CAPITALISM IS INSOLVENT

The question was posed; what will happen when the fall in demand overwhelms the supply side because consumers have been bled white by price rises. The answer - an inventory correction of epic proportions. All inventory corrections, which decelerate turnover raising the requirement for working capital, are associated with crises of liquidity and thus a rise in insolvencies. This is occurring right now. Or to quote Friday's F.T. headline: "Business Faces Perfect Storm of rising costs and lower sales".

Michael Roberts recently analysed the growing insolvency of the dominated (emerging) markets, titled *The Submerging Market Debt Crises.* To put this in context, global debt is around 300 trillion dollars of which emerging market debt (ex-China) was $36 trillion or 12% of the total. Of this $36 trillion, $8.4 trillion represents foreign currency obligations. This is the area where nations find it most difficult to service their debts because these countries are perennially short of foreign currency, particularly the Dollar and the Euro. https://wordpress.com/read/feeds/313842/posts/3928942823#comments

In contrast, the total non-residential mortgage market in the USA currently stands at $14.5 trillion, https://fred.stlouisfed.org/release/tables?eid=1192326&rid=52 while total US non-financial corporate debt stands at $11.65 trillion https://fred.stlouisfed.org/series/BCNSDODNS Together these two debt markets are three times larger than the foreign currency denominated emerging market debt, and if we take into account the other imperialist economies together with personal debt levels, at risk debt in the G7 is at least ten times larger than the emerging market debt described above.

But there is another form of fragile debt which is more significant than the ones already dealt with and that is trade debt. This is the single biggest credit-set in the capitalist economy. This becomes evident when we examine the average maturity of trade credit. According to Dunn & Bradstreet it is 37 days. In other words the maturity of trade receivables is 37 days versus nearly 6 years for US Treasury Bonds, vs 8 years for corporate bonds and 10 years for average residential mortgage bonds (all data for 2019). (Read this article from the Financial Times to find out how corporate maturities have grown in recent years as corporations have locked in low interest rates to help prevent defaults due to potential interest rate rises.) https://www.ft.com/content/85be899b-9b2d-449b-baa6-c93f5e529ec2)

Clearly the longer the maturity, the more these bonds or credits accumulate. The accumulated values for corporate bonds and residential mortgages have been provided above. However, for our purpose's annual issuance, once again for 2019, is the more important. The following amount of bonds were issued: corporate bonds $1.41 trillion, government bonds $<I trillion and new mortgages $1.63 trillion making a total annual issuance of $4 trillion. How does this compare to the annual issuance of trade credit.

This is seldom calculated and even more rarely reported. I have done this calculation before but here I will provide another more accessible approach. In the GDP-by-industry series provided by the BEA the data for intermediate inputs or sales is found. (https://apps.bea.gov/iTable/index_industry_gdpIndy.cfm) These inputs tend to be the sales between corporations where trade credit is found. As Marx pointed out, most commodities within production and commerce are circulated, not by money, but by credit, except during periods when credit breaks down and cash becomes King (C.O.D. as it is known).

We will use the data for 'total private industry'. And we will use quarterly figures as they coincide with the rate of turnover of about 4 found in the goods producing sector. On this basis the period-amount of inputs is $3.7 trillion. If we assume only 2/3 of that is circulated by trade credit, this reduces to $2.5 trillion per quarter. However the turnover period comprises both the production and the payment periods and our concern is limited to payments only (when cash comes in). Using the average 37 days of credit provided by Dunn & Bradstreet, equal to 40% of the turnover period, the $2.5 trillion is finally reduced to $1 trillion. Over the course of a calendar year, or 4 periods of turnover, that amounts to $4 trillion which is equal to the annual issuance of mortgages, corporate bonds and government bonds in the USA.

It turns out that producers and sellers are actually the biggest lenders of all. Trade credit is the mechanism whereby capitalism seeks to jump over the barrier of money and its cost. It was no accident that Marx focused on the centrality of trade credit as constituting the core of the credit cycle. It is the most fluid therefore most volatile of all the forms of credit. It is in the realm of trade credit where problems with the circulation process first appear. Therefore strictly speaking a financial crisis must follow an industrial crisis.

Again, speaking generally, the direction of travel is from short-dated credit to longer-term credit. Most observers therefore only acknowledge a financial crisis once it has jumped to longer dated instruments such as share and bonds, imperilling the markets for this paper. However the inversion of rates, where short-term interest rates rise above longer-term ratios, a negative spread so to speak, and which is always associated with an imminent recessions, hints at this process.

Normally long-term rates stand above short-term rates because the risk is seen to be greater over the longer term due to risk being indeterminable requiring a premium. Therefore for short term rates to rise above long-term rates implies a liquidity squeeze. Such a squeeze is proof of a growing crisis of profitability, or at least proof that insufficient profits are being realised to recoup working capital.

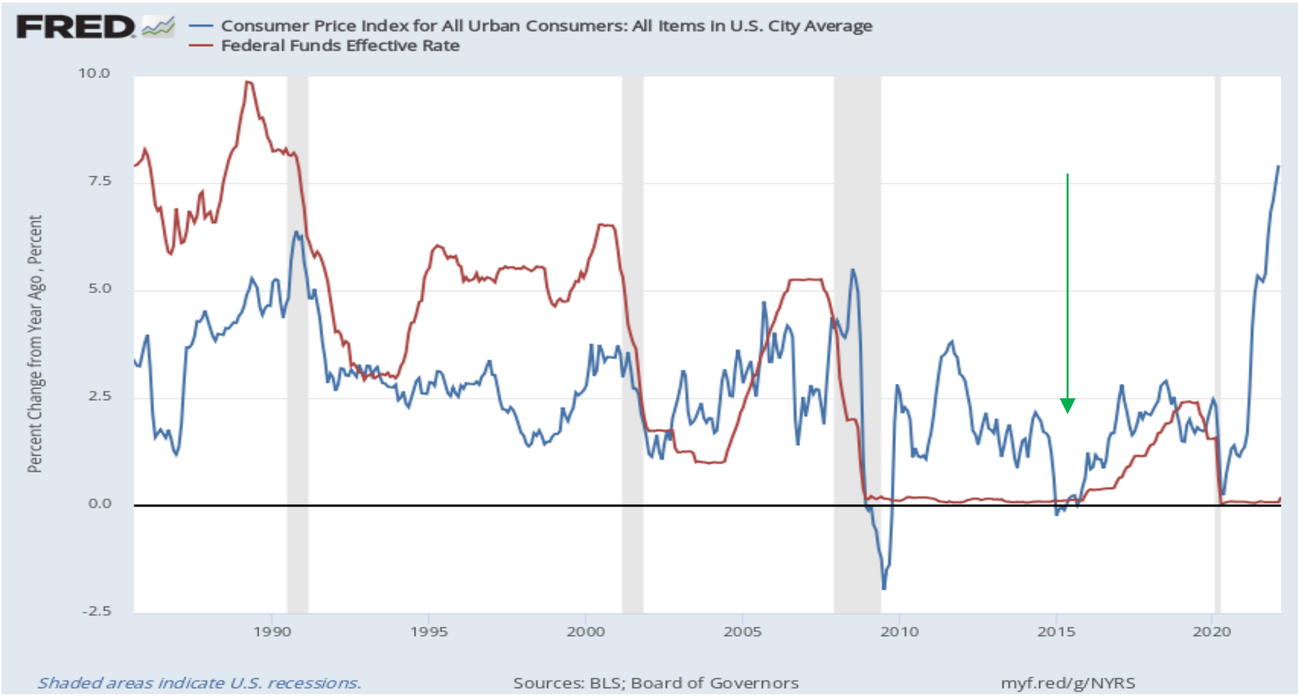
Central bankers are aware that short term rates spike when trade credit begins to shatter causing suppliers to demand cash up front. Bankers know this as well because they are inundated with desperate merchants offering trade bills for cash and who are not deterred by the deep discounts bankers then demand. The response from central banks is to suppress short term interest rates. The tools used have very little to do with QE though QE does set the background rates through its effect on longer term rates.

Central bankers act to contain the credit emergency by flooding the market with liquidity (lessons learnt after 2008). The tools used comprise temporary open market operations, reducing the Discount Rate (the rate at which central banks lend money to commercial banks) and Repurchase Agreements where central banks buy collateral offered by banks (which allegedly has to be A grade). This glut of money creates risk-off conditions and a search for yield, which encourages banks to extend short term finance to producers and merchants whom they would normally shun.

The results can be seen in the graph below which compares inflation to the interest charged by the FED for it funds. Prior to 2000, FED fund rates were positive, that is they exceeded inflation (the red line was above the blue). This changed after the dotcom crash, FED fund rates were negative until 2006 but only because inflation plunged. Then from 2010 with the exception of 2019 they were negative once more. Since 2020 the negative gap is the largest since 1980.

Turning to 2015 we see inflation collapsing during what I called the pseudo recession. In the run up to this, including the 2014 peak in profitability, we see zero response from FED rates. There are no cyclical changes at all. When Yellen eventually raised the FED rate in December 2015 by 0.25% she almost stalled the economy which registered a mere 0.6% growth rate for the quarter, and which only escaped contracting because the People's Bank of China loosened its purse strings.

Graph 1.

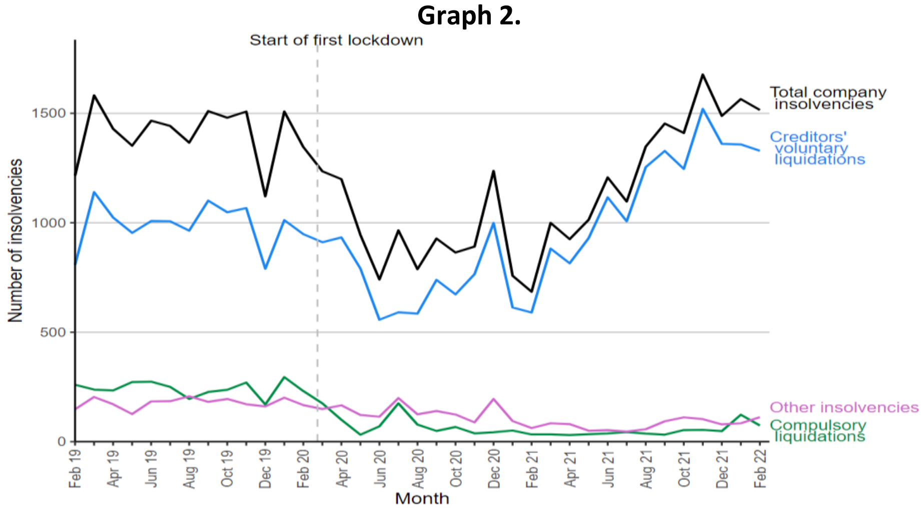


What is different about today is the rampant inflation which has been given a leg up by the Ukrainian war and kept there by growing lockdowns in China. This will tie the hands of the Central Banks caught as they are between containing price rises and dealing with deteriorating liquidity in production and commerce.

Beginning with the UK.

In the UK data is more current, providing insolvencies up to February. The most current data for the USA is for the fourth quarter, where insolvencies have yet to make an impact. If the data in the UK is anything to go by, then it is clear that the 1st quarter is the swing quarter where insolvencies start to multiply.

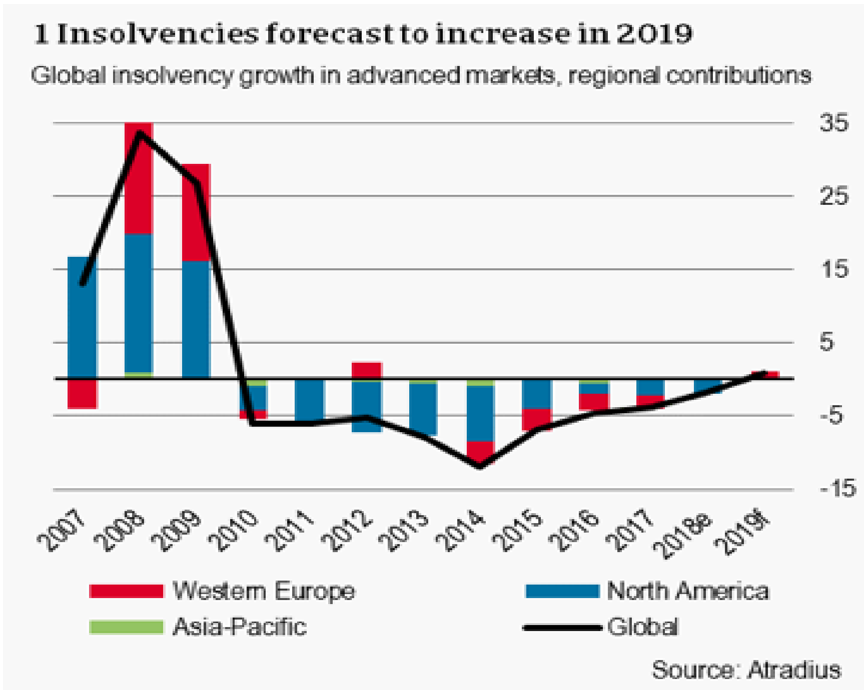
Graph 2.



https://www.gov.uk/government/statistics/monthly-insolvency-statistics-february-2022

The rate of insolvencies now exceeds 2019. Using 2019 as a base year is useful, because due to the stalling of the world economy in 2019 insolvencies rose that year for the first time in 10 years. At the time the graph was drawn up in 2019 Atradius projected an annual global increase of 2.8%. The outcome was 3.2%

Graph 4.

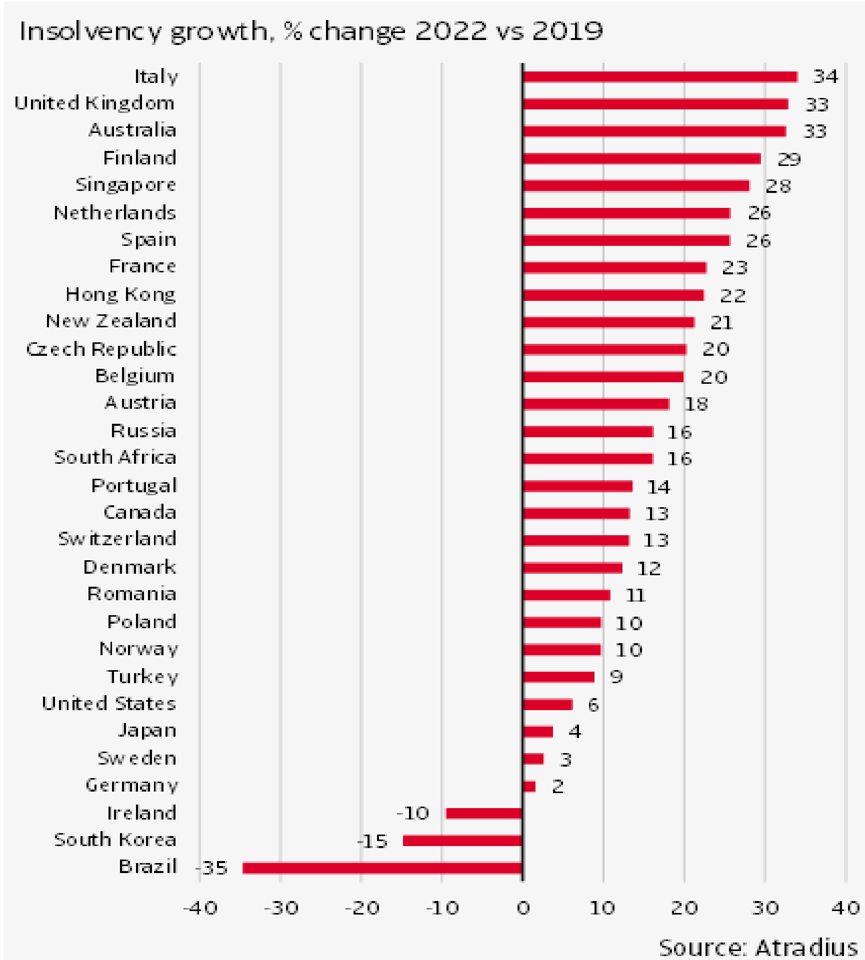


https://group.atradius.com/publications/economic-research/insolvency-forecasts-february-2019.html

"Crédito y Caución expects global insolvencies to increase by 33% in 2022. According to the latest report released by the credit insurer, the still low level of corporate bankruptcies this year is due to the extension of fiscal measures in many countries and the continuation of moratoria on the application of bankruptcy legislation". (11th October 2021 release) https://thecorner.eu/news-the-world/world-economy/corporate-insolvencies-to-increase-by-33-in-2022/98641/ The projection per country can be seen in the graph below. European countries are high in the list, but the USA is low at only 6%. This is unlikely to be the outcome. The level of zombie corporations is extremely high in the USA.

And given that this graph was published in October 2021 before the interest rate cycle turned, it is likely to be a significant underestimate.

Graph 5 (published October 2021)



https://group.atradius.com/publications/economic-research/insolvency-increases-expected-as-support-ends.html#:~:text=At%20the%20end%20of%202022%2C%20insolvencies%20are%20expected,and%20the%20return%20of%20insolvencies%20to%20%E2%80%98normal%E2%80%99%20levels.

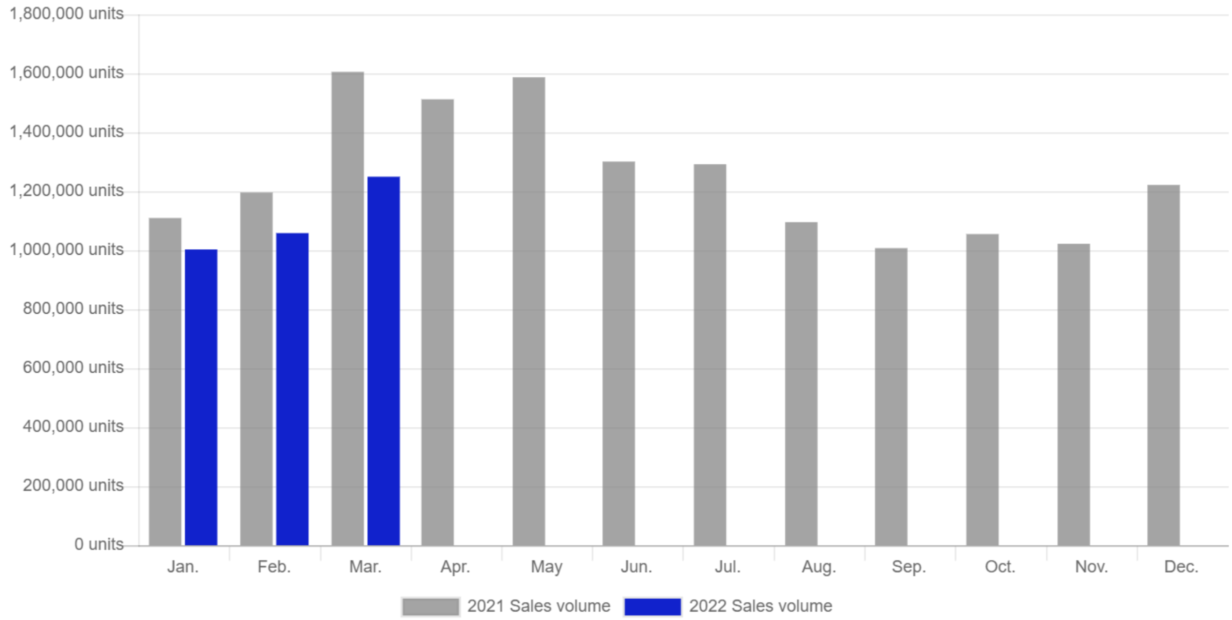
The USA.

While inventory releases for February were revised upwards, retail sales were revised downwards as March progressed. Auto sales for March was the first set of definitive sales released. "*General Motors reported Friday that its sales were down 20% for the quarter, while Toyota sales were off 15%. Stellantis sales were down 14%, while Nissan was off almost 30%. Honda reported a 23% decline, and Hyundai sales were fell just 4% from January through March U.S. new-vehicle sales in March finished at 1.25 million, with an annual sales rate of 13.33 million, according to Wards Intelligence… for February 2022 it was 14.15 million units versus 16.13 million units a year ago… for January 2022 it was 15.16 million units versus 16.84 million units a year ago".* These figures are all annualised (SAAR). Thus for 4 consecutive months, sales have fallen. *https://www.usnews.com/news/business/articles/2022-04-01/u-s-auto-sales-fall-in-q1-as-chip-shortage-slows-factories*

This fall in the volume of auto sales every month seems to belie the view that the fall is primarily due to chip shortages, particularly when the cars that use the most chips, electric vehicles, actually saw a sharp increase in sales which was led by Tesla.

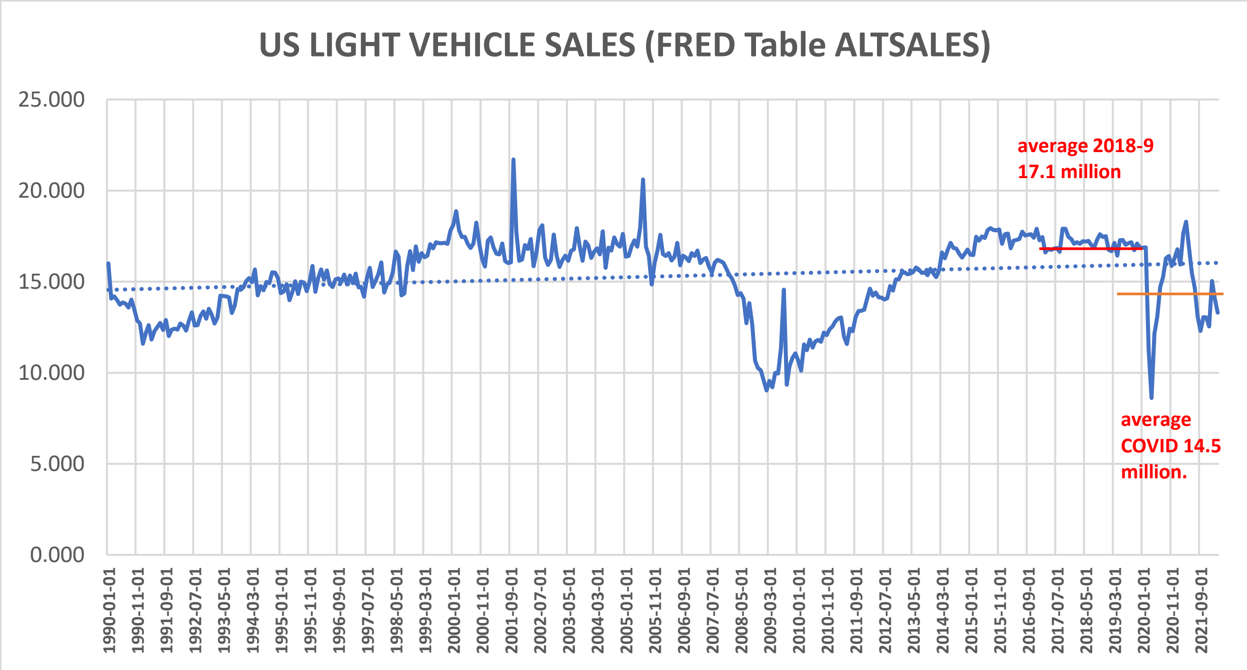
To put these sales into perspective there are two more graphs. Both show volume sales and are not corrected for the change in the composition of sales in favour of high end models during the last two years which raised overall values. However, the composition of sales appears to be reversing if the collapse in the March sales of Ford's F class gas guzzling pickups is anything to go by.

Graph 6.



https://www.marklines.com/en/statistics/flash_sales/automotive-sales-in-usa-by-month

Graph 7.

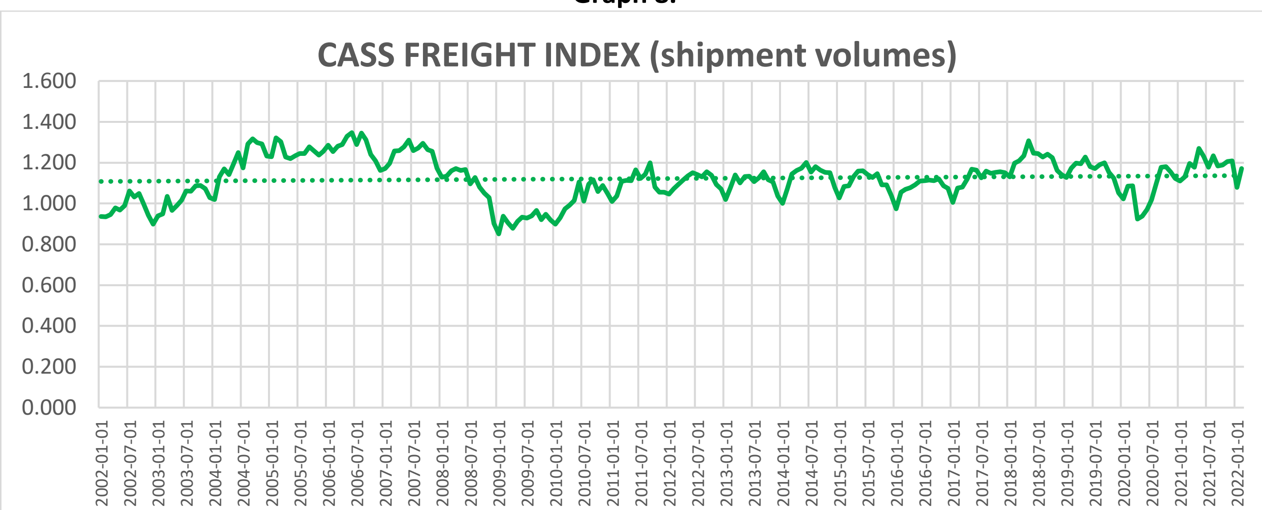


Additionally the two biggest names in retail, both Walmart and Target have recently projected 2022 sales rising below the rate of inflation. This is mirrored by the high frequency data found in the FED CARTS series. "*In the second week of March, the Weekly Index of Retail Trade decreased 1.1% on a seasonally adjusted basis after decreasing 1.4% in the previous week. For the month of March, retail & food services sales excluding motor vehicles & parts (ex. auto) are projected to decrease 3.2% from February on a seasonally adjusted basis and to decrease 4.4% when adjusted for inflation*."

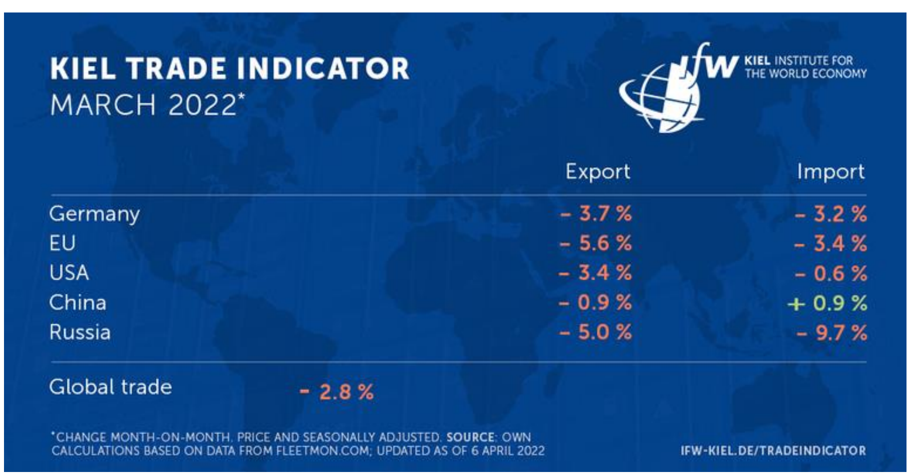
This is also impacting freight which unites producers with consumers. Here the clouds are building as this recent FreightWaves article shows. FreightWaves predicted earlier freight busts long before the mainstream media and analysts latched on. https://www.freightwaves.com/news/breaking-down-operating-expenses-tied-to-a-trucking-bloodbath-in-2022 The nub of the argument is whether demand will fall to 2019 levels or below. It is likely that the March retail data will show a fall below 2019 volume levels as anticipated by the CARTS data above and when we deduct the sharp fall in motor vehicle sales.

In any case, as Graph 8 shows, freight levels never exceeded their 2019 levels to begin with. And as Graph 9 shows, the fall in freight is affecting not only the USA, but globally as well, due to the Ukrainian effect.

Graph 8.



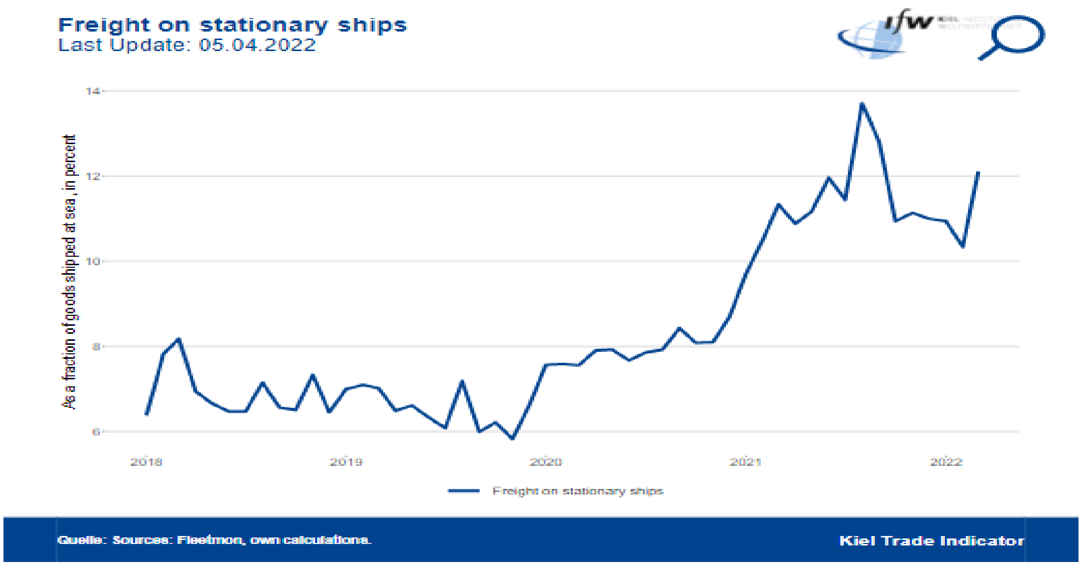
Graph 9.



https://www.ifw-kiel.de/publications/media-information/2022/kiel-trade-indicator-0322-world-trade-in-downturn/

This slowdown in shipments is yet to relieve the congestion at sea and at ports, as the next Kiel graph shows. I hold the view that the rise in congestion may have more to do with collapsing demand than infrastructural issues. A pause rather than a bottleneck. Will shippers copy the experiences of the 1980s, when some of the ships congregating outside congested Nigerian ports were disappeared to claim on insurance policies. On a more serious note, if we factor in the inventories in congested containers with the growing inventories on shelves in warehouses and shops, then an inventory correction is inevitable.

Graph 10.

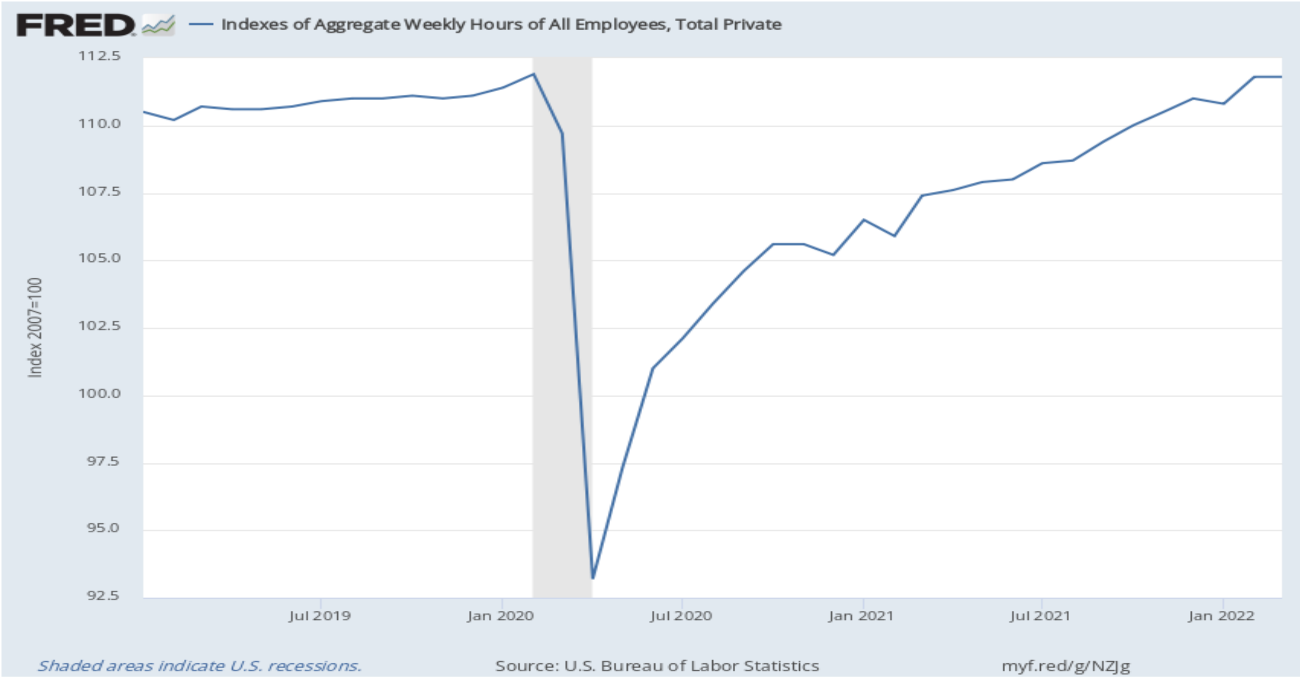


The bear squeeze is over.

With the exception of fantastical weekly unemployment claims and seasonally adjusted employment gains, the economic data has deteriorated. Both the weekly jobless claims and the increase in employment need to be scrutinised. First jobless claims. In order to claim a worker must have been continuously employed for at least 6 months. I am no expert, but it seems that the recent jump in employment as Covid receded will have disqualified many workers from claiming due to their being employed for less than 6 months, and even those previously on furlough, if their income was below the threshold of $2,700. Perhaps the US Unions have a better take on the difficulties claiming benefits currently.

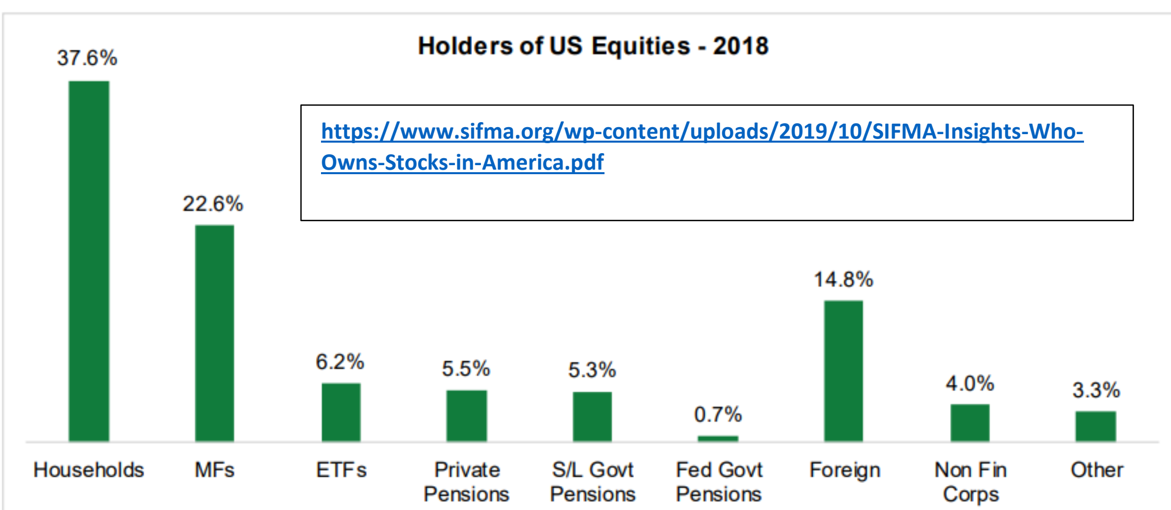
Turning to the monthly employment data released last week which appeared sufficiently positive to feed the narrative of a tight labour market, or did it? The better way to analyse labour statistics is to use aggregate hours worked per week which adjusts for part-time work as well as the average work week. It also reduces the effect of adjustments. In sum, it is much closer to the actual expenditure of labour time which is key to the production of surplus value. In the graph below we find no growth between February and March in aggregate hours. And since December 2021, the hours worked has grown by only 0.75%. However during this time the increase in employment was 1.75%. This difference of 1% is equal to 1.58 million jobs, or about the same amount of jobs created this year, so something is remiss. It is probable that seasonal adjustments to the job numbers has led to a degree of double-counting. In all, current hours worked are no higher than in 2019 and certainly not high enough to compensate for the collapse in hours during the lockdowns. It therefore throws into question the GDP data which shows the gains in 2021 outweighing the losses in 2020 resulting in no fall in GDP when measured over the two years.

Graph 11.



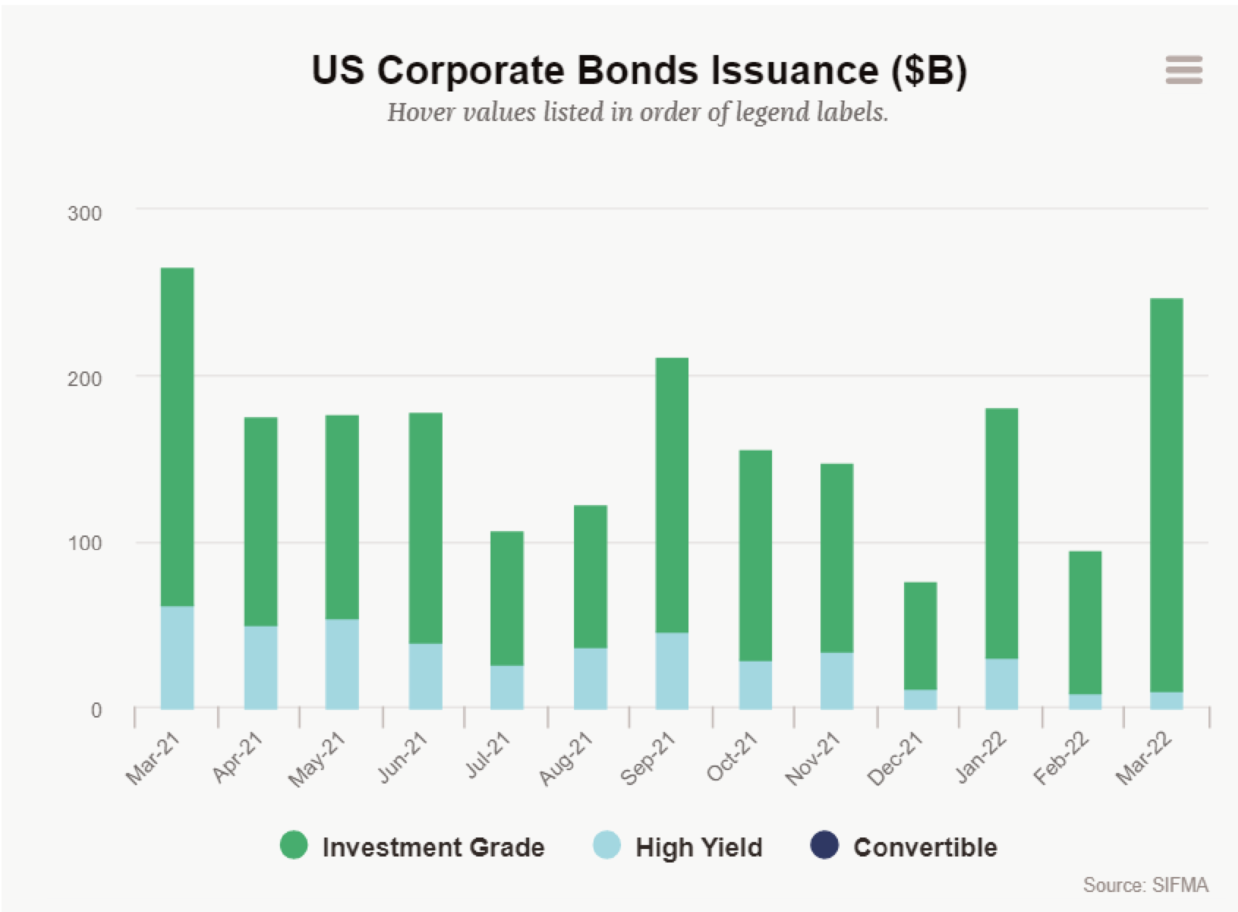
Over the course of this week, the markets resumed their sell off, though it was mild. The markets are behaving quite peculiarly. Could the clue be in FactSet's latest report: *Despite higher inflation, rising interest rates, military conflict in Ukraine, and a resurgence of COVID-19 in China, analysts have more* ***Buy ratings*** *on stocks in the S&P 500 as a percentage of their total ratings in more than ten years."* (my emphasis). Shades of the frauds before 2008. Are these advisers (who mainly work for funds and investment banks) luring in retail buyers while their institutions and insiders are off-loading stock?! After all, individual shareholder portfolios are collectively bigger than the shares owned by Mutual Funds, ETFs and Private Equity put together. As long as individuals are buyers not sellers, the markets will be buoyed, and as long as they believe that shares are held for the long term, they will be last in line to sell in a panic.

Graph 12. (Provided by SIFMA)



The Bond Markets are more cautious. We are witnessing a higher frequency of interest rate inversions, and if not actual inversions, then regular instances where shorter yields are playing tag with longer yields. This is found in all the categories and in particular between the all-important 2-year and 10-year treasuries where there is practically no daylight. In addition, in March there was little demand for High Yield bonds. That market is currently dead. The current rise in interest rates has led to the biggest loss in bond prices for 42 years (when interest rates move up bond prices move down, delivering losses).

Graph 13.



The Ukraine.

If history is to consider Putin to be the butcher of Ukraine, then Zelensky will be remembered as being the butcher's block on which the Ukrainian people were sacrificed. No wonder there are defections as well as the sacking of dissenting generals in his regime. Evidence has emerged that at the eleventh hour, just before the invasion, Schulz the German chancellor, had offered Zelensky a deal to guarantee the integrity of the Ukraine, a deal which Zelensky rejected because his oligarch masters in Washington objected. Evidence is also emerging that on his visit to Israel, Bennet the Israeli prime minister, urged him to broker peace with Russia, but once again Zelensky demurred, accepting instead a US bribe of $14 billion. Thus while the Western Press owned by the warmongers declares that it is Putin who is intransigent, it is actually the other way round, because the Yankees want this war to drag on as long as possible to weaken Russia.

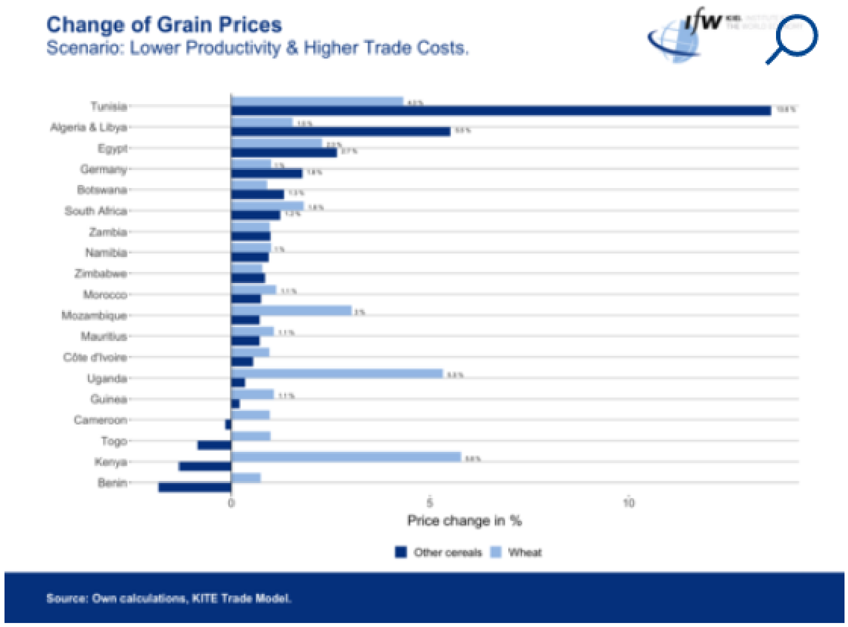
It is clear that Zelensky is Washington's pimp doing their bidding by prolonging a war even if that means the collapse of the Ukrainian nation and its economic dismemberment. The Pentagon continuously eggs him on saying he can win the war. https://uk.news.yahoo.com/ukraine-war-putin-achieved-zero-031800374.html But the Ukrainian army is now reduced to only light weaponry and is being systematically pushed back in the East. Even in Mariupol, key to the campaign, only pockets of Ukrainian resistance remain, wherein are trapped numerous high ranking NATO officers and specialists, hence the desperate attempts at helicopter extractions leading to the loss of the few remaining Ukrainian Mil 8 copters.

As I said before, this is not a Ukrainian war, but a NATO war fought by Ukrainians as evidenced by the depletion of NATO armouries. This much was clear from the shouting match in Congress between Senator Gaetz and the US Defence Secretary Lloyd Austin over US support for Ukraine which drew this response from Biden: "*'What the hell do you think we've done? Why do you think they're able to fight? We've trained them and we've given them weapons".* https://www.msn.com/en-gb/news/world/biden-hits-back-at-matt-gaetz-over-ukraine-questions-e2-80-98what-the-hell-do-you-think-we-e2-80-99ve-done-e2-80-99/ar-AAVW2lD?ocid=uxbndlbing Further the Financial Times on Thursday revealed the extent of NATO aerial spying on Ukraine, and while NATO denied it was providing real time information to the Ukrainian military, it hid behind plausible deniability by declaring it could not speak for individual countries.

I have heard about drive by shootings but drive by photo-shoots in Bucha, that is novel. Contrary to the Pentagon's claims that Zelensky is winning, the tide of accusations about Russian barbarity in newly liberated areas says otherwise. When it comes to the Western media we have to become detectives and the first question any detective asks is – what is the motive? What possible motive could the Russians have have had, leaving bodies strewn all over the place in Bucha, but in a manner which allowed trucks laden with reporters to slalom around? Russia knew full well that such barbarism would only play into the hands of the Ukrainian and Western press and be used to smear the Russians in blood. But there is motive as far as Zelensky goes, namely, to prevent demoralisation as Russia takes the East, and by using the Syrian sketchbook, to try and draw in NATO. This is classic deflection, seeking to substitute rage for demoralisation, the coarsest of propaganda which plays with death rather than respectively addressing it as tragedy.

With each passing week the global fall out from this war becomes clearer and with it the growing knowledge that more people will die outside the Ukraine than in it. The United Nations reported on Friday that food prices have already jumped 24% year on year, most of it in March. The Kiel Institute has broken this into projected price rises per country in the Graph below, which predictably shows that it is the poorer countries dependent on imported food, who are most at risk. Food riots are now becoming a common occurrence. Biden must be the oldest sergeant major recruiting for revolution in history. The neo-cons thought they had started a fire in the Ukraine, when in fact they have set the whole world on fire. But then what do you expect from these anti-humans.

Graph 14.



https://www.ifw-kiel.de/publications/media-information/2022/ukraine-war-threatens-africas-food-security/

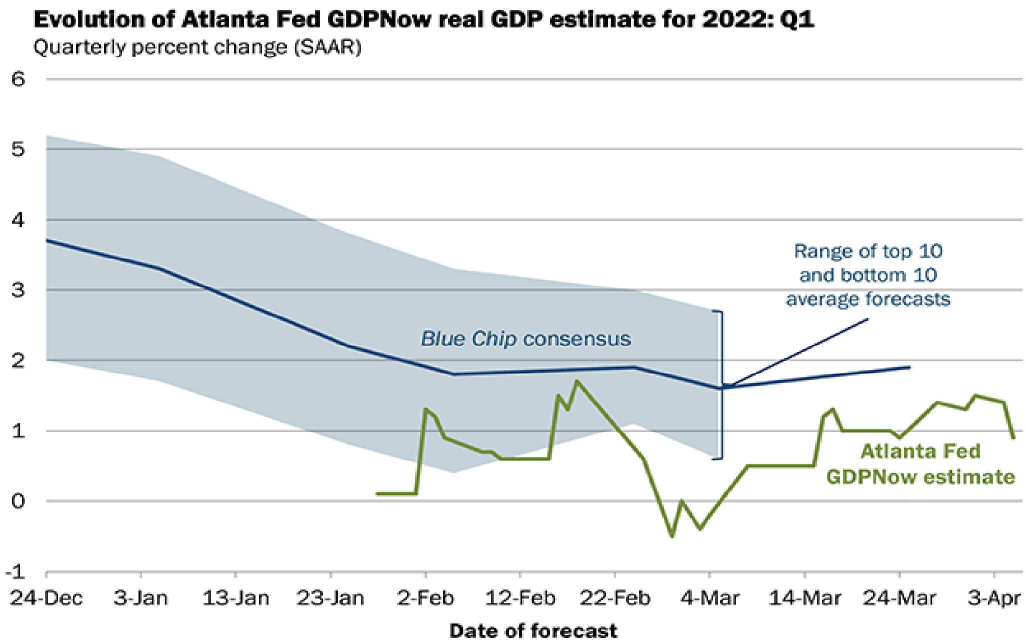
Conclusion.

CNBC brought out a survey on Friday showing that it was not only the poorest 60% of US consumers, those who live from paycheck to paycheck, who are cutting back on spending because of inflationary pressures. It now includes those earning above $100,000, sixty eight percent of whom reported feeling financially stressed. In short the majority of the bottom 80% of society who collectively consume 45% of output are in financial difficulties and making cutbacks. And unlike the advisers mentioned by FactSet, the majority of them feel there will be a recession this year. "*The American consumer is in a dark mood,"* said Mark Zandi of Moody's Analytics of the CNBC survey data. https://www.cnbc.com/2022/04/08/as-inflation-bites-higher-income-consumers-are-cutting-back-too.html

The final graph of this article by the Atlanta FED seems to be capturing this darkening mood. Its prediction for first Quarter GDP growth has now been scaled back below 1%. As fresh data comes in it is likely to be scaled down even further especially data on consumer spending. One hint of what is to come came in the final estimate for February's wholesale inventories today where the build in inventories was raised from 1.2% to 2.5%, in contrast to the consensus estimate of 1.5% compiled by Econoday. Higher inventories divided by lower sales equals a liquidity crisis.

We are now entering the most challenging of times for the markets - the earnings season for Quarter 1. Without a doubt corporate financial reports will show falling profits year on year and quarter on quarter. The only question is how the markets will react to this? A recession is brewing regardless of the markets, but if in the face of an undeniable recession, the markets tumble, this will add petrol to the fire, and if the speculators then come to a realisation that the FED is powerless to respond because inflation still has momentum, that it is therefore unable to issue 'a get out of panic card', then we are in for a period unrivalled even by 1929.

Graph 15.



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.

https://www.atlantafed.org/cqer/research/gdpnow

Brian Green, 8th April 2022.