fluid I refer, as Marx does, to circulating capital. Fixed capital is far less volatile than circulating capital as the graph below shows. Circulating capital whips around in the wind like a chaotic sail. Whereas fixed capital is sticky, that is investment decisions are measured in years, decisions regarding circulating capital are made in months if not weeks. Furthermore, changes to circulating capital always pre-figure those made for fixed capitals.

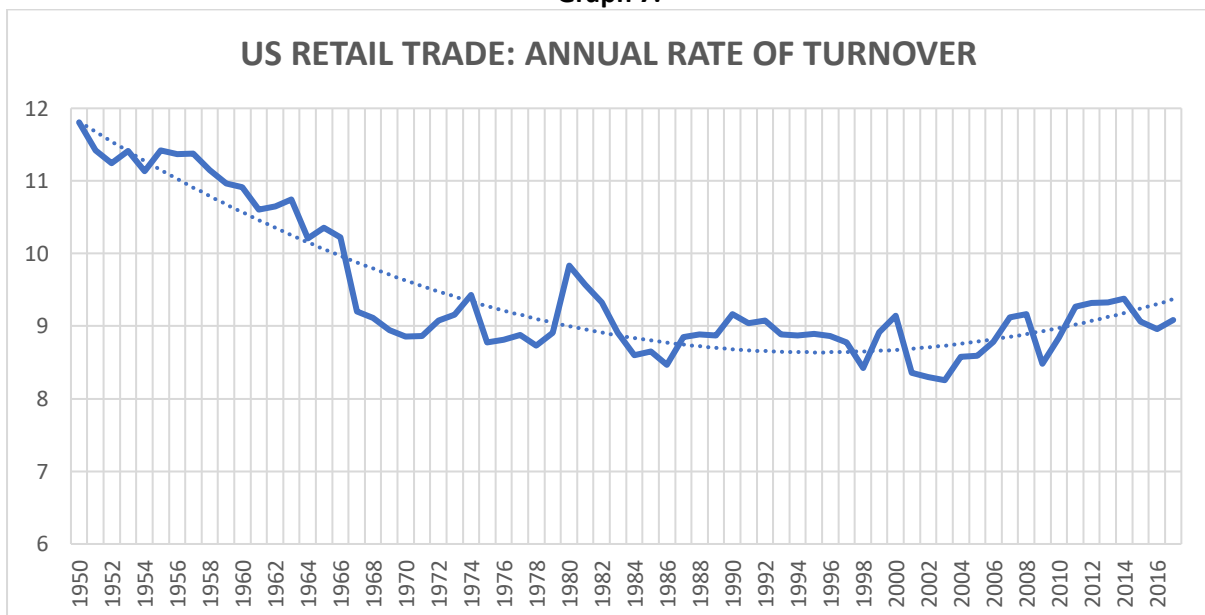
Graph 6.



(Source: See accompanying spreadsheet GO & GV 1987 – 2017)

While it is vulgar to describe the industrial cycle as an inventory cycle (Federal Reserve), it is not vulgar to describe it as predicated on the rate of turnover of circulating capital. It is the fall in the rate which provokes the credit crisis which can act as a precursor to a more generalised financial emergency. Conversely, it revives during the period of rising animation. This is shown in the Graph 7 which plots the annual rate of turnover for retail, the most sensitive and representative of all the rates of turnover.

Graph 7.



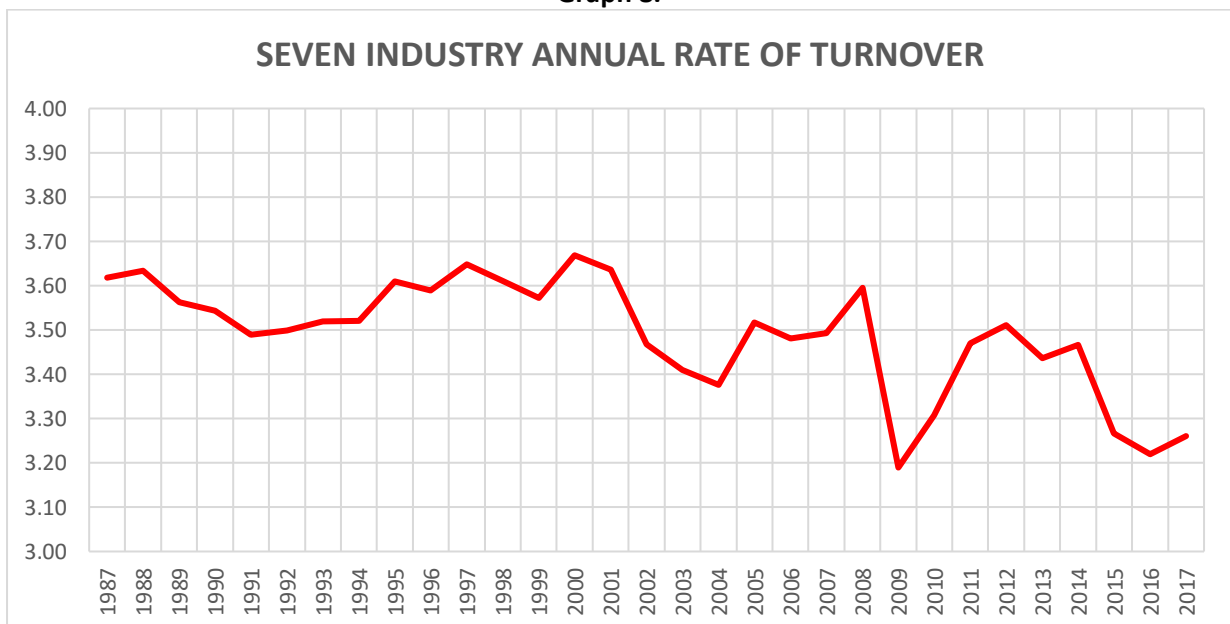
This graph was first published in an article on this website titled: *PAUL MASON AND THE CASE OF THE ZERO MARGINAL COST*. It demonstrates that the rate of turnover peaks in the year prior to the recession and revives only as part of the resolution of the recession it helped to cause. The last sentence contains the dialectical relationship of turnover as cause and solution. Changes to turnovers do not directly cause a recession. They are the lever, but all levers require a change of effort to move them. That change is caused by the difference between the relative fall in the rate of profit and its absolute fall. One of the highlights of Mr Tapia’s Chapter is the evidence he presents, often at the hands of bourgeois investigators, showing that the fall in the rate of profit occurs first in heavy industry. This has a direct impact on circulating capital because it provides many inputs to industry.

It would be more accurate to say; that the rate of profit during the upside of the industrial cycle falls first and most swiftly in those areas with the highest composition of capital, or alternatively, where the composition has risen quickest. Mr Tapia then goes on to show, again correctly, that this can occur even when the average rate of profit is rising. This fall in the rate of profit Marx described as the relative fall in the rate of profit. It falls not because the mass of profits is falling, but because the mass of capital in some sectors is rising faster. (Under these conditions there is often a breakdown in the process which equalises the rate of profit because of the rapid onset of this event, and, which is only subsequently resolved in the recessionary period itself.)

Whatever the case, the uneven fall in the rate of profit results in a disincentive to invest in these industries which Mr Tapia once again highlights in this valuable chapter. Such a sectoral fall in investment impacts the rate of turnover, because a deceleration in overall investment is always experienced as a fall in demand which extends the period of circulation of capital. At some point quantity turns in quality. If the deceleration in turnover becomes generalised, so that it takes longer to realise profits in all industries, then the mass of annual profits realised must fall and what began as a relative fall in the rate of profit now escalates into an absolute fall in the rate of profit, the trigger for a generalised fall in investment and therefore of recession.

This pattern can be seen in sharper relief if the period under observation is reduced as has been done in Graph 8. Turnovers peak in 2000, 2008 and 2014.

Graph 8.



(Agriculture forestry fishing and hunting, mining, utilities, construction, manufacturing, information, arts entertainment recreation accommodation and food.)

Attention needs to be focused on the period after 2014 since when there has been a sharp fall in turnover and with it a sharp fall in the mass of profits as found in Graph 2. (In the second half of 2018 turnover becomes complicated by the tariff wars which led to an increase in inventories intended to avoid hikes in tariffs in 2019.) What is interesting is that the fall since 2014 is of such magnitude as to be normally associated with a recession. This did not occur because of the supportive monetary conditions found in 2016 in China, the US, the EU and Japan.

Why is this important? It is important because the elongation of the period of production and circulation, the combined turnover, usually requires more circulating capital. The same capital, for example, that sufficed for an average 8-week turnover, now no longer suffices for a 10-week turnover. Under this stringency, more credit is needed pushing up interest rates, which may reach the point where it shatters the chain of credit. This did not happen as interest rates hardly budged.

Now it is important to recognise that there is a difference between a structural change in the rate of turnover and a systemic change. A structural change can result in a longer circulating period, or what is the same thing, a reduced annual rate, but with no necessary increase in the amount of circulating capital. For example, when production was first outsourced to China from the US the rate of turnover fell because what took a day's journey by truck within the USA, now took weeks in a container on a vessel plying between China and the US. Nevertheless, because the cheapening in material inputs outweighed the extra capital needed to finance the extra days of passage and port clearance, total circulating capital actually fell.

However, in the case of a systemic fall in turnovers, one responding to changed market conditions, an extension of the period of circulation is always associated with a rise in the mass of circulating capital as presented in Graph 6, where circulating capital rises or falls according to the duration of the cycle.

This is the primary reason that I have described the world economy, post 2016 as being stuck in the phase of rising or growing animation. (Marx's description of the six phases of the industrial, ne business cycle, can be found in Chapter 22 of Volume 3.) This is the reason why I suggest 2019 could be more like 1929 than 1937.

The deceleration in turnover, which is common to China as much as to the USA can be interpreted in one of two ways, both of which are ominous for the fortunes of the capitalist system. Firstly, that the current phase of globalisation is exhausted. That to increase the turnover of capital, the world economy needs to move towards a single market so that "just in time", which minimised working capital and made possible the international value (production) chain, can overcome its remaining national frictions. Of course, the opposite is happening today with the imposition of tariffs and shortly quotas.

Secondly, that the effect of monetary policies in 2016 which prevented a full-scale global recession has been the equivalent of a stimulant or pain-killer which has masked the underlying condition of the world economy making it appear it is fit for work, when it is not. Just as a fall in investment slows down the rate of turnover, so subdued investment will prevent a recovery in turnover. In other words, the subdued nature of turnover is a proxy for the subdued nature of investment with investment hobbled by the partial recovery in profitability post 2014.

It took the reduction in pain-killers, that is rising interest rates, to reveal that the world economy is riddled with debt. Of course, the central banks can increase their dose of pain-killers, but this masks the fact that the condition of the patient is actually deteriorating making more probable, that what

was once chronic and manageable, has now become acute and unmanageable. The world economy may have avoided 2016, but it is unlikely to avoid 2019.

The underlying condition of the world economy today is worse than it was in 2016. In addition, the pill cabinet is almost bare. Central banks do not have the resources they once had in 2008 to rescue the economy today. The US fiscal deficit is already 4.5% and heading for 5% in an economy which has not yet entered into recession. China's indebtedness means it is unable to finance the scale of infrastructural spending that revived global industry in 2009. It is in this context that the trade war between China and the US becomes scary.

Once the recession breaks out, this trade war will become flammable. Currently the tariff war is one of pressure. Its purpose: to force China to remember its station, that it is a mere contract manufacturer to the great and good multi-nationals, that it may only exist as a bottom feeder in the international value chain. The USA aims to prevent China seeking to rise above its station, to become the first amongst equals with its 2025 ambitions. It is in a word, the fight over control of the international value chain between those who monopolise it, essentially the USA, and those who would challenge this monopoly, essentially China. It is for this reason that it is wrong to argue that capitalism today shares too many interpenetrations and connections making conflict counter-productive. The international value chain may tie national economies together, but their economic prospects also depend on it, and for this very reason it will intensify the struggle to control it, not diminish the struggle.

When market conditions turn internationally, so too will the nature of the trade war. Then it will no longer be a case of struggling to command profits but to avoid losses. The purpose of competition changes from one of enrichment to one of survival where the object is to force your losses on to competitors. Capital needs to be destroyed but whose capital? In the end that can only be answered by military means, as it was in the Second World War, with the destruction of German and Japanese industrial assets. The coming recession, and with it the shrinking of the world market, means the market is no longer big enough for both a USA and a China.

Conclusion.

The whipping around of share prices over the last two weeks is synonymous with a bear market aggravated by unruly algorithms. The largest single day rise in the Dow Jones after Xmas was due to a \$64 billion buy order on behalf of pension funds seeking to re-balance their portfolios between shares and bonds before year end. It did not represent the floor for this bear market.

A fragile equilibrium exists. Asset markets are in line with expectations for the future. Currently, forward looking price to earnings ratios appear reasonable. For some investors this may represent a buying opportunity showing that capitulation has not been reached. In addition, ten-year bond rates which doubled between 2016 and November 2018 have now fallen back by over half a percent. In real terms, applying the GDP deflator, 10-year yields are no higher than in 2016 when adjusted for inflation and are thus supportive.

However, in uncertain times expectations can change rapidly as negative economic reports pile up. Over the last six months soft data reports, (surveys) were more optimistic than hard data, actual analysis carried out by the BEA, the Department of Labour and the Census Bureau. For a while it was appeared that the soft data was the leading indicator and it was hoped that the hard data would follow its lead. What has happened is the opposite, the soft data is following the hard data downwards.

This is exemplified by the two recent soft data surveys reported by regional Federal Reserve offices. The first was the report by the Richmond Fed which on its own in normal times would have been

sufficient to unsettle the market. *“Fifth District manufacturing activity weakened in December, according to the latest survey from the Richmond Fed. The composite index dropped from 14 in November to -8 in December, weighed down by drops in the indexes for new orders and shipments. At -25, the shipments index was its lowest reading since April 2009. Richmond FED December Survey)* More significantly on the last day of 2018, the more important Dallas FED reported. The Dallas FED is at the heart of the US oil industry which has recently suffered sharp falls in prices. It’s main conclusion: *“The general business activity index plummeted 23 points to -5.1, hitting its lowest level since mid-2016. The company outlook index also fell markedly, dropping 17 points to -3.4, also a two-and-a-half-year low.”*

What is key is the rapidity with which economic conditions are deteriorating. In the summary of conditions found in the various districts contained in the Beige Book, issued a few weeks earlier on the 5th of December, Richmond governors wrote: *“The regional economy continued to grow at a moderate rate since our previous report.”* A moderate rate implies GDP growth of 2%. The Dallas governors also wrote: *“Growth in economic activity slowed to a moderate pace. A broad-based softening was seen in manufacturing, retail, and housing.”* Both regions described current conditions as moderate though in the case of Dallas it had slowed from strong. The FED uses four broad categories to define growth: solid, moderate, modest and slight. Hence at the beginning of December, growth though slowing, was moderate, but by the end of the month conditions now rivalled 2016.

It is precisely these rapid revisions to expectations that will shape the first quarter. And it is why Trump is eager to defuse the trade war by re-orientating away from tariffs intended to please his base, and towards a more refined and less visible assault on Chinese technological aspirations. Despite this re-orientation, which should lift shares for all of a week, the underlying conditions in the world economy continue to deteriorate. It is likely that the first quarter of 2019 will present a challenge to global capital which it has not experienced since at least 2008.