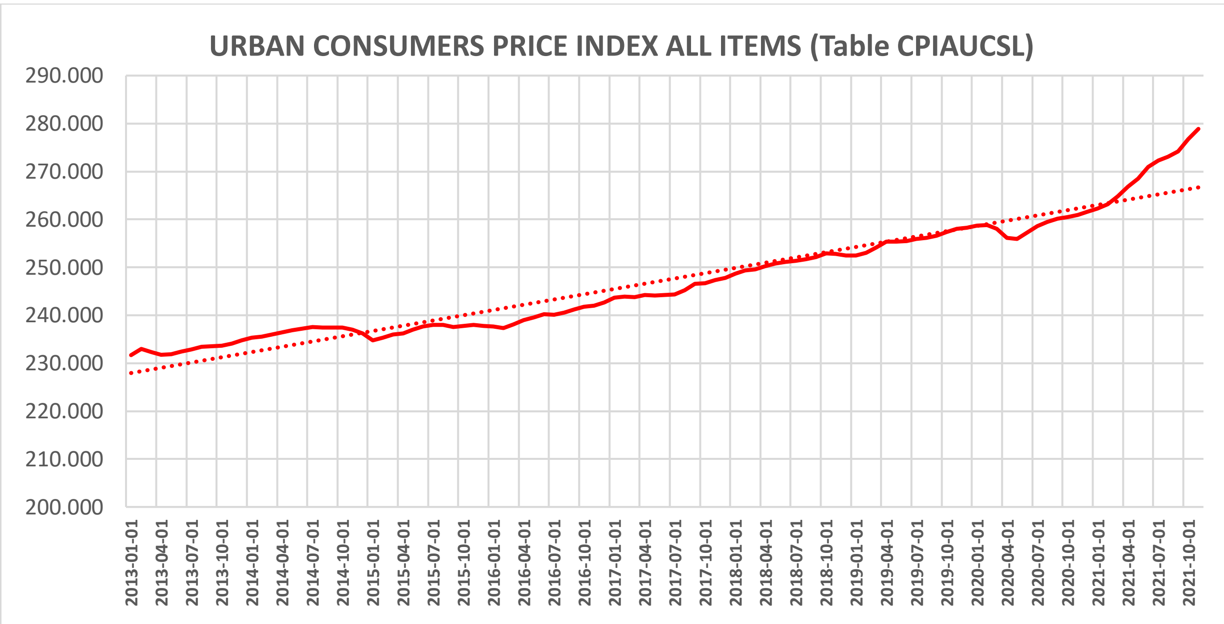
BACK TO THE PAST – 2016
This time the global economy may not avoid recession.

The global markets had their worst opening week since 2016. Despite the pandemic there are a number of similarities with 2016. Global growth slowed dramatically into the final quarter of 2015 and remained subdued in the first quarter of 2016. Stock markets took note and retreated. I called this period the "psuedo recession" because it was not allowed to develop into a fully fledged recession because of central bank support, but which in hind-sight was needed to clear away the dross.

The only difference this time is the perspective of higher interest rates because of the persistence of inflation. In 2015 prices barely rose but by the end of 2021 they were rising at over 6%, well above trend.

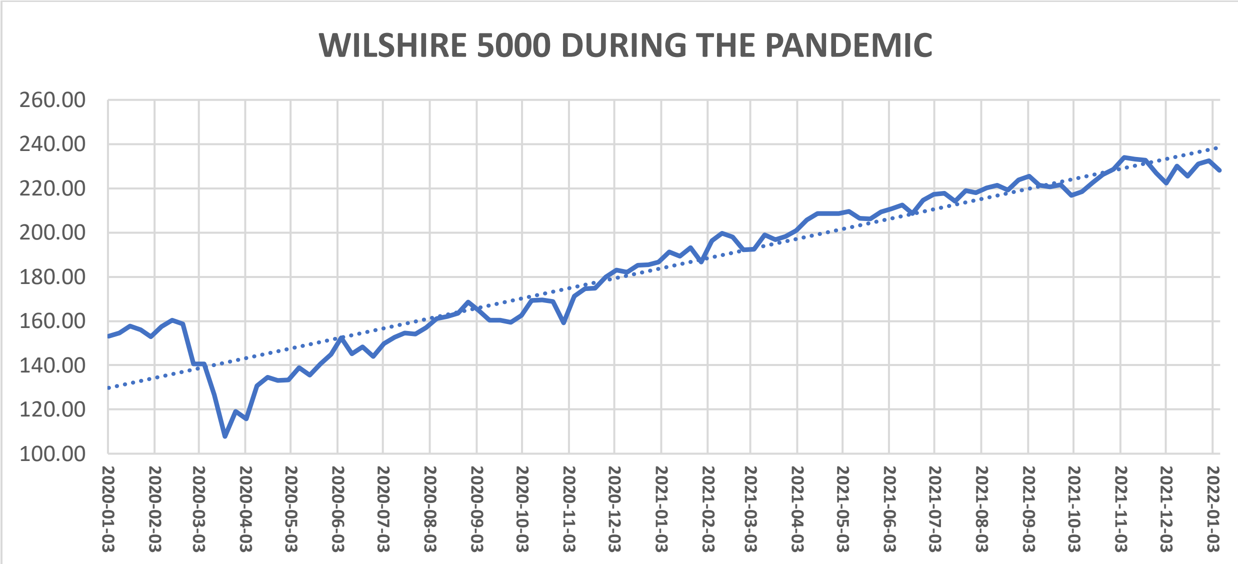
GRAPH 1.



Turning to the stock exchange. Stock prices are now below their mid September point. It is clear that the market cap of shares are beginning to fall having risen by over 47.5% during the course of the pandemic. This is primarily due to the reversal in the fortunes of the biggest Tech companies who have been driving the stock markets. As their prices fall, so too does their weighting in the markets. Thus their fall has a moderating effect on the overall fall of the market. The fact that the market is continuing to fall shows that the selling of these Megaliths is not being compensated for by rotating from these shares into so called underpriced and value driven shares. It is worth pointing out that financials i.e. banks are only 11% of the total market.

It is not only stock markets that are falling. Bitcoin has already fallen 15% in 2022 heading for the so called death cross when according to folklore it should turn into an Albatross. What is driving these falls is the perception that the period of easy money extending as far back as 2009 is over for the time being. The markets are convinced that the FED will be raising rates this year. Thus a correction is in progress, the so called rebalancing to new financial conditions.

Graph 2.



Graph 3.

WILSHIRE 5000, 2015 versus 2021

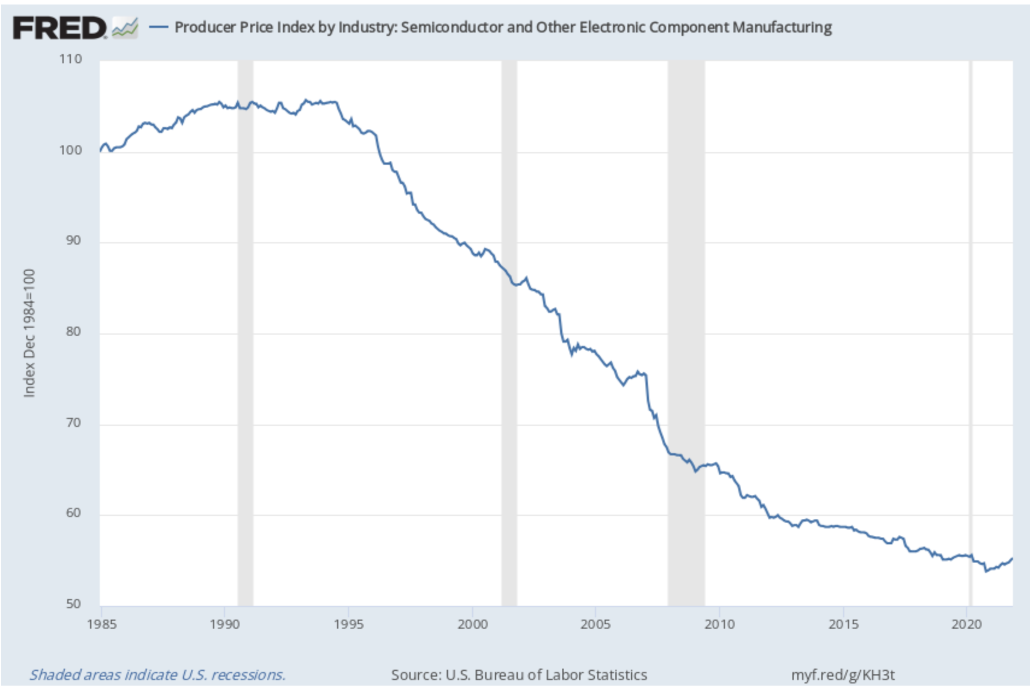
https://assets-global.website-files.com/60f8038183eb84c40e8c14e9/61d89e2c37f5eb84eeb317d7_ft-wilshire-5000-fact-sheet.pdf

But for a correction to turn into a crash, for share prices to fall by at least 20%, requires unexpectedly bad economic news. There are two important releases this week, Wednesday's inflation & Friday's retail sales. Lower than expected inflation will be good for the markets because it will relieve the pressure on the FED to act. As I have said previously, I expect a sharp pull back in demand which will have the effect of reducing demand led inflation. This is important. Capital today is highly concentrated. For example, just 9 shipping lines control 83% of global freight in tonnage. They dictate prices. The UN in November calculated that rocketing freight rates had added 1.5% to global inflation. It appears that under investing in shipping in the years prior to the pandemic while buying each other (consolidation), has paid off handsomely.

Due to this concentration in every industry and in distribution, firms have been able to maximise any advantage in demand. What is curious is that at every step, from mining, to manufacturing, to shipping, to retail every segment has profited. There is no link in the chain that has not seen its profit margins expand. It's like a game of leapfrog with prices jumping over each producer and each merchant in order to reach consumers and empty their pockets of any Covid funds.

There can be no better industry to investigate than the Chip industry dominated by just two key Foundry players, TSMC and Samsung. Before proceeding it is worthwhile to obtain a longer-period perspective of pricing in this industry. Moore's law, until the industry hit 7nm, saw a sharp fall in electronic prices as more transistors were squeezed onto the same size chip.

Graph 4.



Prices have halved since the 1990s and even the recent rise in the price of electronic components is unlikely to return the PPI back to 60 despite the spectacular current price gouging found in the industry as can be seen in the table below. October's WSTS industry forecast projected annual global sales to increase by 25.6% in 2021 and 8.8% in 2022. However, by November the annual rate had fallen to 23.5%. Nonetheless, for the first time, annualised global sales of electronic components breached $1 trillion when it hit $1.05 trillion for the eleven months to November.

However, as the graph below shows, the trend is downwards and as the report indicated, expected revenue growth in 2022 will fall to only 8.8%. Given continuing price inflation that represents a fall in volumes. Turning to Graph 5, the revenue growth in 2021 is of the same order as occurred between 2016 and 2018. The difference then was the growth in volumes. In 2021 the growth in revenues was all price-driven, which means that any hiccup in demand will cause this notoriously volatile industry to nosedive. (Note how weak prices were in 2019.) https://www.semiconductors.org/global-semiconductor-sales-increase-23-5-year-to-year-in-november-industry-establishes-annual-record-for-number-of-semiconductors-sold/

Table 1. Prices in the 2nd half of 2021.

Prices are surging in the chip supply chain

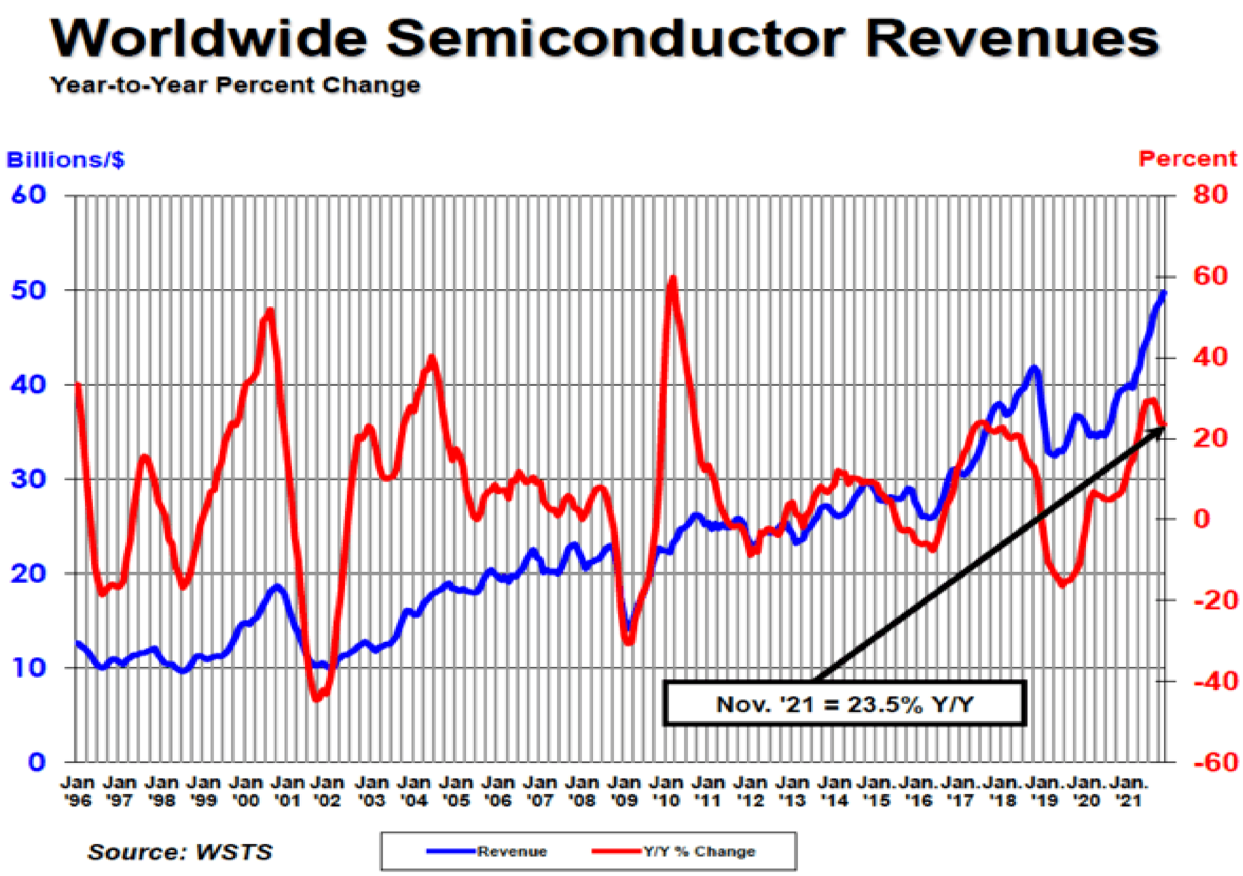
(Estimates around August 2021, change from a year earlier)

Display driver integrated circuits	Up to 50%
Copper	40%
General contract chipmaking services*	30%-40%
Microcontroller chips	30%-40% *(Up to 400% in extreme cases)*
Power management chips	30%-40% *(Up 500% or more in extreme cases)*
Leadframes	25%-30% *(Over 200% for some specifications)*
Ajinomoto build-up film	20%-30%
Chip packaging services	15%-20%
Cutting-edge contract chipmaking services	8%-10%**
Wafer materials	5%

*For mature production technology including image processors and power management chips **Based on TSMC's plans to increase prices for advanced chip production by Oct. 1

Source: Nikkei Asia analysis based on data from companies, Nomura Securities, Counterpoint Research, Sanford C. Bernstein

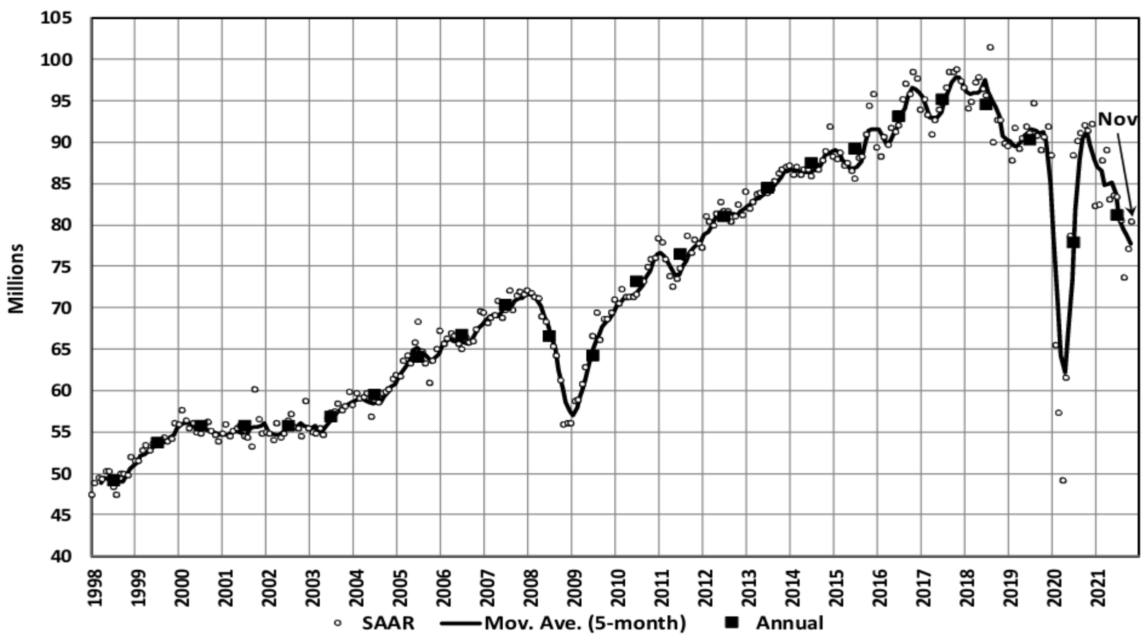
Graph 5.



The effect of inflation in the chip market can be read into Samsung's latest earning forecast. *"Consolidated sales for the period came in at around KRW 76 trillion, while consolidated operating profit was approximately KRW 13.8 trillion. That represents around a 52% year on year jump in profits for Q4 2021, and a 23% rise in sales. Which sounds like great numbers to finish off the year with, but apparently market expectations were even higher."* https://telecoms.com/512851/samsung-forecasts-a-hefty-52-q4-profit-hike/ And despite the prospect of a more subdued market in 2022, TSMC the market leader is still going ahead with yet another price hike.

More ominously, the biggest markets for chips other than servers are declining or stagnating. Car sales which incorporate an average of $500 of chips are down by 15 million units, not all of which is due to chip shortages. However, this quantitative analysis needs qualifying. Car firms, particularly in Europe and North America have focused on selling their more expensive, higher margin cars which contain more chips.

Graph 6. Global Car Sales up to Nov 21.

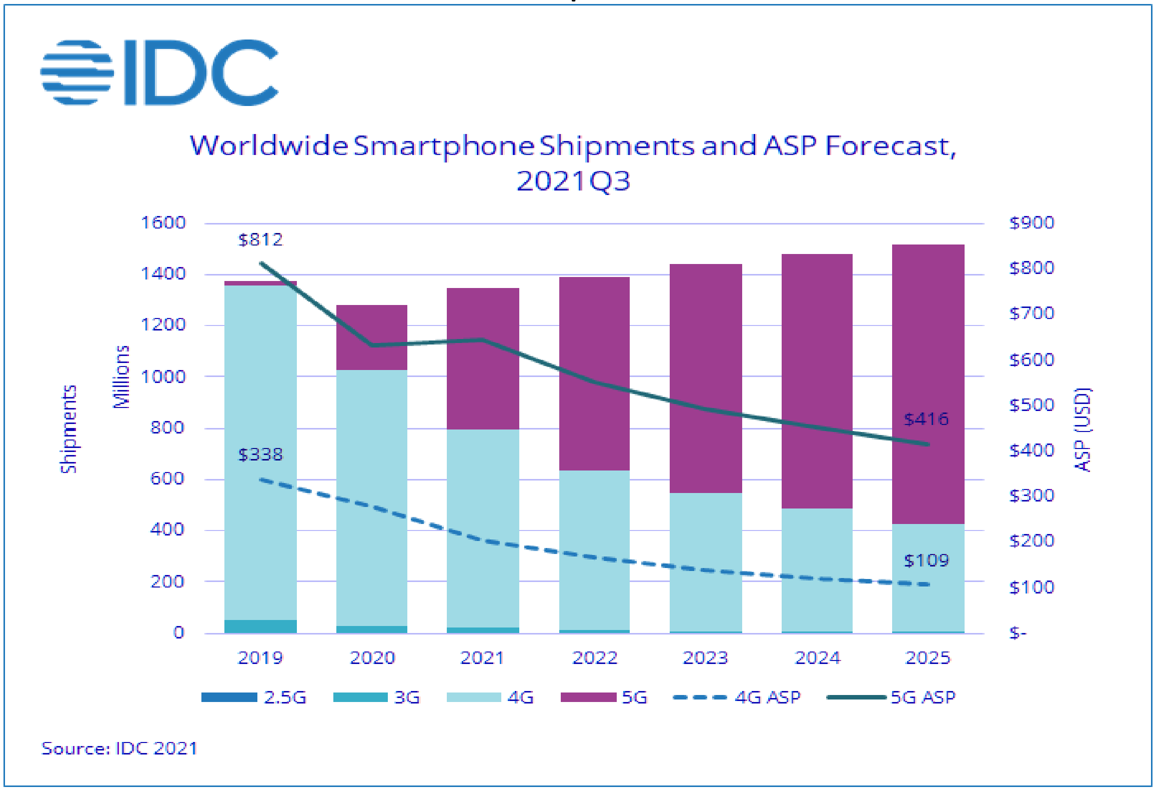


https://lmc-auto.com/news-and-insights/public-data/

The same stagnation in volume sales has occurred in the computer and tablet industry. Worldwide PC shipments totalled 84.1 million units in the third quarter of 2021, up 1% from the third quarter of 2020, according to preliminary results by Gartner Inc. Total tablet PC sales were down 2% but up 10% from 2019. https://www.gartner.com/en/newsroom/press-releases/2021-10-11-gartner-says-worldwide-pc-shipments-grew-1-percent-in-third-quarter-of-2021 https://www.canalys.com/newsroom/global-pc-market-q3-2021

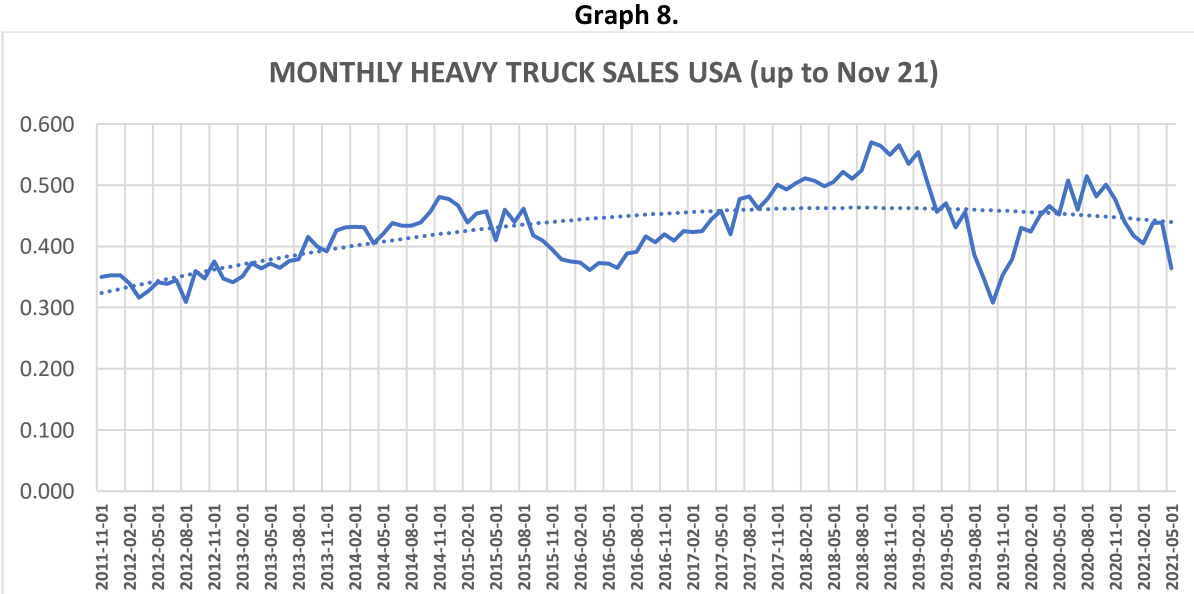
The same stagnation is to be found in the Smartphone Market. It can be said that the numbers game does not reveal the shift in the USA to higher end smartphones such as Apples iPhone 13. Nonetheless the data is accumulating suggesting that the COVID goods surge in demand is over. The combination of an easing supply chain, overextended consumers, and industries continuing to push prices higher is going to end badly for them. Much of the revenue growth is due to inflation not volumes and that means an industry which has got rich by making consumers poorer. This works only in the short-term.

Graph 7.



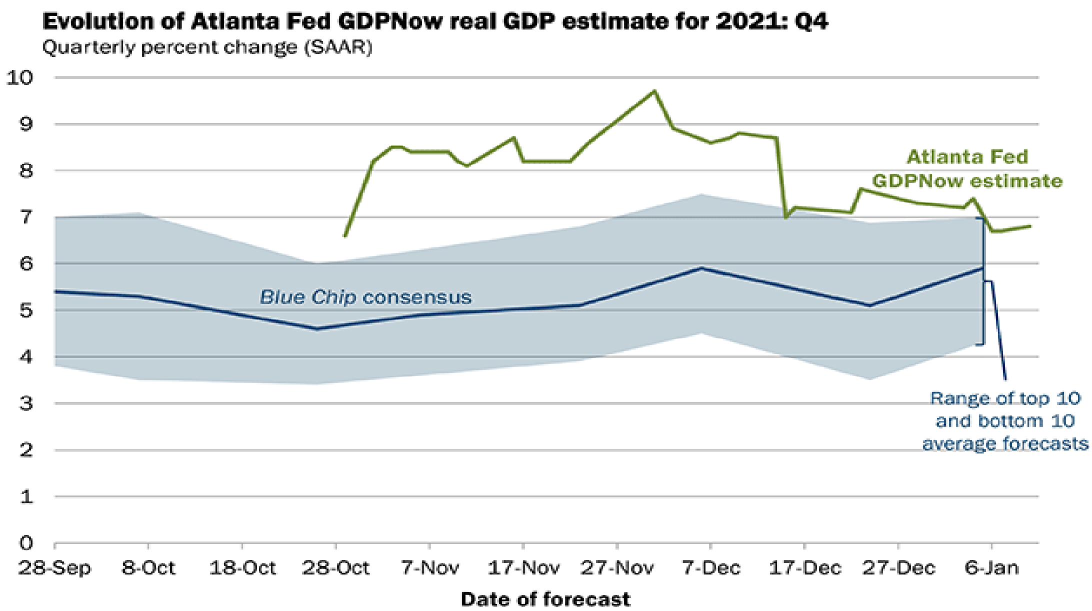
I would also like to add in US Heavy Truck sales for perspective. Admittedly production has been held back by chip shortages, but that does not account for the plunge in sales to levels last seen, you've got it, in early 2016. Once again it is a sign the surge in demand is waning. And it is evidence that despite the shift to goods, the freight volumes shipped in the US in 2021 never exceeded the average shipped in 2018/9. (Cass Freight Index) (Also note how few trucks were bought in 2019 leading to a lack of resilience.)

Graph 8.



All the high frequency data from CARTS (Chicago Fed) to Newsdesk reported a softening in consumer expenditures in December. The exception is MasterCard's report on card spending. https://www.newsdesk.io/six-high-frequency-indicators-for-the-economy/ The December CBO Report estimated total govt spending increased by only 4% in the first quarter (October – December) on an annualised bases while the increase in payroll taxes was only 5%. All of this data is soft, including the slow growth in job creation which fell below expectations in both November and December. Cumulatively, this has led the Atlanta Fed to water down its expectations of GDP growth in the Fourth Quarter by one third.

Graph 9.

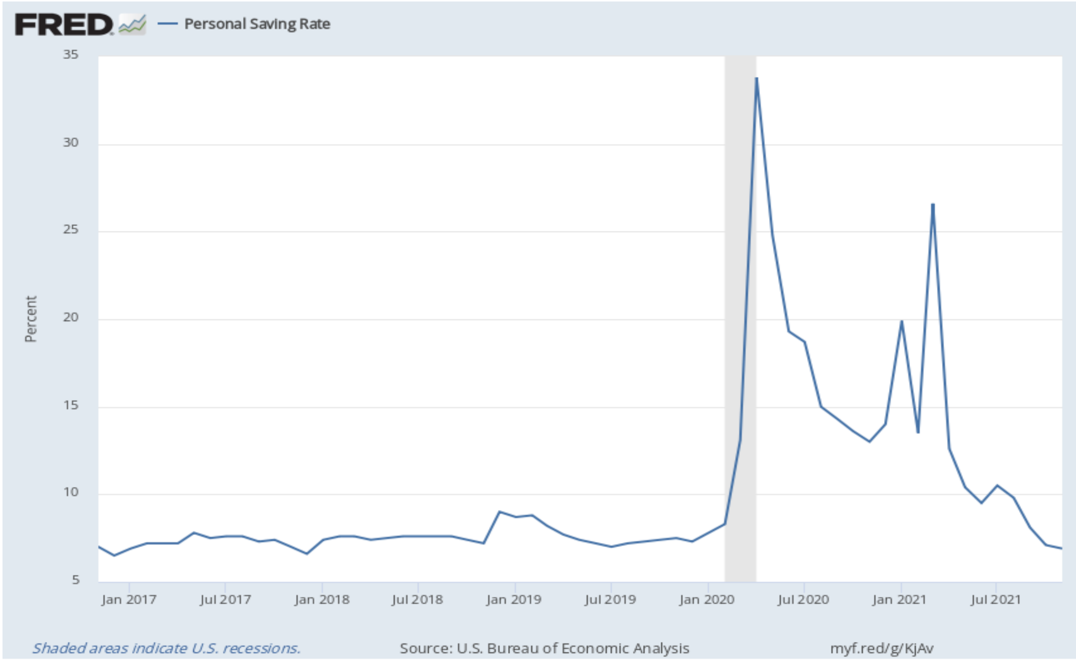


Sources: *Blue Chip Economic Indicators* and *Blue Chip Financial Forecasts*
Note: The top (bottom) 10 average forecast is an average of the highest (lowest) 10 forecasts in the *Blue Chip* survey.

However, Chief Operating and Financial Officers remain optimistic about 2022 in many major economies. The US Business Roundtable Quarterly Survey for Q4 is up 9.4 from their survey in Q3. https://www.businessroundtable.org/media/ceo-economic-outlook-index On Tuesday, Jamie Dimon, most probably the most influential voice on the Street, single handedly lifted stock markets with his rosy outlook for 2022. "*But the consumer balance sheet has never been in better shape. They're spending 25% more today than pre Covid. They've got $2 trillion in their checking accounts either have the wherewithal to spend more. They pay down a lot of debt. The debt service ratio has never been better since we've been keeping records for 50 years. Home prices are up, stock prices are up, jobs are plentiful and wages are going up. And that all tells you what's going to happen in the future. They're in pretty good shape. And businesses, confidence is high, they've got plenty of cash and capital."* That was Dimon doing the rounds today in conversation with CNBC, declaring Americans with some exceptions, have never had it so good nor been so financially sound. Hmmm. The same applies in the UK where Ernest &Young's survey of CFO found them to be optimistic about the UK economy in 2022.

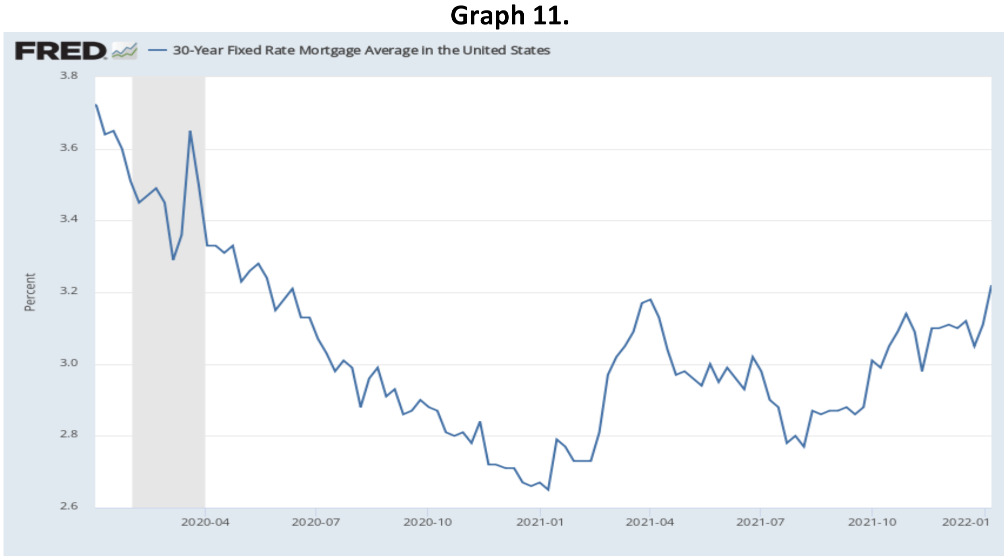
It is of course curious why Dimon would highlight the $2 trillion when in fact the personal savings rate is not only back to historical levels but is also being eroded by high levels of inflation. Inflation makes savers less confident not more confident as any banker knows.

Graph 10.



And it is curious why he should highlight house prices. House prices is the canary in the coal mine. It is the most sensitive of industries to changes in market conditions where sales have already been dropping and inventory building. Even before year end, and prior to the FED disclosing its intentions to raise interest rates in 2022, the rate of price increases was moderating. Since then, 30-year mortgage rates have risen to 3.48% this week, a weekly rise of a quarter of a percent bringing it back to pre-pandemic levels and rising. This has dramatically affected mortgage applications. "*The Market Composite Index, a measure of mortgage loan application volume, decreased 2.7 percent on a seasonally adjusted basis from two weeks earlier. On an unadjusted basis, the Index decreased 32 percent compared with the two weeks ago…and was 12 percent lower than the same week one year ago.*" https://www.mba.org/2022-press-releases/january/mortgage-applications-decreased-over-a-two-week-period-in-latest-mba-weekly-survey

Graph 11.



Shame, is that all one gets from a banker who is paid over $30 million a year ++? Perhaps his ulterior motive is to talk up the markets so he can cash in his share options while the going is good, aka 2008. So it is not only the Chinese property market which is wobbling, so too is the US property market.

Chinese Property Woes Deepen.

The graph below plots the *Markit iBoxx USD Asia ex-Japan China Real Estate High Yield Index (1/2021-1/2022)*. The index has effectively halved since mid-year. The scale of the debt involved can be seen in the table on the next page.

Graph 12.

https://www.cnbc.com/2022/01/07/chinas-property-problems-spread-to-once-healthy-developers-like-shimao.html

More ominously according to Bloomberg data, the value of Chinese house sales at the end of 2021 has fallen at a rate equal to that which occurred at the beginning of the pandemic. Of course it is worth pointing out that pre-pandemic, the last time this happened, was in 2015 during what I called the pseudo recession. It is said that the housing crisis is spreading to more and more parts of the housing market. This is incomplete, it is also spreading to the banking system. As the Financial Times reported earlier this year, Chinese banks are loathe to lend to the private sector because of perceived risk. Chinese Banks may be state owned, but no banker chases losses, not unless they want to volunteer to be scapegoated later on. ("*Chinese Banks Reveal Fears Over Economy"* F.T. 5th January) The law of value takes no prisoners.

Graph 13.

https://www.bloomberg.com/news/articles/2021-12-13/china-s-property-crisis-likely-dragged-economy-down-in-november

Table 2.

China's property moguls and their debt woes

Mainland developers, their debts and their key representatives at the 2021 Two Sessions

● All lines crossed ● Two lines crossed ● One line crossed ● Zero lines crossed

Developer, key person	Position at CPPCC/ NPC	Total debts (billlion yuan)
● China Evergrande, Hui Ka-yan	CPPCC, Economics	835.5
● Country Garden, Yeung Kwok-keung	CPPCC, HKSAR	342
● Shimao Group, Hui Wing-mau	CPPCC, HKSAR	141.2
● China Resources Land, Fu Yuning	CPPCC, Economics	164.5
● China Merchants Shekou, Li Jianhong	CPPCC, Economics	147.2
● Yango Group, Lin Tengjiao	NPC, Fujian	109.2
● Jiangsu Zhongnan Construction, Chen Jinshi	NPC, Jiangsu	78.1
● China Jinmao Holdings, Ning Gaoning	CPPCC, Economics	98.6
● Guangzhou R&F, Zhang Li	CPPCC, Economics	187.7
● Zhenro Group, Ou Zongrong	CPPCC, All-China FIDC	63.6
● Sichuan Languang Development, Yang Keng	NPC, Sichuan	71.4
● Powerlong Real Estate, Xu Jiankang	CPPCC, Macau	59.3
● Yuzhou Group, Lam Lung-on	NPC, HKSAR	64
● Macrolink Group, Fu Jun	CPPCC, Social Welfare	23.2
● Radiance Group, Lin Dingqiang	CPPCC, FROC	55.7

Source: Northeast Securities, Tianfeng Securities, company reports SCMP

https://ph.news.yahoo.com/china-property-debt-crisis-r-064909703.html

Conclusion.

It is often not appreciated how vulnerable a global economy, reliant more on price rises than volume growth, is to a correction. This was the purpose of this article. It sought to show that the fortunes of the major corporations were based on price leveraging made possible by the level of concentration found in every industry in the global economy and chains. When the correction comes in the form of waning demand, it will be brutal.

It is unlikely that there will be more COVID Relief Funds thrown into the world economy. It is unlikely that Biden will be able to pass any substantial spending package soon. On the contrary, around the world, treasuries are tightening up. In the US current Federal Spending which is running at 4% p.a. is well below inflation. The transformation in the perception of COVID, at least verbally, of the pandemic into endemic, is code for capitalist claw back to pare the debt.

In China, the bulk of spending is at local government level, and many are effectively bankrupt. Their predicament will intensify the more the property market and land sales upon which their finances rely, contracts. In 2018 local government raised 15% more revenue than central government but spent 575% more. (National Bureau of Statistics of China, 2019 Yearbook, Table 7-1) Only on Defence and Foreign Affairs, does the central government outspend local government. (Seems the Chinese State is less Federal than the US State.)

The FED will maintain the fiction that it is about to comprehensively tighten monetary conditions. For the time being it has to do so in order to talk down inflation. But its changed stance is rocking the stock markets and other fictitious markets, which has inadvertently confirmed Marx's observation that the key feedstock for speculation is low interest rates (cheap money). No doubt as soon as the markets start contracting, helping further crater demand, which in turn will deflate inflation, the FED will reverse course. Since 2008 it is the case the FED has only one forward gear and three reverse gears. Should the FED unwittingly burst the speculative bubble, then indeed the global economy will be plunged into a depression.

The US remains hostage to its stock markets just as China remains hostage to its property market. Neither is in a position to wage war though they must because the crisis of capitalism expects no less. Both major economies managed to escape a major recession at the close of 2015. It is unlikely they will be able to do so in 2022 because on every front the underlying economic conditions are worse than they were at the end of 2015. In may even turn out that the capitalist class rues the day they prevented the recession in 2015/6 which would have cleaned out the dross instead of allowing much more to accumulate, including history's biggest financial bubble. As Marx pointed out, recessions are not optional. Supressing them only leads to a bigger crisis further down the line, say in 2022.

It is a time to closely monitor events. Volatility has increased. I will thus seek to provide frequent updates to this article as and when the data for the fourth quarter is released. Matters are delicately balanced.

Brian Green, 11th January 2022.