ECONOMIC TURBULENCE IS PROVOKING POLITICAL INSTABILITY.

The week beginning the 5th August was both turbulent and significant. It opened with the Peoples Bank of China (PBOC) setting the Yuan rate above 7 for the first time. The weakening of the Yuan sent shockwaves through global markets, dropping US markets by 3% on Monday. Though markets recovered as the Yuan strengthened, they fell again on the Friday as it weakened once more to end the week down. Admittedly, August markets are thin, because of the holidays, and thus more volatile.

The gyrations were not as significant as the wake-up call showing that China could influence US markets to a degree not foreseen. China timed its intervention well, identifying that the narrative around Wall Street had darkened because of ebbing confidence that the US would win the trade war, or be able to limit its duration. The move from a trade to currency war was inevitable because China dominates global trade in goods.

Another factor that helped prop up the markets later in the week was the behaviour of the 10-year US government bond. As recently as the 30th July, the 10-year was yielding above 2.0%. On the 8th August it fell below 1.6%, or when adjusted for inflation, borderline negative. This represents a loss of a quarter of its yield in less than two weeks. Once again this had riled the markets because of the extent and rapidity of the fall, and, because, it had inverted compared to the 2-year yield. (It has been inverted against the 3-month yield for months.)

Then the fall was reversed. This was read as a good sign by the stock markets, but was it? The reason for this reversal was a poorly covered auction of $27 billion 10-year bonds on the 8th. The original coupon was 1.625% but with the second lowest coverage in 9 years of just 2.2x, the awarded yield amounted to 1.67%. It was this auction which arrested the fall in yields. Following this auction, the subsequent 30-year auction on the Friday, was better received.

Although the 1.67% rate awarded on the 10-year was the lowest in three years it showed that there was a floor to interest rates caused by the deluge of treasury bond issuance on the back of a growing budget deficit. The latest Congressional Budget report for July 2019 shows a cumulative deficit of $867 billion for the first ten months of this financial year. https://www.cbo.gov/system/files/2019-08/55527-CBO-MBR-July2019.pdf It is likely, that despite an expected surplus in September, this year will see a deficit above $1 trillion. The reason for this is that unlike the previous financial year, when expenditures were outstripping income by a mere 2%, this year the gap has grown to 5% of income.

On top of this the Treasury has had to rebuild its cash position due to the breach of the debt ceiling a few weeks ago. Given the new spending commitments made by Congress to lift this ceiling, the US Treasury now needs to raise $433 billion rather than $180 billion in the near future. While the supply side has strengthened it is likely the demand side has weakened because of China's absence. Therefore, despite being the custodian of the world's reserve currency, it is likely the volume of issuance will prop up interest rates in the US at a time when its competitors "enjoy" zero rates.

Also, noteworthy, was the rise in the spread between high risk bonds and low risk treasuries. The spread rose to 4.5% setting off alarm bells about the state of the high yield market. Much of this fear was prompted by the reporting of negative cash flows in smaller oil companies mining tight (shale) oil and gas during the second quarter. These miners are one of the largest issuers of this low quality, high risk "covenant light" debt.

Money fled equity funds and high yield funds. On the flip side, cash streamed into low risk money market funds. The weekly figure of $102 billion was the second highest since 2007. Given these alternating flows why did share prices recover. The answer is share buy backs.

Today the modern titans of Wall Street are not bankers but the CEOs of Big Tech companies. Gone are the Mellons, the Rockefellers, the Morgans and Rothschilds. Now it is the turn of the Tim Cook's, Satya Nadella, and the Larry Page's of the corporate world to dominate financial markets. As I have previously argued, the 2008 crash was a financial crash born out of the decline of banking relative to industry. This forced the banks to exploit the retail market and to lever it. By retail we refer to non-commercial mortgages, car loans, student loans, credit card loans and so on. This view may have been controversial in 2008 but now it is clear cut. Financial capital does not dominate, and those who argue that it does, clearly do not understand the consequences of globalisation and its restructuring of the world economy.

The raw figures are indisputable. The market cap of the top 5 Tech corporations, (Microsoft, Apple, Alphabet, Amazon and Facebook) represents 11.4% of the total market cap of the S&P 500. In contrast the market cap of the largest 5 banks is only 4.6% (J.P. Morgan, Visa, Bank of America, Mastercard and Wells Fargo). It is the dividends, the share buy backs and acquisitions generated by these corporations, amounting to $1.284 trillion in 2018, that created the financial wave all ships rode. https://www.ft.com/content/81ff6034-8b91-11e9-a1c1-51bf8f989972 In contrast, the rise in new bank credit between July 2018 and July 2019 increased by only $0.73 trillion, or by $0.36 trillion when reduced to Commercial/Industrial loans, Real Estate Loans and Consumer Loans. (FED Table H8.)

Economic turbulence gives rise to political instability.

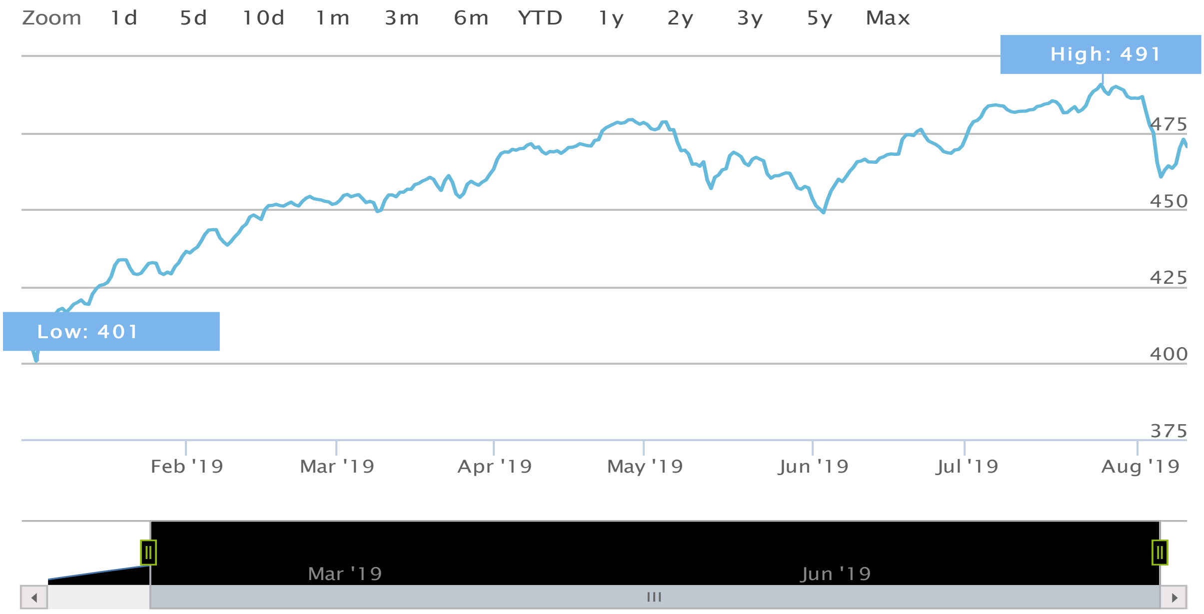
On Thursday, Barclays Bank issued a warning that the world was now in an industrial recession and more ominously, that "the trend is not likely to slow down anytime soon". At last a sober bank. https://www.cnbc.com/2019/08/08/barclays-declares-industrial-recession-warns-forecasts-too-upbeat.html FactSet confirms this trend. Revenue growth for the S&P of just 4.1% is the lowest since 2016. Adjusted for share buy backs (FactSet organises its data on the basis of earning per share) and inflation, revenue growth is negative, particularly for corporations with over 50% of their sales outside the USA. In addition, FactSet has now increased its projected profit fall for the third quarter to 3.1%. This is on top of the profit fall per share in quarter two, the first back to back fall since early 2016. https://www.factset.com/hubfs/Resources%20Section/Research%20Desk/Earnings%20Insight/EarningsInsight_080919.pdf

On the 12th other major banks followed by downgrading the second half of 2019. "*Analysts who study individual stocks also have begun to lower estimates in sectors most affected by global growth and rates: energy, technology, financials and industrials, all of which have been coming down fast in the last several weeks.*" This includes the likes of Citigroup and Goldman Sachs, the latter having earned the enviable reputation of getting things wrong, and without embarrassment, reversing positions. https://www.cnbc.com/2019/08/12/sp-500-earnings-could-turn-negative-for-2019-amid-the-trade-war.html

Global shares have fallen sharply from their highs but are still up on the year despite the global industrial recession. The US markets which have the highest weightings continue to bolster the markets. This can be seen from the two graphs below. The first, the Stoxx 1800 covers global shares and the 600 is confined to European shares.

The global 1800 rose further than did the 600 since the beginning of the year. It has also fallen more sharply over the past week or so. The two largest European economies, Germany and Britain are likely to have entered into recession. The data for July suggests that both will have negative growth in back to back quarters. So much for the Brexiteers and their "resilient" UK economy.

GLOBAL STOXX 1800



EUROPE STOXX 600

It is not only in Europe, that the tug of recession is being felt. The same can be said of South East Asia. Taiwan, South Korea, Singapore and Malaysia are highly dependent on global manufacturing chains, many of which are centralised in China. The disruption brought about by the trade war which has accelerated China's drive to become self-reliant, is beginning to play havoc with these economies. https://www.straitstimes.com/business/economy/singapore-malaysia-among-exporters-most-at-risk-in-us-china-trade-war-fitch

South Korea's recently announced fall in annual exports of 13.5% was worse than the expected 12%. (Trading Economics.) Singapore's exports were down 6.8% year on year in June, while retail sales plunged 8.9% versus the 3.7% expected. https://www.straitstimes.com/business/economy/retail-sales-drop-for-fifth-straight-month-with-89-per-cent-plunge-in-june Taiwan saw exports stabilise after falling heavily in May. In addition, the tension between South Korea and Japan is intensifying.

Singapore's predicament is worth exploring. The leaders of the Leave campaign and their financiers see Singapore as the model Britain should aspire to. As chewing gum in public is illegal in Singapore, perhaps Johnson's new focus on "stop and search" should include the search for gum alongside drugs and blades. Singapore's preliminary annual growth rate fell to 0.1% in the 2nd quarter against expectations of growth of 1.1% having fallen 3.3% quarter on quarter. This is the lowest growth rate since 2009 and even then it looks overstated given the internals. Currently it appears that the open Singapore economy is totally exposed to the forces blowing through the world economy. A salutary lesson to the Brexiteers, but one which they will ignore as reality to them is a mere inconvenience.

Which leaves India. On the face of it, India seems to be bucking the trend. However, India's "Chinese" type GDP figures are disputed. Critics claim they are inflated by at least 2.5%. For an economy with highly indebted banks, industrial and real estate corporations, even the deflated figures look flattering. Further, India's tech-centre which is highly reliant on call centres, is also vulnerable to machine learning which threatens to decentralise this industry.

Perhaps, it is the playing of the Hindu nationalist hand in Kashmir that gives the game away. The *Indian Times* speculates that Modi showed his hand because the opposition Congress Party is on the floor. Other reasons given is that a possible Taliban Yankee settlement in Afghanistan, will free Pakistan's hand in Kashmir. However, the more probable reason is that the economy is tanking. "*A government trying to raid the balance sheet of a central bank anywhere in the world is not a good thing. It shows that the government is desperate, he said, speaking at a CFA Society India event here."* Former governor D Subbarao https://economictimes.indiatimes.com/news/economy/finance/subbarao-says-raiding-rbi-reserves-shows-govts-desperation/articleshow/70496362.cms

This economic malaise not only applies to urban areas but to rural areas as well. India has had only 69% of its normal rainfall by the end of July. Water wars are tearing the countryside apart in many places and turning town against countryside. Agriculture is being hurt, and these are the regions where Modi supporters are concentrated. So what better way to distract the Hindu masses, than with a dose of jingoism. Given the economics behind the revocation of most of Article 370, the populist Modi surpasses himself when he presents oppression in Kashmir as opportunity, opportunity to economically develop Kashmir when the Indian economy is itself unravelling.

In Latin America, the impending ousting of the right-wing president of Argentina after one term of office has once again rattled the markets. The Peso which fell by 30.3% when the first results were announced, amounted to the worst fall in 18 years. It is certain that the same fate will face Balsonaro. Once again, the left's yodelling in the foothills of history, of the unstoppable march of the populist right, is completely misplaced. As the Crash of 2019 unfolds, and it is accelerating, it will be the reformist left that will be thrust to the fore, not the right, at least to begin with.

It is clear the shifting economic sands is beginning to unsettle the political superstructure. Hong Kong is at the vanguard. While the CIA shit stirs in Hong Kong, it is interesting to see how Trump and other national leaders, hold back their support. Trump's political instincts, in common with other members of the ruling class, is to fear the mob. Trump knows that disaffection is not limited to the youth in

Hong Kong. In the United States, as elsewhere, the youth is angry and estranged, and what began in Hong Kong, may not stay in Hong Kong.

It is mostly said, that Central Bank interventions have been designed to provide the rich with their mansions, yachts, minks and diamonds. But it can also be said that they fear a repeat of 2008 even more. They know that while they got away with it in 2008, they are unlikely to get away with it a second time. Hence like squirrels they have bought land in New Zealand for their safe houses, and unused military bunkers and missile silos in the USA. What they fear most is that the gigantic international working class, which outnumbers them 1,800 to 1, will wake up from its political slumber. This is what the Crash of 2019 potentiates.

Conclusion.

This article continues the theme formed by the contradiction between industrial production falling while consumer spending is still rising, and, how it will be resolved in real time. It is of course ironic that the under-consumptionists are absent in this debate. But it is time to have a dig at them. At no point since 2014 has there been a crisis of under consumption in general terms. Of course, consumption has been hugely uneven and unequal, skewed towards luxury goods, but in aggregate terms there has not been a slump in consumer expenditures. Quite the opposite has occurred, which makes it important to explain, why this has not reinvigorated the economy.

I have shown in previous postings, that when circulating capital, which has to be replenished at the end of each circuit of capital, is added to fixed investment, total investment equals or exceeds final consumption of consumer goods. Therefore, that it is investment and not consumer spending, which determines the direction of travel of the economy. Furthermore, that in the end, investment which is based on the rate of profit, will trump consumer spending based on the rate of interest.

This is what we are seeing currently. In the USA, which remains the financial heart of the global economy, the mood is darkening. The algorithms are having to take account of reality. Originally the operating view was that the 2nd half of 2019 would see an upturn in the world economy. That expectation has now been dashed. Profits are not going to recover, while simultaneously the debt collector is knocking on more and more high-risk corporate doors.

Of course, the FED can turn on a dime and proclaim more rate cuts. But this time this will be seen as weakness, as a state of financial emergency. Low interest rates, acting through the agency of the Stock Markets, slowed down the resolution of the contradiction between industrial contraction and consumer expansion. But events over the last week may show that the resolution of this contradiction is now at hand.

Brian Green, August 2019.