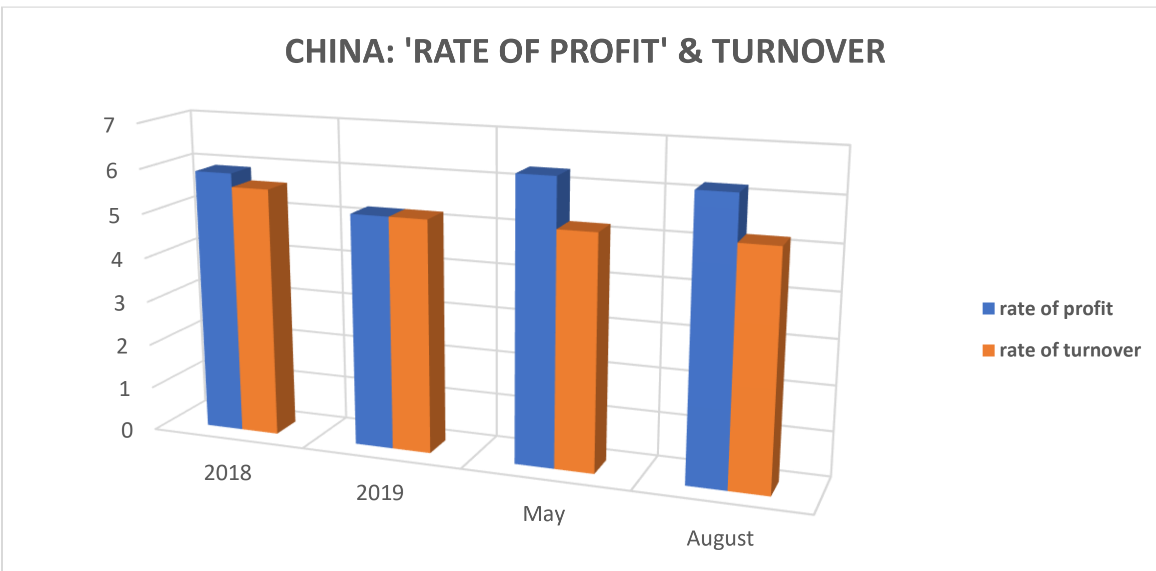
CHINA CURRENT RATE OF PROFIT
and US retail data filled with false positives.

This was a week which could have disturbed the Stock Markets. However, earnings reports and economic data served to buoy the market, especially the dubious retail data released on Friday. This article also includes the Chinese complex rate of return up to August 2021.

Graph 1 below provides the most up to date Complex Rate of Return (closest to Rate of Profit) provided by the data found in the 14th October release of '*The Profit of Industrial Enterprises above Designated Size from January to August in 2021' by the* National Bureau of Statistics of China. http://www.stats.gov.cn/english/PressRelease/202109/t20210929_1822602.html

Graph 1.



This series covers industrial profits and not tertiary profits. There are two important observations. The first being the 12% fall in profits between 2018 and 2019. 2019 together with end 2015 were the two weakest years for growth and profits since the massive investment wave in China petered out in 2013. The second being the improvement in profitability this year. By May 2021, profitability had risen to 6.3% from 5.9% in 2018 holding at 6.2% in August. This rise in profitability has much to do with the change in consumer preferences away from services to goods, which China excels at producing.

The annual rate of turnover on the other hand fell from 5.6 in 2018 to 5.2 in May and 5.2 in August. As long as the annual rate of turnover is depressed it acts to block any significant rise in profitability. Furthermore, looking at both the CPI and PPI indexes in China, conditions in its internal market look likely to squeeze margins as well. The annual rate for the Consumer Price Index rose by only 0.7% (?) whereas the Producer Price Index leapt to 10.7%. This squeeze will be partially offset by the annual growth in exports up to September which showed a rise of 28.1%. (All data from Econoday release 15th October.)

China's property crisis.

Much has been written about the deepening property crisis in China centred on Evergrande. The official line from the CCP is that the situation remains manageable: "*But it stressed China's property sector is healthy overall and any 'spillover to the financial industry is controllable'" https://www.scmp.com/economy/china-economy/article/3152530/china-evergrande-crisis-caused-poor-management-exception* This is simply not true. To begin, all property in China is owned by the state. With regard to residential property the state has ceded only the right of use (turning property into an exchangeable use value). Generally the maximum right of use, either in its freehold or leasehold form, is 70 years, and in 2007 the government enacted a law to strengthen the right of the user against that of the state. http://english.www.gov.cn/services/investment/2014/08/23/content_281474982978047.htm

The reason for this background is that the state can influence both the purchase and the sale of these 'holds' in a way a government in the West cannot. In other words the state in China can interfere in the market. *"China can stop a transaction. The government can change the number of years you have to own a home. Or if prices are too low, the government won't give you a certificate of sale," Gan said. "That is what's happening now." You won't see the price drop substantially, but you will see the transaction volume drop massively,"* https://www.msn.com/en-sg/news/world/china-has-at-least-65-million-empty-homes-enough-to-house-the-entire-population-of-france-it-offers-a-glimpse-into-the-country-s-massive-housing-market-problem/ar-AAPvvfk?ocid=uxbndlbing

And that is exactly what has happened recently. The government is desperate to prevent speculators, property developers and homeowners offloading property. *"September has traditionally been a strong season for residential property sales in China, but the slowdown deepened last month. Sales volume in 28 Chinese cities monitored by CRIC declined 25% in September year on year, according to the report. In the financial hub of Shanghai, volume dropped 45%, while Beijing, Shenzhen and Guangzhou saw a decline of 30%. Combined contracted sales by the country's top 100 real estate companies plummeted 36% to 759.6 billion yuan ($118 billion) in September from a year earlier, deepening a downward spiral emerging in July, China Real Estate Information Corp. said in a report. More than 90 developers saw a decline in their sales from a year ago, with 60% of them recording a drop of more than 30%, according to the report."* https://www.bloomberg.com/news/articles/2021-10-08/china-developers-sales-plunge-as-evergrande-contagion-emerges

To gain perspective on this development requires knowledge of the size of residential property in China. "*Every year, China starts building 15 million new homes - five times as many as the US and Europe combined, The Economist reported in January. More than 90% of households are homeowners, according to a January research paper on homeownership in China from the National Center for Biotechnology Information. More than 20% of homeowners in China own more than one home. The US, for comparison, has a 65% homeownership rate. Real-estate holdings also account for an outsize proportion of household wealth in China: 70% of household assets - far higher than what you'd find in Western economies - are held in real estate.*" It is also 29% of the economy. Admittedly floor space in China is only one third the size of a typical property in the US, but in terms of material used this is offset by China building more high-rise apartment blocks. Taking all this into account, it is likely that materials used up in Chinese residential construction consumes two and a half times that used up in US and Europe, or half of the world total.

For more useful and illuminating information and analysis on Evergrande and China, please visit Michael Robert's Blog https://wordpress.com/read/feeds/313842/posts/3588831692

Thus while the residential property slump in China may not necessarily lead to a financial crisis it will reverberate throughout global industry as the demand for materials and machinery falls away. It will also affect personal consumption because falling prices reduce household wealth. This will add to the deceleration of the Chinese economy where economists are continuing to write down their future estimates of GDP growth. For the time being the Chinese economy is being supported by exports but even here the good times are over.

In sum, the conditions developing in China could provoke a global recession within the next 6 months, and if China avoids a financial crisis, this will not prevent such a crisis breaking out in the USA, home to over 40% of the world's fictitious capital.

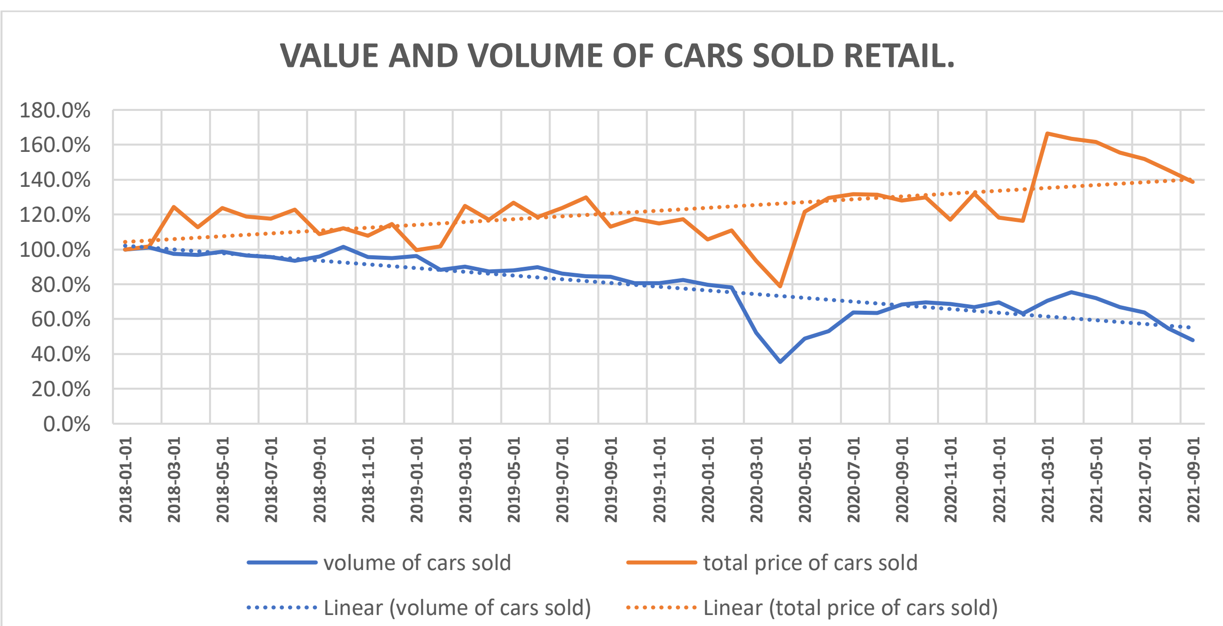
US false positive data.

Two major sets of economic data came out this week. The first was inflation which bore no surprises. While the overall annual CPI figure ticked up by 0.01% the core index came down. Excluding food and energy it is becoming clear that inflation has passed its peak.

The other set of data, US retail sales, was a real surprise. The consensus was for a fall in retail sales. High frequency data including the sources provided in my earlier posting suggested as much. This is what the usually sober Econoday Report had to say. *"A major collapse in unit vehicle sales did not equate at all to weakness for dealer sales, frustrating forecasters and making for a surprisingly strong September retail sales report."*

Let us therefore focus on auto sales in the US. Volume sales fell by 6% from August but the value of sales at motor dealers was up by 0.5%. In Graph 2 below the volume and value of retail auto sales are plotted. Before the pandemic the rising gap between the two was primarily due to the growing proportion of higher priced SUV and light trucks being sold.

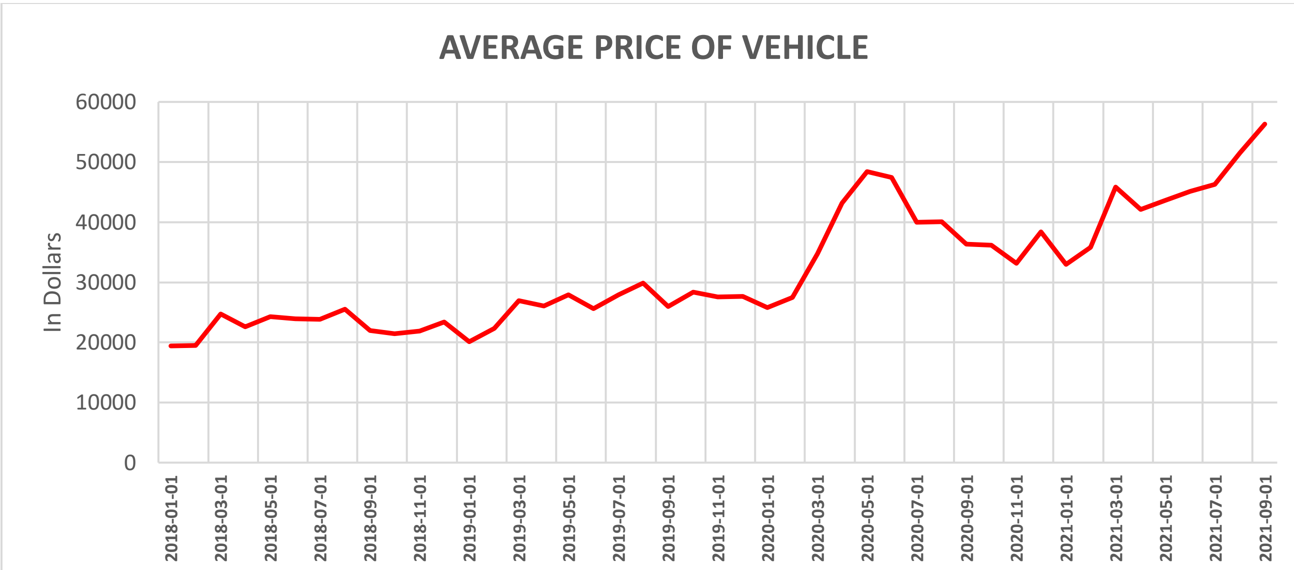
Graph 2.



(Sources: MARTS 441 historical tables for sales value and FRED Table LAUTOSA for volume.)

This discrepancy between total value and volume resulted in a higher average sales price per vehicle. This is plotted in the graph below. However, the dramatic rise in bumper prices on the right was due to pandemic effects rather than changes to the mix of vehicles sold. Prior to the pandemic the average price was $25,073, and during and post the pandemic, it jumped to $56,363 an alleged increase of 69%.

Graph 3.



According to the tables used above annual auto price inflation up to September was 29%, but the official BLS data for auto inflation is only 9.1%. Thus there is a discrepancy of 20%. Of course there could be some adjustment for the mix of vehicles sold but such an adjustment in only 12 months is unlikely to account for the 20% discrepancy. Moreover, according to the data above, issued by the Census Bureau, the average sale price for a vehicle was $56,313 whereas the American Automobile Association quotes the average retail sale price at the end of the 3rd quarter as $42,921 "*From a pricing standpoint, the average new vehicle transaction price reached $42,921 at the end of the third quarter, according to J.D. Power,…*" https://www.msn.com/en-us/money/news/car-sales-plunge-as-chip-shortages-choke-off-supply/ar-AAP2Evf?ocid=uxbndlbing

We find a discrepancy of 30%. Indeed if prices rose by only 9% from September 2020 when they were at $36,363 then the Census Bureau Price would be below the JD Power price rather than well above it. Clearly if the JD Power data is correct then retail sales have been significantly boosted by inflated auto sales. If auto sale prices were reduced by just 10%, then instead of the 0.7% rise in retail sales, these would have fallen by 1.0%, which would not have gone down well with the markets.

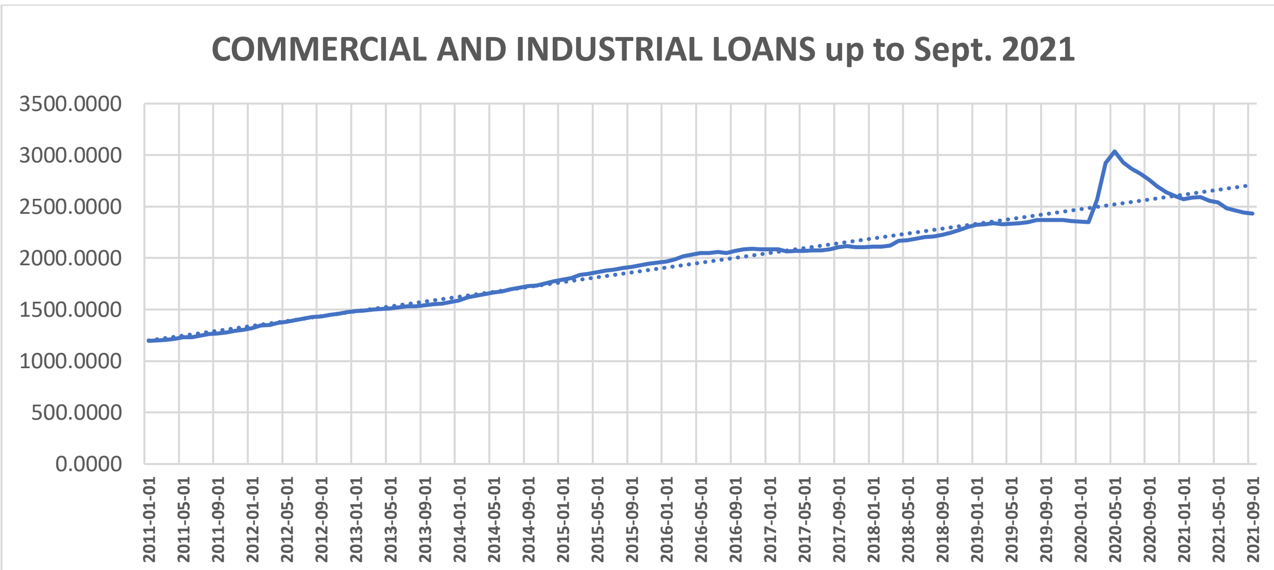
The question is therefore posed, if this granular inspection of auto sales reveals figures to be inflated, where else are such discrepancies to be found. If anything, it is easier to estimate car sales values because unit sales are much lower and ticket prices so much higher than other commodities.

The other issue which buoyed the markets was the rash of profit releases by the banking sector. All beat expectations due to a reduction in their bad debt provisions and gains from the world of fictional capital such as fees for advising on mergers and acquisitions, fees from looking after the wealth of the rich, and gains in market cap derived from the share and bond markets.

What was ignored by the markets and which all the banks reported in unison was that their loan books were stagnant. Loans to commercial and industrial customers either did not grow or fell. True the demand for loans from corporations has been blunted by the infusion of Covid funds, but nevertheless when banks stop lending it is a sign of future trouble in the economy.

Further confirmation of this stagnant loan book can be detected in the trend below for Commercial and Industrial loans which are the shorter-term loans handed out predominantly to smaller corporations. These vital loans are now below the longer-term trend which avoids the aftermath of 2008. In real terms they are down over 5% from early 2020.

Graph 4.



(Source: FRED Table BUSLOANS)

Energy prices. The madness of marginal costs.

Marginal cost and utility are the vulgar language of neo-Ricardians and the stuff of neo-liberalism. Marginal cost has been used to construct energy markets where none existed before, or what is the same thing, where energy provision has been privatised. This costing is responsible for the debacle in Texas when the electricity network failed during an ice blizzard, it is responsible for the negative price of oil during the early stages of the pandemic, and of course it is responsible for sky high energy prices in Europe today. Even those spheres of the energy market where marginal costs do not dominate are influenced by prices in these spheres because of the inter-connectiveness of markets and substitute costs.

This form of market is called "pay as you clear" and for more information and counter-argument please follow the Financial Time link below. The EU has welcomed this model saying it encourages the production of green energy because it is cheaper. Therefore if the market is governed by the higher marginal cost producers through the auctioning of electricity, the super profits of the green energy producers will expand that sector faster. Only if one takes a sectional view of the economy is this true, and it is only manageable when the supply of below average cost electricity is increasing faster than demand. https://www.ft.com/content/f37d2a36-4609-4b3e-9795-064b6d459676

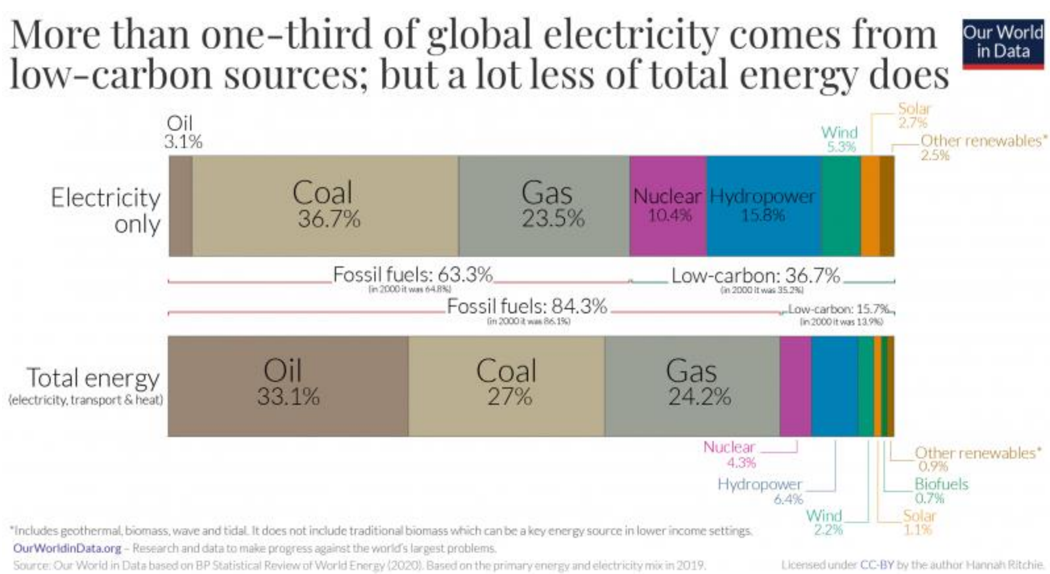
The article also reports on the pressure being applied to the EU commission by countries such as France, Spain and Italy to revert back to average costs. If we assume prices have been modified by prices of production, than it is true to say that market prices for that sector are normally determined by weighted average prices of production. Marginal costs play an indirect role, not a direct role, in determining market prices. Marginal prices move the weighting that is all. If new production comes online with a marginal cost below the average, and depending on its magnitude, then over time it will reduce the average weighted cost and therefore the market price. And vice versa if demand enables higher cost production to be brought online. Under these circumstances market prices will be more stable and predictable.

Let us return to the argument that "pay as you clear" encouraged green electricity and energy. There is a further element worthy of consideration. Base load power stations, whether coal, gas or oil fired, benefit from running 24 hours a day 365 days a year. That was how they were designed with the possible exception of more modern pure gas installations. Thus the continuous auctioning of electricity meant they were being switched on and off continuously due to volatile market prices falling below their cost price on numerous occasions. This is uneconomic and, yes, not good for the environment due to the damage done to these stations and the pollution caused by running them up and down. Thus this pricing system did not so much benefit green electricity as disadvantage black electricity production.

In the end of course this led to more expensive electricity. Market prices based on weighted averages will tend to deliver lower annualised market prices for consumers. Thus not only have consumers been paying green taxes in their bills but also higher prices. The fact is that green electricity remains an immature industry and will continue to be so until electricity can be stored economically, or high voltage DC grids economical up to 4,000 Km connect areas of the world where the sun is shining, or the wind is blowing.

This cannot be done without large scale state intervention and international co-operation. Until then the production of green energy will remain miniscule and markets volatile. As the graph below shows, total green energy is under 16% of global energy use and still only 36% of electricity use.

Graph 5.



In the run up to COP26 the figures are in fact going the wrong way. Market forces have driven up the production of energy from fossil fuels particularly coal. Once again the CCP has been caught flat footed. So much for those who consider China a planned economy. The Chinese state keeps getting uprooted by the market. The CCP is not so much a planner as a fire fighter, it tails rather than leads the market.

Conclusion.

From the Marxist perspective China and the USA form perfect book ends. A potential industrial crisis in China beckons while a financial crisis in the USA looms at a time when the other major economies are also wilting. This is what distinguishes 2008 from today when China had the capacity to rescue the world economy. In China 29% of GDP is formed from real estate and should that sector shrink by only a tenth or 2.9%, it will on its own halve GDP growth even before the multiplier takes effect.

Next week non-financial corporations start reporting in the USA, and we shall see if their results correspond to their financial counterparts. This sector's revenue will confirm, or not, the actual state of retail sales, and if their revenues are being squeezed, as is likely, this will have a disproportionate effect on their profit margins because of higher input prices. If this turns out to be true, then share prices are not yet in the clear this month.

Brian Green, 16th October 2021.