

WILL THERE BE A SEVERE CORRECTION OR EVEN A STOCK MARKET CRASH THIS OCTOBER?

There is something called the 'October Effect'. This represents a niggling suspicion in markets that October is a vulnerable month for stocks. Statistically, September trumps October for significant corrections. However, the Crash in 1929 which began in September intensified in October, and there have been a number of notable October events recently, such as the 1987 stock market crash. While it is too early to say one way or another before the profit reporting season is in full swing, the negative data in the real economy is beginning to pile up.

Let's begin with Retail Sales.

Econoday's most recent weekly report provided data for August. In China retail sales were up month on month in August by 1.1% having fallen 2.6% in July. The year-on-year figure came in at +0.5% before inflation. In Japan household spending fell 3.9% in August and was down 3.0% year on year. For the EMU (European Monetary Union) August sales rose 0.3% having fallen 2.6% in July. Year on year there was no growth.

In the USA, according to the Chicago Fed 'CARTS' Index based on the Census Bureau reporting of weekly retail data, September Retail sales less Auto sales rose by 0.2% adjusted for inflation. But as Graph 1 shows, the fall in auto sales was dramatic. <https://www.chicagofed.org/publications/carts/index> JP Morgan's high frequency data paints a gloomier picture for September with card transactions down 5%. <https://privatebank.jpmorgan.com/content/dam/jpm-wm-aem/global/pb/en/insights/eye-on-the-market/S1-US-reopens-embedded.pdf>

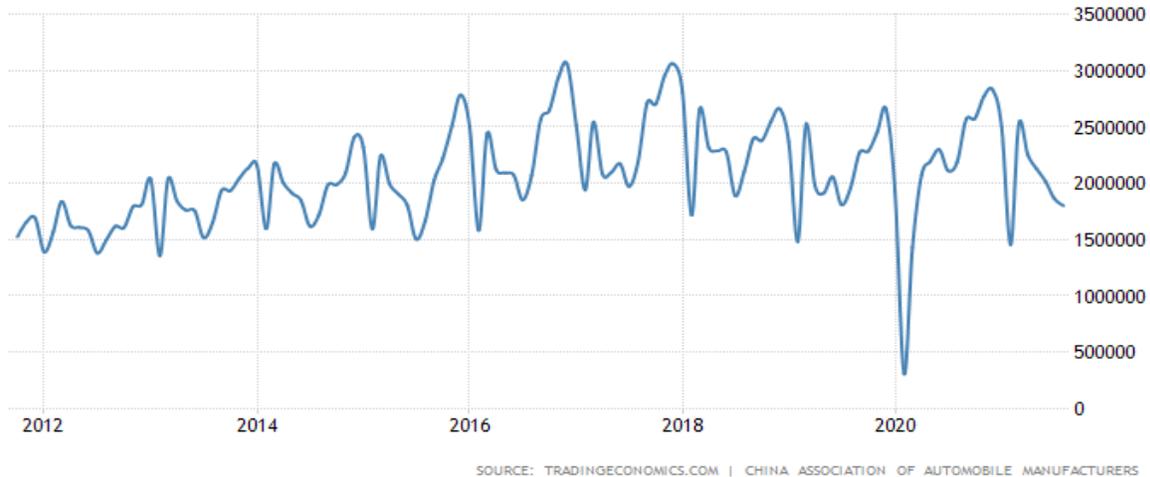
Graph 1.



The plunge in US car sales to a low of 12.2 million vehicles annualised in September fell below the consensus figure of 13.4 million. A number of experts acknowledged this was not entirely due to chip shortages which constrained car production, but to sales having been brought forward last year and earlier this year courtesy of the COVID Relief Funds. As US car sales represent 22.5% of retail this reduction in sales will impact overall retail sales and therefore consumer expenditures.

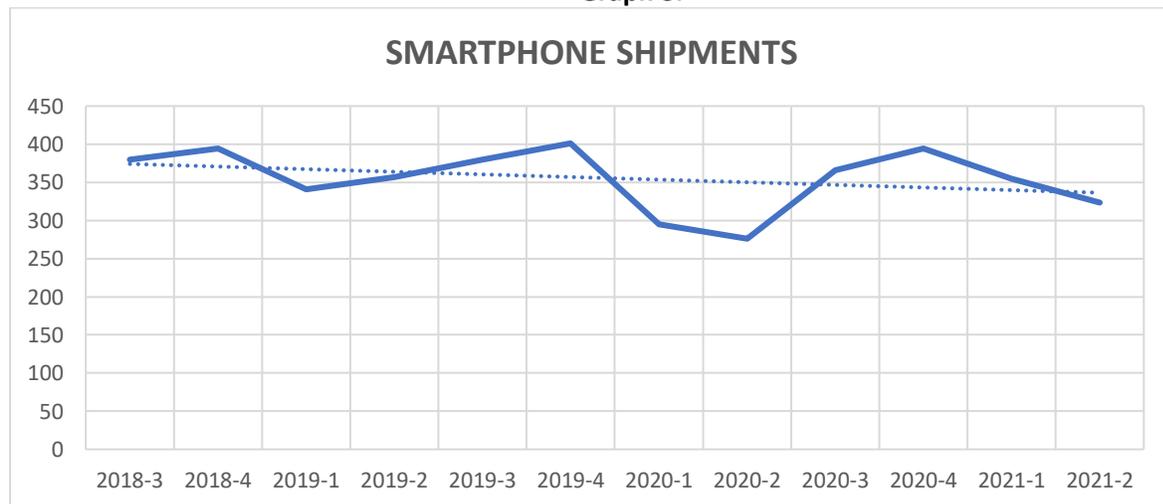
The same applies to the largest car market in the world, China. Once again car sales fell in August. Car sales dropped by 18.2% compared to a year ago, the fourth monthly fall in a row.

Graph 2.



The same applies to the world’s second largest consumer product, smartphones. They too fell in volume in Q2. They were down 18% compared to the same Quarter in 2019. In fact comparing the so-called boom in sales caused by COVID, and taking the best previous quarters into account, the running average was still down 5% compared to 2018 and 2019. That 5% exceeded the shortages of delivered phones due to chip unavailability of 3%. The trends can be found in the Graph below. Data for the third quarter should be out towards the end of October.

Graph 3.



<https://www.counterpointresearch.com/global-smartphone-share/>

This picture is amplified by global data. Although the broadly referenced CPB Trade Monitor only covers July in its most recent release, it already shows a sharp slowdown in world trade and production which is not entirely attributable to the Delta Variant. It shows world trade and production retreated by 0.4% and 0.3% respectively. <https://www.cpb.nl/en/world-trade-monitor-july-2021> This view is reinforced by the bi-annual release of the Brookings-FT Tracking Index for the Global Recovery (TIGER). It found the recovery “appears in danger of stalling”. It argues that government intervention this time around in the presence of supply side constraints, will be more complex and problematic. And it shows how deep the scarring has gone in dominated (developing) economies unable to resort to fiscal measures and handicapped by the dearth of vaccines. (Brookings Data Show Global Rebound at Risk by Chris Giles, F.T. 11th October.)

Gaming the system or genuine shortages.

The commodity that has exemplified supply chain issues has been computer chips. Computer chips are found in most non-edible products. A shortage of chips therefore inhibits production everywhere. But is there an actual production shortfall. In an earlier post I compared the value of global chip production to user markets such as cars, smartphones, and other computer items. Probably, given the balance between chip production and end user demand, it did not appear there was a supply problem nor a demand problem. This latter effect is confirmed by the first three graphs where the volume of cars and smartphones are down significantly from their pre-pandemic levels.

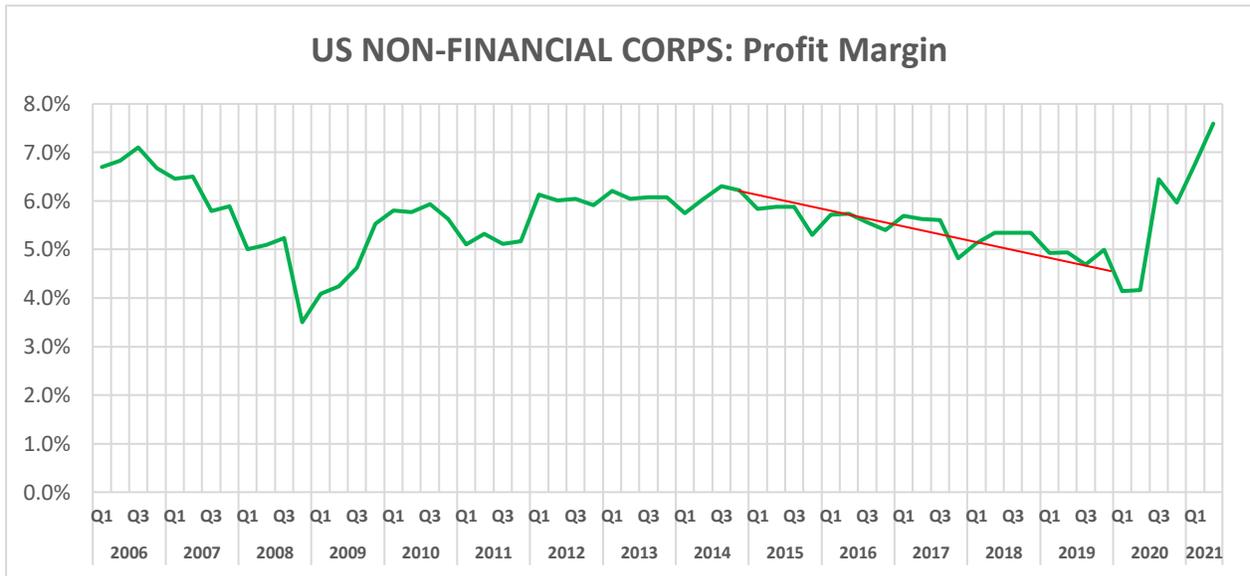
This observation seems to be confirmed by the chairman of TSMC, the Taiwanese firm that dominates global chip production with its FABS. *As Liu explained unpredictability and uncertainties in the global chip industry were mainly caused by the US sanctions against the Chinese tech companies. “We believe currently the total production capacity is still bigger than real market demand”, as quoted by the Nikkei Asia Review.* Comments by TSMC Chairman for shortage of chips <https://roboticsandautomationnews.com/2021/05/26/tsmcs-chairman-real-reasons-for-the-global-chip-shortage/43430/> So earlier this year he concluded that total production capacity was sufficient to meet market demand, which by the way has fallen from its mid-year levels. For example high frequency data for Q3 smartphone deliveries are down on Q2 while the boom in gadgets to work from home is over as well. “Despite its total production capacity being adequate”, TSMC could not resist joining the inflationary wave by raising its own prices.

The debate about production bottlenecks mimics the discussion in mid-year on this website about soaring new house prices in the USA, which was also blamed on low inventory, but which did not correct even when inventory built up including that of the more expensive homes. The same applies today. Inventory levels are going up worldwide with the possible exception of retail inventories, but certainly in the field of manufacturing and wholesale. It appears the shortage of labour, containers, trucks, and trains and previous production deficits has been overtaken by gaming the system.

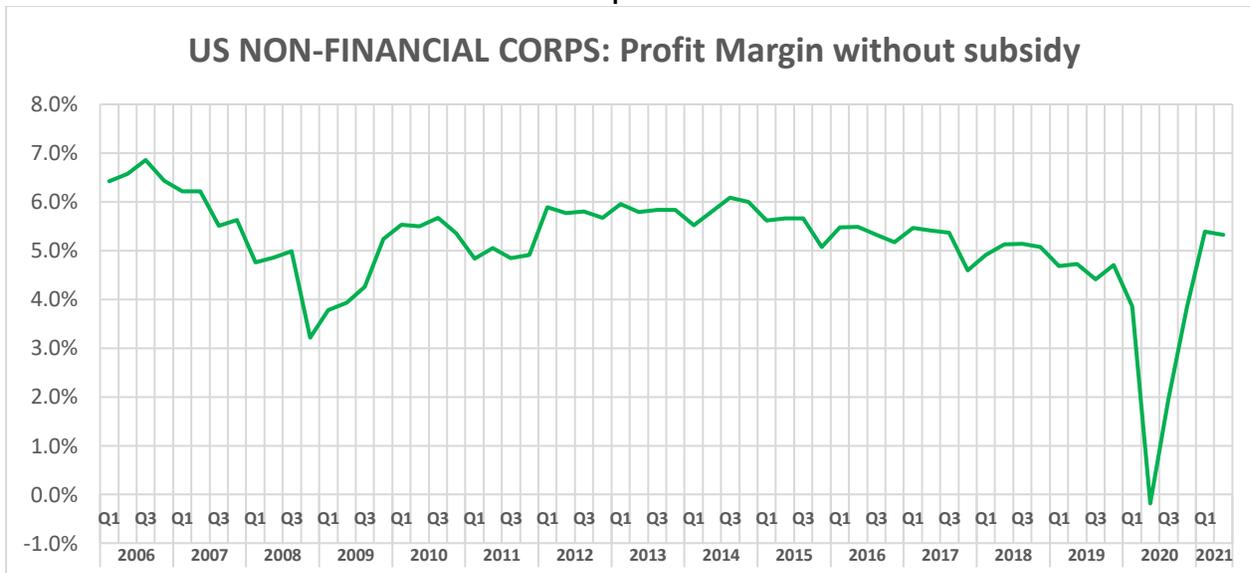
It is contradictory that at a time when end user demand is faltering, price pressures continue. Under these conditions one can assume that it is probable that producers such as shipping lines are maintaining artificial shortages, that they are skilfully under-utilising their capacity, and that they are taking advantage of the COVID Funds effect to boost their margins. After all less than 2000 companies dominate the global economy.

This does appear to be the case in the USA at least, as the Graph below shows.

Graph 4A.



Graph 4B.



(Source: Table 1.14 for pre-tax profits and gross output, GDP-by-industry for turnover.)

In Graph 4, we see a declining profit margin beginning at the end of 2014 and extending all the way through to the end of 2019. This is associated with an absolute fall in the rate of profit which I have mapped out in other posts. For this period the average margin was 5.4%. For the 4 quarters to which Covid Funds applies, margins jumped to 6.7% but this was also due to subsidies. This actual difference in margin translated into an additional \$340 billion in annual pre-tax profits with subsidies and £200 billion without subsidies. This \$200 billion figure picked out of the pockets of consumers when added to the \$950 billion given directly to US non-financial corporations by the Government amounted a total of £1,150 billion. To put this in perspective, this windfall almost equals the \$1,300 billion in total pre-tax profits earned by these corporations during the entirety of 2019.

Of course, corporations raising their prices in the end is self-defeating. As has been shown on this website a number of times, from the vantage of gross output, or total sales, capital in the form of fixed investment and circulating dominates the circuit of commodities. Circulating capital for example is one and three quarters larger than Personal Consumption Expenditures annually. That being so, one capitalist's output is another capitalist's input, and if output prices are going up then so too must be input prices. <https://theplanningmotivedotcom.files.wordpress.com/2021/05/gross-output-vs-gross-value-added-1.pdf>

Rising output and input prices in the end contra each other out and profit margins no longer rise. If however, end use is dampened by these price effects, then margins become squeezed. This is felt first by producers at the end of the production chain where demand effects are more immediate. We are likely to be in this situation currently.

If that is the case then profit releases covering the third quarter which are trickling in will show this effect.. Squeezed margins and therefore declining profits would undermine share markets already pressurised by rising interest rates. Thus the next few weeks will determine if the bubble economy continues or if it finally expires despite the CPR and TEEs from central banks.

China vs the USA.

I was going to review the book commissioned by the Brookings Institute titled '*China Today*'. I have decided against it because it is not only partisan but verging on jingoism. Written by a panel of leading experts in their respective fields, they discuss the rise of China which they see as a capitalist state but with strong central control based on authoritarian rule, and how the USA should respond to either constrict its development or outcompete it. Really a case of USA good, China bad.

Where this book does succeed is to plot the political landscape carved by the escalating economic conflict between these two powers. It shows how complicated life can become when competing powers collide and it is witness to the colossal waste of human labour time, especially intellectual labour time, when the world economy splits into two technical architectures. Who says capitalism engenders efficiency, this book is testimony to the opposite, the epic waste and redundancies integral to this system.

Above all, this book helps explain why the phase of globalisation which lasted for 20 years began to peter out in the middle of the previous decade. Globalisation was essentially based on the emergence of a new international division of labour whereby the dominant economies specialised in Research & Development (and advanced engineering) while China became the contract manufacturer or more accurately the contract assembler of choice. By the mid-teens China had begun to gather together unrivalled engineering expertise, experience, and resources as it emerged to become the workshop to the world.

It was no longer content to simply produce for others. It sought to produce for itself. No longer was the mass of imported inputs assembled for export, but an increasing share began to be diverted into its growing internal markets soon to become the worlds' largest. This had the interesting effect of reducing the gap between world exports and GDP growth because less of its output was being re-exported and to a lesser degree, re-imported for final assembly.

The imperialists were affronted by China moving up the value and production chain. It seemed China no longer knew its place. The book has a chapter, one of its better ones, dealing with the growing antagonism

between Chinese industry and Germany industry, when Chinese firms started producing their own competitive products displacing German products. This is of particular significance, because China depended primarily on the machinery and equipment provided by German Corporations with which to industrialise, and these corporations in turn depended on the Chinese market for much of their growth and profits.

While the book tries to determine the balance of economic, financial, and military forces between the two, its biases undermine this investigation. It is much better to obtain this evidence from the horse's mouth so to speak. Earlier we heard from the chairman of the worlds biggest chip producer whose outstanding performance is made possible only by the use of Extreme Ultraviolet Photolithography (EUV) produced solely by the Dutch company ASML. This is what ASML's Chief Executive had to say at the recent *China Enterprise Future Development Forum*. Peter Wennink assumed that its monopoly would only endure for another three years, and that within 15 years China would be dominating the global chip market. He is right about the 3 years and wrong about the 15 years which is too pessimistic. Already at the 14nm and 28nm level, the bulk of advance chip production, China has produced much cheaper DUV (Deep Ultra-Violet) lithography machines though indigenous EUV is still years out of reach. <https://www.archyde.com/lin-yifu-lu-asml-bans-the-sale-of-lithography-machines-fears-that-it-will-be-overtaken-by-lu-and-withdraw-from-the-market-after-3-years/>

Nicolas M Chaillan is another front-line spokesman. He was the first chief software officer employed by the Pentagon. Now he is gon, having resigned. His resignation letter is attached to the link below. As he told the Financial Times over the weekend in his first interview since resigning, the USA has lost the AI and software war with China. He criticised the slow pace of technological transformation within the US military. It is a done deal he said and within 15 years China will overwhelm the USA. It is worth reading the letter in full which appeared on LinkedIn.com https://www.linkedin.com/pulse/time-say-goodbye-nicolas-m-chaillan/?src=aff-lilpar&veh=aff_src.aff-lilpar_c.partners_pkw.10078_plc.Skimbit%20Ltd._pcrid.449670_learning&trk=aff_src.aff-lilpar_c.partners_pkw.10078_plc.Skimbit%20Ltd._pcrid.449670_learning&clickid=2gXxumxlOxyIRXJ2Aj3fJVK6UkBXMK3110lt0Q0&mcid=6851962469594763264&irgwc=1

There is one chapter in *China Now* which is perceptive. It discusses Xi's balancing act between the metropolitan areas which are at the heart of China's economic success and the rural areas. Many of Xi's political competitors had their bases in rural areas which meant that Xi had to raise living standards there to undermine his opponents. It meant that the project of lifting the Chinese out of poverty was self-serving, therefore not enduring.

But this was not Xi's main concern. It was the metropolitan areas that were key, city over countryside, and here he was tasked with maintaining loyalty as the economic war with the USA commenced. It was clear that the US state department had a two-fold strategy, inhibit China's technological development and disturb the metropolitan areas in so doing. The Chinese "middle class" may suffer authoritarian rule at home, but they are great travellers, are outward looking, and consumers of the best the world can offer. For example China and its tourists account for nearly a third of the global market for luxury items (Statista). Thus the State Department assumed that if the Chinese middle class became disaffected because of the tribulations caused by this economic fight, they would turn on the Chinese Communist Party.

We shall never know, because the Pandemic and January 6th, showed the United States to be an inept and incoherent society certainly not a country to be emulated by the Chinese "middle class". The main point

to be made is this. If the USA is unable to hold back China or disturb it politically, then it will resort to war. The USA has everything to gain from such conflict and everything to lose should it not act.

There has been much debate on Michael Robert's website regarding China. I would like to restate my position. I consider the United States to be the aggressor and the threat to the world, not China. As a sub-imperialist power by virtue of its porous technology, it has everything to gain from peace. Unlike the USA, time is on its side, but this advantage will not be ceded by the USA. It is not so much defending China as it is preventing the USA from embarking on war. It is not so much defending the absence of democratic rights in China as it is exercising the democratic rights won in the West to frustrate the plans of the war mongers.

It must never be forgotten these two powers are fighting in a ring, with ropes woven by the law of value. After 2008 it was China who uplifted the world economy with the greatest wave of industrial investment outside of war in the history of capitalism. Today China is as fragile as the USA despite its better organisation. They may both be perpetrators but at the same time they are the victims of the most constricting force born of the law of value, the tendency for the rate of profit to fall.

The property bubble may appear disconnected from the Chinese economy. It is not. The property bubble became unsustainable because of the collapse in profitability of the Chinese economy. Speculation is always watered by the fountain of value and when that fountain starts gurgling, drying out the speculative edifice, it begins to crumble.

Conclusion.

The second half of October resonates with significance. This week US inflation and retail sales data will be published. Within two weeks the profile of profits will become clear. Markets are currently gyrating. They are nervous, and further cascading bad economic data could undo them. Close attention is needed.

11th October 2021.