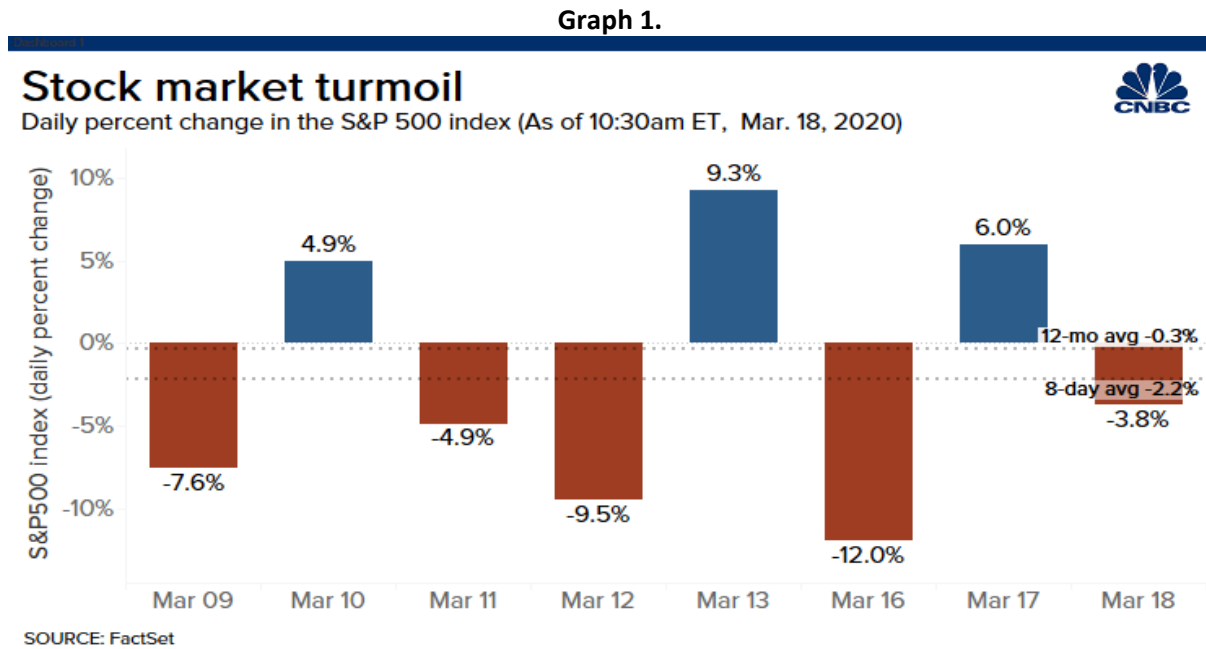


RECESSION FOR CHINA, DEPRESSION FOR EU AND USA?

The market crash is now four weeks old. The first two weeks registered falls without a liquidity crisis (see pie chart below). The third week registered sharp falls with a liquidity crisis. The fourth week registered the biggest weekly falls with severe dislocation between assets because investors decided to be "all out" having been "all in" prior to February the 19th.

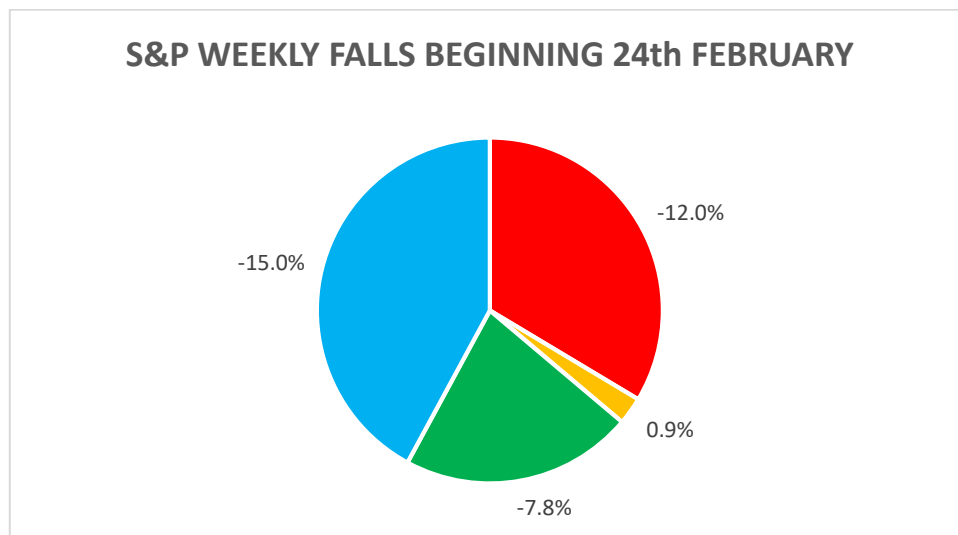
The USA first.

Graph 1 shows the daily movement in the S&P 500 over the last week. The Pie chart below it represents the weekly movement covering the four week financial collapse.



<https://www.cnbc.com/2020/03/22/breaking-down-this-sell-off-among-the-most-extreme-and-rare-wall-street-has-ever-seen.html>

Graph 2.



(Source: FRED Table SP500)

Graph 2 shows that the cumulative fall is 33.9% over these four weeks. This is as fast a fall as occurred in 1987 and more importantly 1929. However, we must be alert to two differences between now and 1929. Firstly, the computerisation that collates information speeds up both decision making and execution, and, the much higher leverage that exists today. Both are accelerants, literally.

Graph 3.

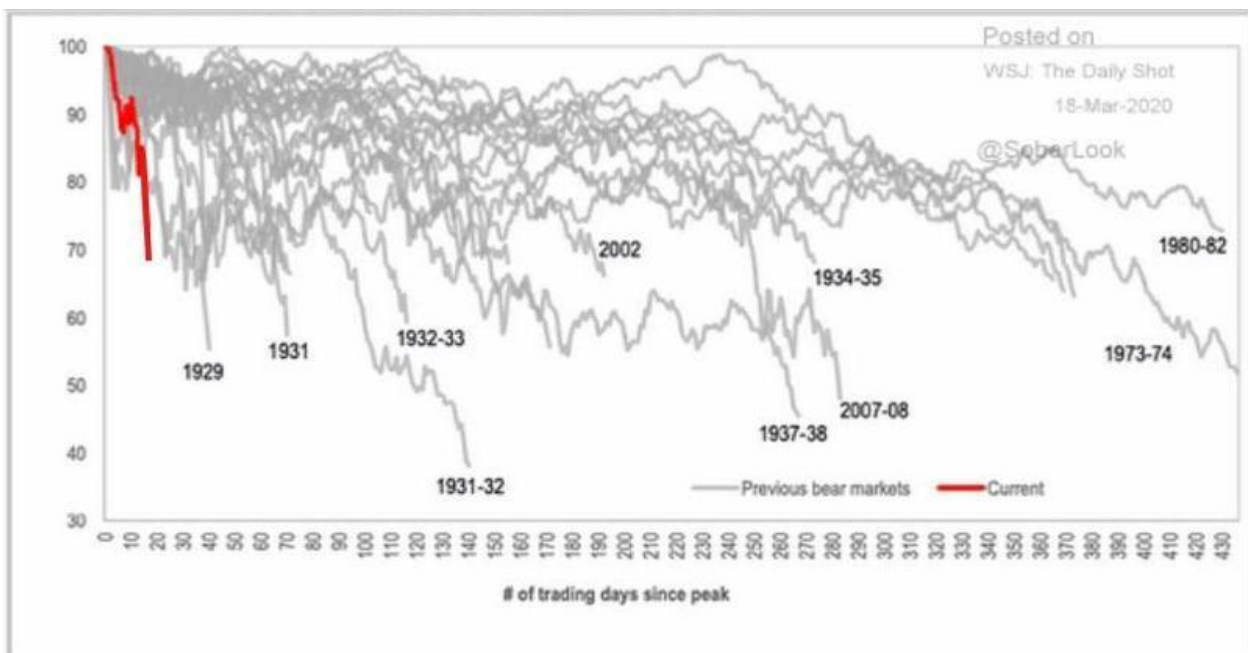
Chart 2: Bear market comparable to 1929 & 1987



Source: BofA Global Investment Strategy, Bloomberg

Another graph prepared by Zero Hedge shows the relative movement of all the downturns. This gives a more comprehensive perspective. It shows a faster movement than either 1929 or 1931.

Graph 4.



The future trajectory of the market depends on three factors. Firstly, whether a medicine is developed in the next 60 days which prevents the disease from becoming critical, or even prevents it from developing. Secondly, the impact on the economy becoming visible. The reason that the markets fell by 15% this week, more than any time since 1987, and in excess of any week in 2008, was this impact becoming visible. According to Econoday, the Empire State Fed Activity report was expected to print at +4.8, instead it tumbled to -21.5. Likewise, the more important Philadelphia Fed report, which was expected to print +14 but fell to -12.7. Both missed by over 26 points, a historically significant margin.

Thirdly, grasping the severity of the plague itself. This is a “known unknown”. While Germany is conducting 160,000 tests weekly thereby containing the outbreak, the official count in the USA is a mere 32,000 to date. (The figure for that other emporium of neo-liberalism, the UK, is 50,000 to date). Because of increased testing in New York the numbers of confirmed cases increase 28-fold over the last week to stand at 8377 on Friday. Although the latest figure for confirmed cases has reached 20,000, it is likely that hundreds of thousands if not millions of Americans (north) are now affected. Predictably, Trump the incompetent, has been seeking to play the race card, blaming the virus on the Chinese in order to deflect criticism of his own lack of foresight and leadership.

It was the combination of hard evidence coming through on the impact on the economy together with an emerging picture of the extent and severity of the plague, that overwhelmed this week’s efforts by Central Bank to keep the economy afloat, which was not helped by the cack-handed attempts by Congress and the Administration to put money into the hands of workers and consumers.

What is also coming clear is the loss of jobs should no cure be found within 60 days. Jobless claims jumped to 281,000 this week up by 70,000 surprising the markets. But regionally the jump is much higher. According to the FT, 78,000 filed for unemployment in Ohio in the first three days of this week versus 5,400 the entire week before. In Pennsylvania 121,000 filed compared to 12,000 for the whole of the previous week. Steven Mnuchin, treasury secretary, attempting to inject a sense of urgency into Congress opined that the jobless rate could shoot up to 20%, double that of the great financial crash of 2008. <https://www.ft.com/content/dc4b8186-6989-11ea-800d-da70cff6e4d3>

These figures of course eclipse the figures set out by the tame International Labour Organisation this week. It sees a mid-point figure of 13 million job losses worldwide. That is less than the job losses Steven Mnuchin is foreseeing in the USA alone. It also sees a loss of wage income of up to \$3.44 trillion, which spells mass poverty and which will kill many workers and their families. https://www.ilo.org/wcmsp5/groups/public/---dgreports/---dcomm/documents/briefingnote/wcms_738753.pdf

It is likely that the next step for the markets is a fall to 40% should no cure be found in 60 days. If history is a guide, after the initial sharp volatility, the subsiding should be more gradual, and because of this, nerve shattering for the speculator the more it endures.

China.

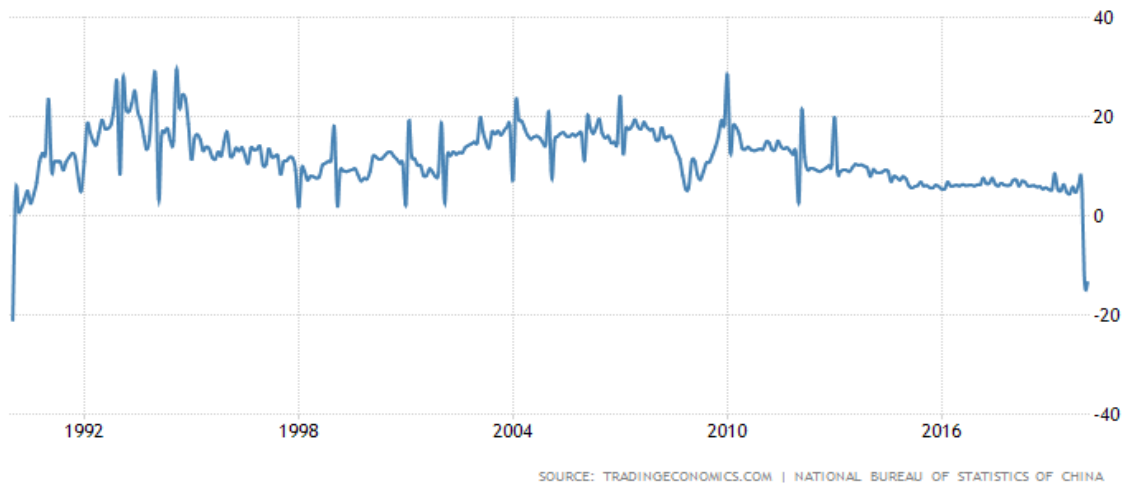
If the Chinese authorities are to be believed, and if they can contain new cases resulting from returning Chinese, then they have effectively contained the plague. China first in, will also be China first out. This is reflected in the financial markets there. Stock Markets have fallen by less than half the fall in the USA and Europe. According to the STOXX 1-year trailing index, the STOXX global 1800 is down 23.01%, The North America STOXX 600 is down 22.07%, Europe STOXX 600 is down 18.93% and Asia/Pacific down 10.63%. <https://www.stoxx.com/indices>

In addition, the Peoples Bank of China has not fired as many blanks at the economy. Nor has it collapsed interest rates in the same way as the US FED, the ECB and the Bank of England. It thus has more firepower in reserve compared to the other central banks.

Graph 5. Fixed Investment.



Graph 6. Industrial Production.



Graph 7. Retail Sales.



The extent of the fall in investment, production and sales was last experienced in 1989 in the aftermath of the Tiananmen Square protests. The key question is; what are the prospects for the Chinese economy in the months ahead? Will the recession be V shaped? A very deep V shape. JP Morgan estimates that Chinese GDP fell 50% quarter on quarter.

The biggest problem facing the Chinese economy continues to be the corona virus, specifically its impact on the EU and the USA, its two key export markets. While the supply side shock was responsible for the descending leg of the V, it is the demand led shock that will hold back the ascending leg of the V. Thus, while the Chinese economy will recover, and every Yuan of financial assistance will be much more effective at this stage, rather than the descending stage, the recovery will be subdued.

If we define a recession as 2 to 3 back to back quarters of falling GDPs, then it is likely that China may escape with just a recession. The other major imperialist blocks will not be so lucky. Should their share markets collapse beyond 40 and the plague endure for another three months, which is highly likely in the absence of a near term cure, then to be sure, a depression will commence, penance for the bubble economy post 2014 and penance for governments and administrations rotten to the core who did not prepare for a pandemic.

CNBC reported that IHS Markit sees global GDP growing by 0.7% in 2020, only because China is expected to grow by 3.9%, versus falls of 0.2% for the USA, 0.8% for Japan and 1.5% for the EU respectively. In the same article, CNBC reported a veteran analyst calling this the worst financial crash since 1929. <https://www.cnbc.com/2020/03/20/analyst-anticipates-worst-crisis-since-1929-amid-recession-fears.html>

I believe that the 0.7% growth forecast is optimistic. The probability is a period of extended GDP contraction, not only because of the virus, but because the world economy was already screeching to a halt. In 2019 investment, industrial production and merchandise trade all stagnated. According to the latest CPB estimates covering the whole of 2019 linked below, comparing the final quarter of 2019 to 2018, world trade contracted by 0.7% while global production rose a mere 0.1%. <https://www.cpb.nl/en/worldtrademonitor> The latest data on investment covering Q3 for the OECD countries registers a 0.9% fall. <https://data.oecd.org/gdp/investment-gfcf.htm>

The contagion spreads to bonds of all qualities.

This week, Wednesday, the Bank of England was forced to intervene in the markets for the second time when the Gilt market became “disorderly” according to the new Governor of the Bank of England. There was also a run on Sterling, caused in part by the flight to the Dollar, with Sterling falling to \$1.15.

The BOE reduced interest rates to 0.1% and restarted quantitative easing by agreeing to buy £200 billion of Gilts. These measures temporarily stabilised the markets and the Pound. While the immediate spark may have been the growing talk in financial circles of a “London Lockdown”, the underlying reason was years of growing balance of payment deficits and consequently reliance on foreign capital to fill this hole.

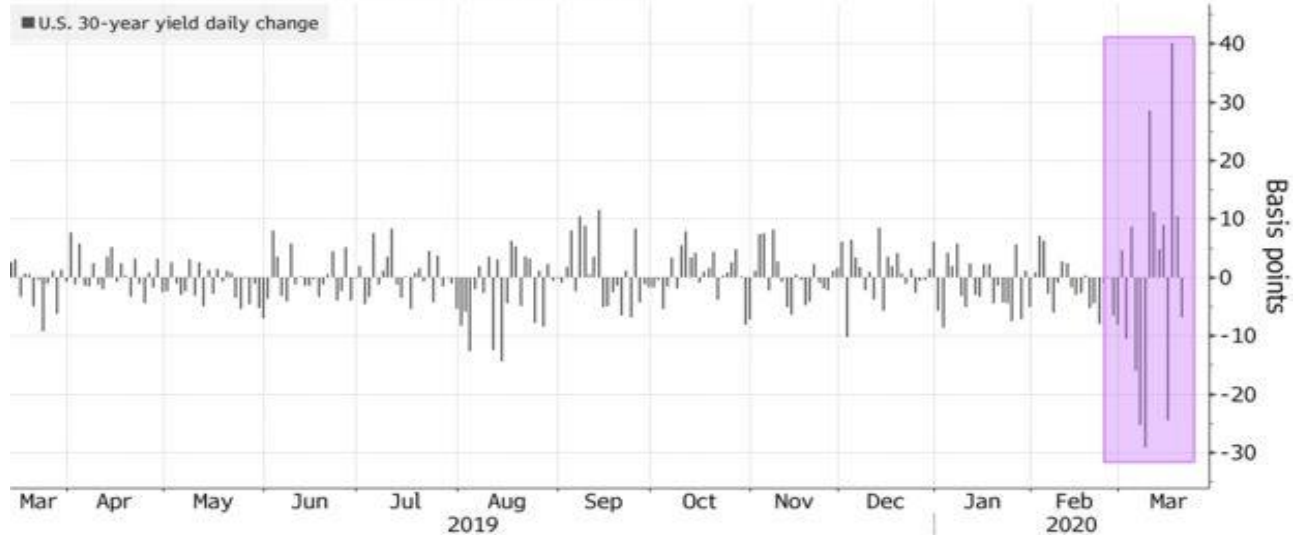
The crisis this week is a stark warning to the Johnson government of the vulnerability of the UK to Brexit at a time when the world is entering a depression. One can only imagine the consternation in Number 10 Downing Street when the realisation finally dawned that Brexit is not so much as done, but overdone.

The same disorder was found in US treasury bonds. Now mark, these are the highest quality bonds. This forced the FED to intervene twice in one week, on Sunday and Wednesday. The scale and frequency of these interventions is reminiscent of the interventions at the height of 2008.

Graph 8.

Wild Swings

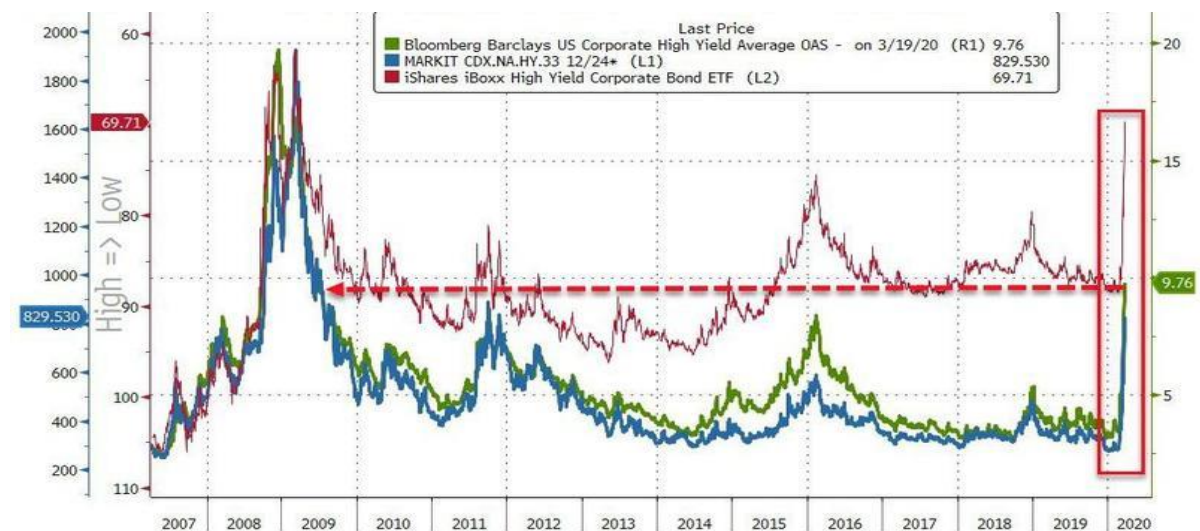
Treasury yield moves stoke chaos and pain



However, what differed from 2008 was that the Wednesday rescue of the REPO market to the tune of \$1.5 trillion was not directed at the banks, but non-bank financial institutions (shadow banks), particularly hedge funds as I have opined in earlier articles. *“Too big to fail is back, and this time it’s not the banks, it’s levered financial institutions,”* said Mark Yusko, the chief executive officer of Morgan Creek Capital. Yusko said he supported the Fed’s stepping in, but added that hedge fund firms have gotten too big by borrowing too much. *“It’s a bailout,”* Yusko said of the Fed’s actions. Leverage of 50 common to make the cents on the trades over the last 10 years. <https://www.bloomberg.com/news/articles/2020-03-19/before-fed-acted-leverage-burned-hedge-funds-in-treasury-trade> It was these trades whose unwinding led to disorder in the deepest global market of them all, US Treasuries.

The contagion continued to spread to all classes of bonds particularly junk and leveraged bonds. On the 19th of March Junk bond yield rose to 9.76% approaching 2008 levels and the amount of distressed bonds rose to \$533 billion.

Graph 9.



Much of these distressed bonds were found in the oil patch. And here we must include high cost producers such as the North Sea as well. Whiting Petroleum in the USA has a \$770 million bond maturing next year which is trading at 24 cents currently. Similarly, Antero's bond trades at 32 cents and California Resources at a mere 4 cents. Chesapeake Energy has called in the lawyers and Moody's has downgraded Occidental Petroleum debt to Ba1 or junk. Occidental's \$57 billion purchase of Anadarko in May 2019 has turned into a disaster, the polar opposite of what the President of Occidental envisaged at the time: *"With greater scale, an unwavering focus on driving profitable growth and our commitment to growing our dividend, we are creating a unique platform to drive meaningful shareholder value"* Chevron who lost the bid must be laughing all the way to the toilet. Yet another success as well for the sage of Omaha, the one and only Warren Buffett.

In the meantime, revolvers (revolving credit facilities) keep getting drawn down. Ford is another name seeking to increase liquidity by drawing down its entire \$15.4 billion. This in the face of recent plunges in auto sales, for example Seattle, which is a corona hotspot, where auto sales fell 20%. *"Ford has suspended the company's dividend in order to preserve cash reserves, and has also drawn down two lines of credit—\$2 billion under its supplemental credit facility and \$13.4 billion under its corporate credit facility—totalling \$15.4 billion."* It is seeking to have \$50 billion of liquidity on hand so as to avoid being bailed out as was the case with GM and Chrysler in 2008." <https://www.reuters.com/article/us-health-coronavirus-autos-usa-idUSKBN20Y3FK>

Finally, one of the props supporting markets, share buy-backs are off the table, including the Tech companies. Even these companies, including Apple, may find that their cash chests barely covers the loss of sales over the next six months. The difference between these cash rich corporations and the rest is they alone will remain solvent. In any case, the political mood as exploited by Elizabeth Warren is that any corporation in receipt of a government cash injection must agree to a moratorium on share buy-backs.

The sell everything mentality intensified this week. In an FT article titled: *A sell Everything Mindset is Taking Industry Veterans by Surprise* (21st March) the author describes how a 40-year veteran described this as the strangest market he has ever had to deal with. No class of asset traded reliably. Goldman Sachs describes how they were reduced to selling what they could rather than what they wanted to obtain cash for their panicked clients. This is what happens when cash becomes King. The author ends with a quote that what is happening in the markets, should only happen "every few millennia" or less. I disagree, greedy reckless speculators, aided by indentured central bankers, compress time.

But it is in Europe where the distress is deepest. The European banking index is down by more than 70% since 2008. <https://www.cnn.com/2020/03/20/coronavirus-hits-european-banks-as-they-still-face-post-crisis-issues.html> The problem in Europe, as evidenced by Italy, is that it does not have a unified tax structure and a common treasury. For all the talk of the Brexiteers, Europe is not a federation but an assembly of states. One that is therefore over-reliant on monetary policy through the European Central Bank. Whereas in the USA it is the shadow banking sector which is most at risk, in Europe it is the under-capitalised banks, with Deutsche Bank the front-runner.

The loose political and financial structure of the EU was always going to be tested, and that time has come. The good fortune of the northern nation states, piggy backing on the exceptional industrial growth of China, is over for good, because for one, China is now more self-sufficient, and, secondly that investment boom is exhausted. Germany's future lies in Europe. If the EU is to survive, the north-south split needs to be overcome. And as for the Euro, it is either all-in or all-out? The old EU cannot survive in its present form.

Call it what you like, its MMT.

This week many large economies including the UK agreed to helicopter money, to part paying the wages of their workers to prevent them being laid off. The self-employed and claimants were not so lucky. In the case of the UK this largesse is as yet un-costed. The dysfunctional in every way, US government, is last off the blocks as usual. Congress is discussing a \$1 trillion injection while Munchkin speaking on behalf of the administration wants \$2 trillion. We shall see.

However much this money amounts to, it is helicopter money. The genteel folk around Wall Street eschew the term MMT preferring the more polite word "monetary finance". But this is playing with words. Consider the mechanics. The FED has stated, regardless of purpose, it will buy back a similar amount of bonds, as will be issued to cover the rapidly expanding fiscal deficit. If we assume, that the cash injections in the end amount to \$3 trillion, (about half in real terms compared to 2008) the Treasury will issue debt for that amount and the FED will buy it back. So, while the deficit will soar to beyond 10% of GDP (consider also the loss of tax as the economy closes down) the debt held by the public will not swell.

This is MMT in action. In 2008 the free marketeers criticised the FED's Quantitative Easing as inflationary. They were right. Only it was not goods that increased in price, it was financial (fictitious) assets that soared in price. This was because the recipient of this state largesse was the top 1% who had plenty of money to spend on themselves, and who used the extra money to restore and expand their wealth through the art of speculation.

This will no longer be the case. The recipient of a substantial part of this largesse will mainly be ordinary Americans (north) who don't have \$500 to rub together. For them it will be a choice between eating or freezing or boiling (it is a large country with diverse weather) or saving. Clearly, they will spend the money on goods.

The result of value production falling 20% as the economy closes down, facing an increase in the value of demand of 15% in the form of the monetary injection, will be clearly inflationary from the outset. The MMTers never understood that an effective MMT policy had to be inflationary from Day 1. They always believed they could rev up MMT to the point where capacity was fully utilised and then gear down as prices picked up. The next few months will tell who is right.

I was asked the important question separately on Facebook: would MMT financed through taxing the rich have a different price effect to one purely financed by monetary expansion. The answer is no. The only difference is that the rich would be poorer if taxation was the route. Stripping the cash hoards out of their hands, and speculative funds have to be considered mobile hoards, and taking that cash which exists outside the economy and forcing it back into the economy, where it will be spent by ordinary people desperate to feed and house themselves and their families, will be inflationary. Whether it leads to hyper-inflation it is too early to tell.

As globalisation fractures, the global urgency to find a vaccine, increases.

The bad news is that the corona virus is not seasonal. Its spread in hot countries like Australia confirms this. The good news is that there are currently over 50 candidate drugs being tested for efficacy against the corona virus. The best news is that all pharmaceutical companies who are members of the International Federation of Pharmaceutical Manufacturers and Associates, have signed a pledge to share resources and pool clinical trial data.

The shape of the outcome of this plague is dependant on finding a drug to combat it. China next week is to test an inoculation on humans having proven its effectiveness on monkeys. Let us be clear. If a

cure or even partial cure is not found this year, economic necessity will force the capitalist class and their medical stooges to abandon containment. By then ICU facilities will have been expanded but not sufficient to prevent millions of deaths. But these deaths will have already been eclipsed by the deaths from poverty this economic catastrophe has cost the poorer nations, where most citizens live from hand to mouth on a daily basis.

Conclusion.

Isolation has brought out the importance of smartphones enabling virtual communication as billions self-isolate. But smartphones also exemplify the depth of the economic crisis this plague has caused. *“Global smartphone shipments dropped 38% year-over-year during February from 99.2 million devices to 61.8 million, the largest fall ever in the history of the smartphone market, according to a new report from Strategy Analytics. “We started to track smartphone market back to 2003. This is the biggest ever fall historically,” Linda Sui, analyst at Strategy Analytics said in an email.”* <https://www.cnbc.com/2020/03/20/coronavirus-smartphone-market-had-the-largest-fall-ever-in-february.html> This collapse in sales is a product of both a demand and supply shock. The production chain for the manufacture of these phones passes through a corona hotspot near Seoul in South Korea, where Samsung and LG manufacture critical parts such as screens and chips. Once again bottle necks illustrate the vulnerability of these supply chains and the fragility of just in time production methods.

Senegal also exemplifies the rise of China and the demise of the USA. While China is building makeshift hospitals in Senegal, the US has had to withdraw its hospital ship and set a course for home. While the US cannot fend for itself, China is now able to provide assistance all over the world, particularly Italy and Spain. Cuba and Russia too.

For years the financial world has been living on borrowed time, not so much kicking the can down the road, but riding the bubble down the road with the central banks ensuring the right gradient and filling in any pot holes that could burst the bubble. The spiky virus has ended all this. Should a cure or even the promise of a cure not be forthcoming in the next 60 days, there will be no floor under the markets and the descent into depression for the USA, the EU and Japan will be rapid. The sins of the father will be bestowed on the father.

This plague is man-made or rather capitalist made. Viruses establish local ecospheres in order to protect variety. When humans, because of the pressure of profit, either in the form of capitalists exploiting nature, or impoverished workers living in overcrowded conditions seeking to feed themselves, negligently interact with nature, there tends to be a viral rebound in the end. Secondly, the capitalist class were repeatedly warned of the imminence of a pandemic, but they refused to listen, they continued to cut medical facilities and/or to financialise them, making this reduced capacity more dysfunctional.

It is worth repeating. A store of 200,000 ventilators and millions of protective gowns and masks would have cost \$10 billion or 1% of what they spend on their military each year. Instead of this insurance they have lost \$24 trillion in shares as of Friday. For every \$ they set aside for contingency they would have saved \$2,400. Such recklessness, greed and incompetence means they do not deserve to be a ruling class. They deserve to lose it all, and be replaced by a new ruling class, whose morals and interests are the polar opposite, the international working class.

Brian Green, 22nd March 2020.

