

UNDER A BAKING SUN PROFIT TEARS THE WORLD APART.

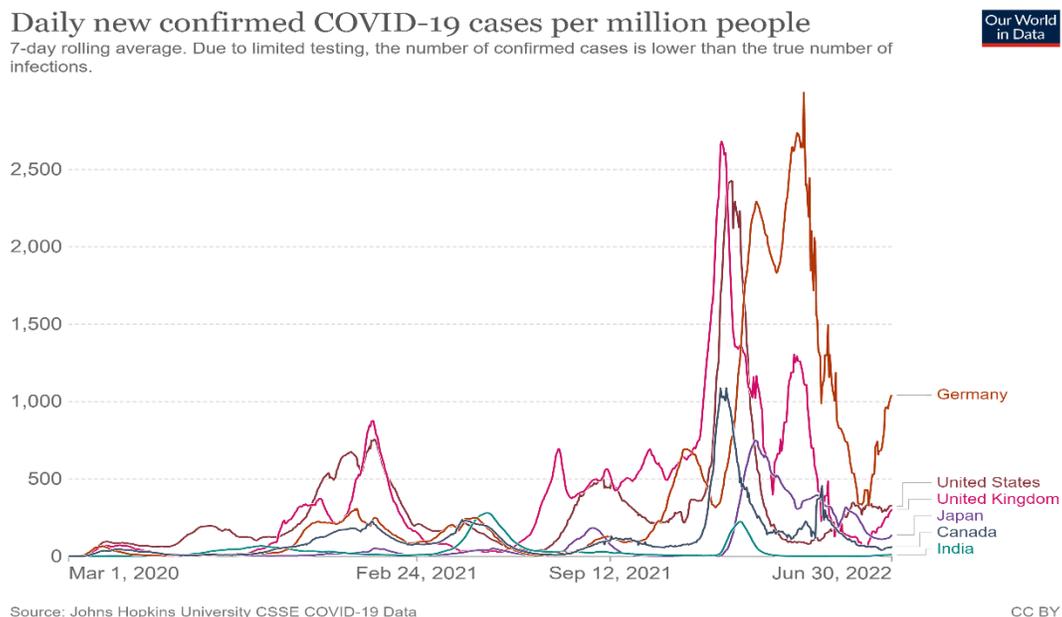
The war in Ukraine has catalysed the movement to a multi-polar world and in the process increased national tensions and class stresses within nations. In turn this material process has provoked ideological discord as economists and institutions elbow each other out of the way to offer their increasingly improbable solutions, including using tattered Keynesian texts to fan the embers of Bretton Woods back into flame. Some hope. These debates can be found on Michael Robert's Website and Facebook site. He does an admirable job bringing them to our attention.

The bankruptcy of capitalism is everywhere found. Fissures abound. A world disfigured by the profit motive. Priorities de-prioritized. Always miscalculating. This is how a great system ends, by ruining itself.

The Imperialists in their NATO flak jacket sought to use the Ukraine to weaken Russia and through Russia to weaken China. Instead they have been burnt by the backdraft. Not only are their [armouries intended for land warfare being depleted by exports](#) to the Ukraine, but their industrial capacity to replenish these weapons limps far behind. While it is true that their air and sea warfare capabilities are intact, the arrogance borne of defeating technologically inferior rivals, particularly in the Middle East, has clearly contaminated their military thinking and capacities. Russia has prevailed and it will conquer all of the Donbass region and make them part of Russia to prevent future Ukrainian attacks. Whether it takes Odessa turning the Ukraine into a landlocked and therefore failed economic state depends on whether Zelensky accepts reality or continues to be induced by the US into continuing the war.

In most ways, the military aspect is dwarfed by the economic fallout. What kind of imbecile goes to war in an over-heating world still reeling from the pandemic. Only the capitalist, who like a Lipizzano horse wearing blinkers, can only see the road ahead paved with profit, oblivious to the fires raging around it. Covid has still not had the final say as the new BA.5 variant gains traction. If German caseloads appear to be ahead, that is because the Germans continue to test unlike the foolish British government.

Graph 1.

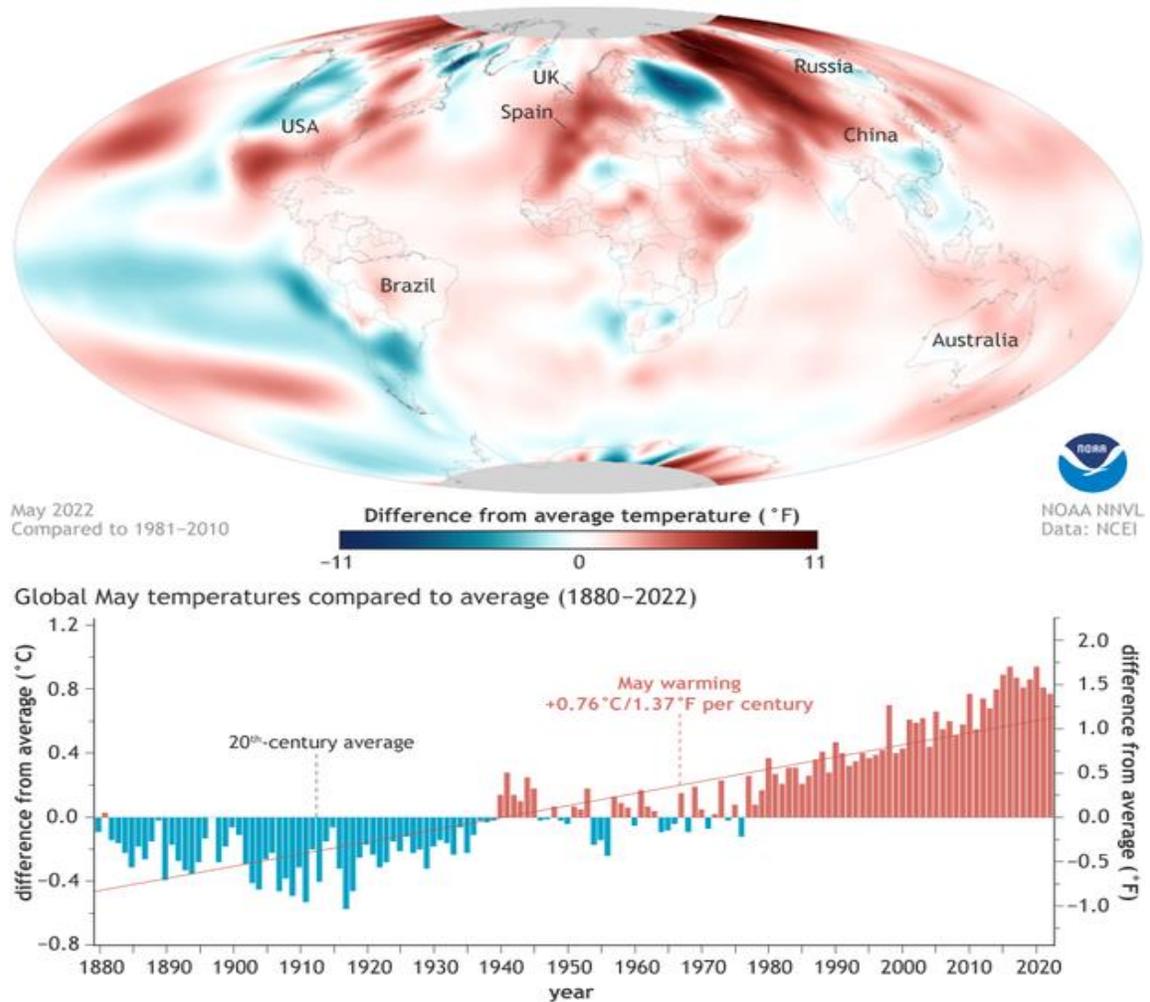


[The Lancet](#) recently published a report which: “...observed that BA.4 and BA.5 had exceptionally high immunity evading properties and the potential to infect triple vaccinated individuals or those recovering from Omicron infection or both.” There is also emerging clinical evidence that BA.5 colonises the lungs as with the earliest variants, making it a variant of concern because it combines [transmissibility with pathogenicity](#). Thus instead of fomenting war, our capitalist rules should about-turn, and face up to their responsibilities at home, except they won't. Swabs not guns.

In the UK this is particularly acute because the new Ukrainian G7 pledge by Johnson of more arms, comes out of the pot that funds vital services in the country as the [Scottish and Welsh governments](#) pointed out. And this donation comes from a country where workers have endured the longest fall in living standards since 1955 according to the [ONS](#). Seems like Johnson is intent on doing to the UK what the US stooge Zelensky has done to the Ukraine, that is to level it down.

When it comes to global warming the same imbecilic behaviour is observed. The embargoes on Russia and the subsequent interruption of Russian gas supplies has led a rush to the most polluting fossil fuels - coal and shale gas. It has led to an abandonment of pledges. The carbon footprint generated by this war is devastating. As the graph below for May shows, temperatures remain elevated.

Graph 2.



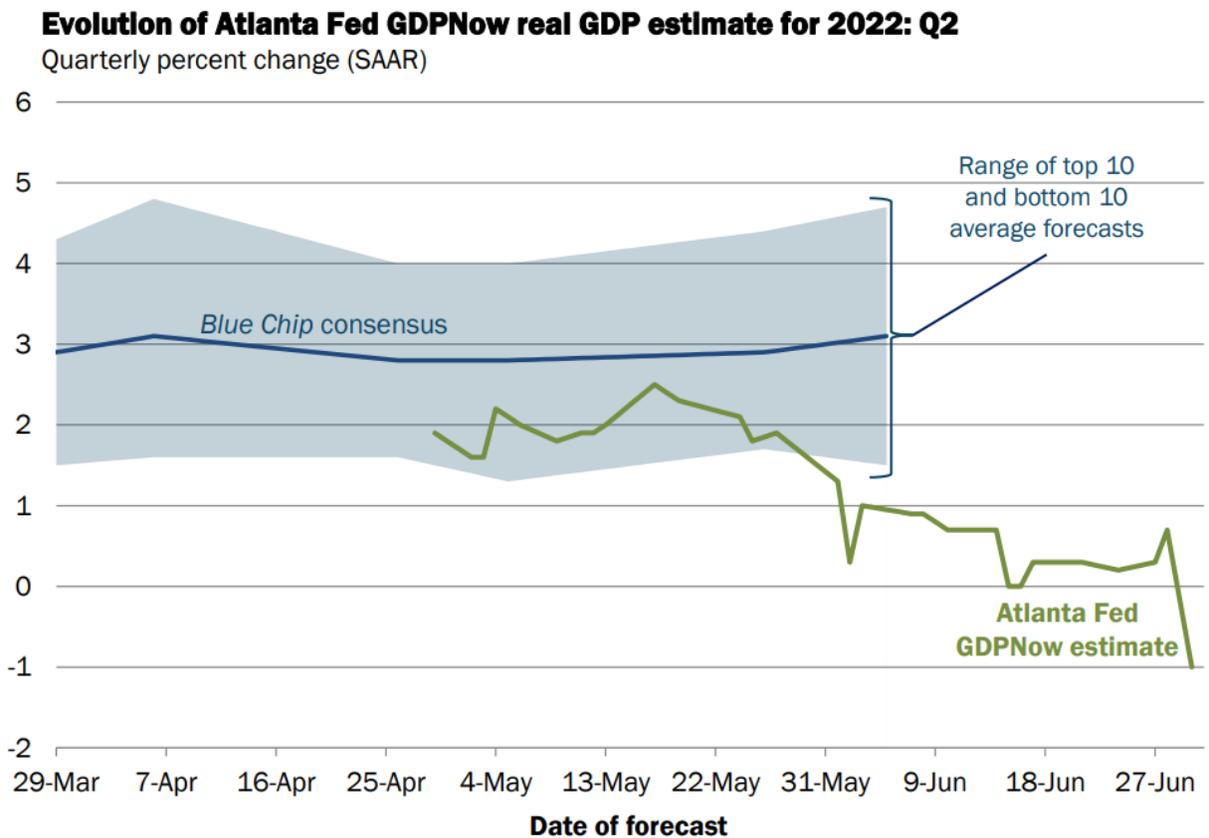
Despite global hotspots in May such as India and Pakistan, May’s global average was not a record but in the upper range since 2010. *“The May global surface temperature was 1.39°F (0.77°C) above the 20th-century average of 58.6°F (14.8°C). This ranks as the ninth-warmest May in the 143-year record, 0.30°F (0.17°C) cooler than the warmest May months (2016 and 2020). It was the coolest May since 2013, but it still marked the 46th consecutive May and the 449th consecutive month with temperatures, at least nominally, above the 20th-century average. The ten warmest May months have all occurred from 2010 to present.”* June will be instructive because it will be associated with increased irradiance from the sun.

In inverse proportion to the fall in environmental goals are found the pledges to increase arms spending. The NATO provoked war in Ukraine is being used as cover to increase arms spending by NATO. The offensive arms race is revving up to an aspirational 2.5% of GDP (outside China and the USA where it is higher), and this at a time when every cent, penny or Yen is needed to protect our planet.

The US economy.

Powell of the FED doth protest too much. He uses every opportunity and forum to claim that the US economy is strong and can take more interest rate rises without necessarily provoking a recession. This is the FED mantra, really a dirge. They have to chant this otherwise the FED would be barred from raising interest rates to curb price rises. No! Mr Chair, the US economy is not strengthening. Your own team says so. Here is the latest projection from the Atlanta FED which shows that the economy is due to shrink by 1% this quarter (down 3% from its first projections). Now mark, absent June data will be far worse.

Graph 3.



It seems unavoidable that Second Quarter GDP will escape contraction and that this contraction will be deeper than the 1.6% registered in the First Quarter. A back-to-back quarterly fall in GDP is the test for recession. As the Table below shows, an expected fall in Q2 GDP of +2% makes this a medium size post-war recession, but one which has only started. However, it cannot be ruled out that the National Bureau of Research may use the 'sparkling' employment data to declare the economy as 'not out'.

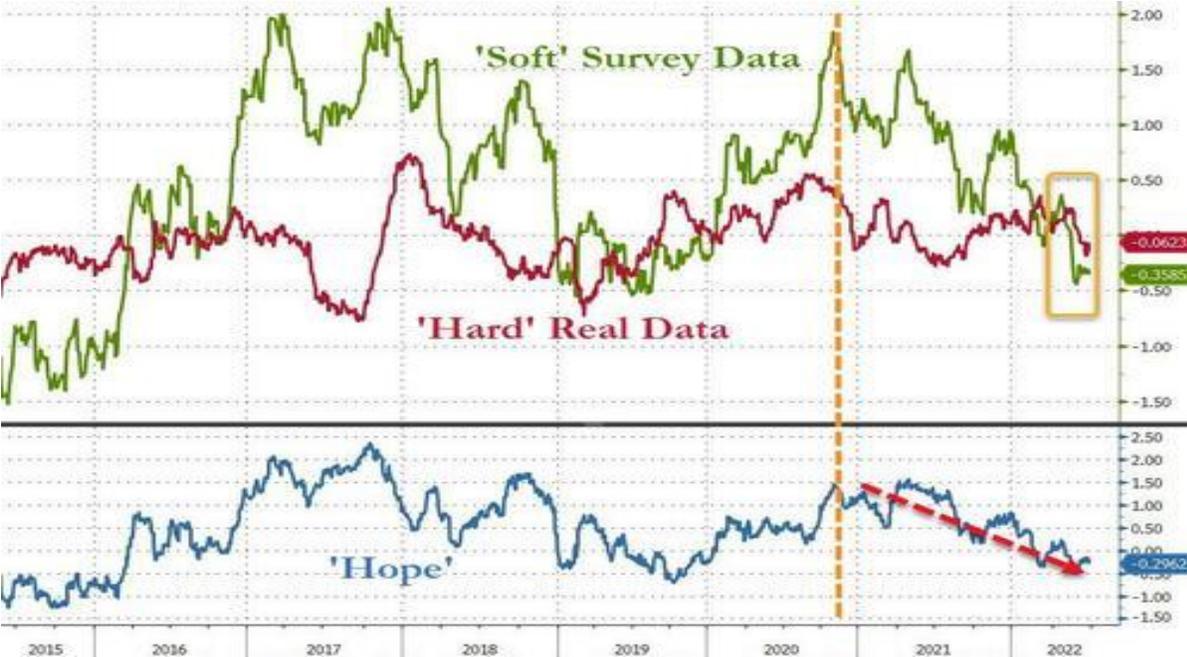
Table 1.

Start and end dates	Depth of recession
Feb 45 – Oct 45	-1.1%
July 53 – May 54	-2.2%
April 60 – Feb 61	-2.4%
Dec 69 – Nov 7 0	-0.8%
Nov 73 – March 75 (global recession)	-3.4%
Jan 80 – July 80	-1.1%
July 81 – Nov 82	-3.6%
July 90 – March 91	-1.5%
March 2001 – Nov 2001	-0.3%
Dec 07 – June 09	-4.3%

I believe this recession, before it ends, will only be comparable to 1929.

Readers of this website will know I do not place great store in soft-data, or surveys, because they can be impressionistic. However, there is one pattern that is worth taking note of which is highlighted by the graph below. It is the interaction between the soft and hard data (aka government reports) during times of economic slowdowns. During those times, for example 2015 (the pseudo recession) and 2019 (stagnation), the soft data fell below the hard data. This inversion has been found recently.

Graph 4.



It is difficult to account for the inverting of the two graphs above. It could be that soft data is more up to date, it could be that seasonal adjustments causes lags because they are historic, or it could simply be spin. Whatever the case, the more rapid fall in the soft data always presages sharp economic deceleration.

The fall in soft data for manufacturing is replicated in the freight industry. Last Saturday [FreightWaves](#) reported that: *“The spread between long-term contract truckload rates and spot rates has expanded beyond early pandemic amounts when demand for capacity dropped to its lowest level since the great recession in 2009. While this data point may paint a bleak picture for truckload carriers in general, this environment favors the ones that have focused on operational efficiency over pure growth in the past two years.”* *“Spot rates include fuel costs, which have increased 60% to 90% over the same period of time. This means carrier margins have eroded much faster than the nominal rate implies, thanks to inflation in operating costs... The takeaway from this is that the spot market has become a place of desperation for carriers to bid against each other for freight, while the contracted freight market is now an extremely profitable safe haven.”* Freight like manufacturing is buffered by the tail of long term orders & contracts.

Graph 5.



For once Wall Street is paying attention to Main Street. This is especially true for the Bond Markets where the 10-year yield has retreated below 3%. As for the Stock Markets, the S&P 500 has had the worst first half-year since 1962 (not 1970 as Bloomberg has it) and the Nasdaq since 2008. The Wilshire 5000 market cap is currently sitting just above \$38 trillion having fallen by close to \$11 trillion from its recent high last year. If history is a guide, it can be expected that the markets will fall at least 40% before the bottom is reached. The Nasdaq is four fifths of the way, with the S&P only half of the way because it was not as frothy to begin with as was the Nasdaq.. Thus the minimum fall in market cap should be of the order of \$20 trillion or almost one year’s GDP, an enormous game changing fall.

The only class of assets that has not fallen is housing, though that too is in the firing line. Despite the ten-year treasury rate falling below the 3% mark, the 30-year mortgage rate is likely to hold above 5.5% for the time being making housing the least affordable in living memory. Housing remains vulnerable to a sharp correction. It remains a black swan.

It is interesting to follow the debates about whether or not there will be a recession and when. Fiore, the spokesperson for the Institute of Supply Management is quoted by *Econoday* saying no recession in manufacturing is “*looming*”. On the other hand [Mark Zuckerberg](#) reading the algorithms on the wall, warned his workers “...*this might be one of many worst recessions I’ve ever seen*”, which when translated into worker speak reads: I expect you to lose your jobs to preserve my capital. In many ways Zuckerberg’s perspective is more important than Fiore’s because the revenue received by Meta derives mainly from manufacturing and it is one of the first victims of a cut in forward capital spending in manufacturing, whereas ISM data is backward looking as manufacturing works through backlogs, i.e. historic orders.

Despite the loudmouths at [JP Morgan](#) insisting that the economy will grow by 1% in the second quarter, and esteemed voices such as Larry Summers predicting a recession only by year end, more and more voices are now recognising the economy is on the cusp of a recession. Fortunately this facile debate will settled in a few weeks’ time when the dire June data arrives to clinch the argument. By then an inkling of how deep the recession will be will also become apparent. But anticipating this debate and hoping to give succour to the markets, some economists are already predicting the FED will come to the rescue by cutting rates by 2023. Just as they were wrong about recession in 2023, they will be wrong about rate cuts in 2023, because the rate cuts will happen earlier, but then earlier will already be too late.

The next leg of the fall in share prices is predicated on a revision of expected earnings. Alongside the nonsense that the recession will only occur in 2023 if at all, goes the nonsense perspective of continuing elevated earnings and margins. “*In terms of quarterly EPS guidance, 103 S&P 500 companies have issued quarterly EPS guidance for the second quarter. Of these companies, 71 have issued negative EPS guidance and 32 have issued positive EPS guidance. The number of companies issuing negative EPS guidance is above the 5-year average of 59 and above the 10-year average of 66. In fact, the second quarter has the highest number of S&P 500 companies issuing negative EPS guidance for a quarter since Q4 2019 (73).* Yet despite the high number of negative corporate guidance’s, [FactSet](#) has only downwardly revised its original March 31st earnings growth from 5.9% to 4.1%, or by a mere 1.8%.

However, FactSet does recognise that without the 217% earnings growth in the energy sector, non-energy profits would have contracted by 3.5% rather than have risen by 4.1%. This difference of 7.6% speaks volumes about the growing importance of the energy sector in the USA. Who say War is not good for business. It seems that High Carbon is taking over from High Tech as the USA regresses back to a basic sector economy.

Little wonder then, that the only growth sectors which showed a significant annual increase in their market capitalisation, was Energy and Utilities. This can be seen in the Table below taken from [Fidelity](#). At only 6% of total market capitalisation, Energy is currently gushing profits sufficient to prevent total profits from falling (in the opinion of FactSet). Long may it not last long.

Goldman Sachs hedged its bets as it reported its revised outlook on margins on the 28th June: *Profit margins for the median S&P 500 company will likely decline next year, whether or not the economy falls into recession, the Goldman Sachs strategists said.* On the 1st of July [Yardeni](#) was still predicting a profit margin similar to 2021 based on his expectation of higher profits in the second half of the year. However, some voices have already broken rank and are beginning to predict a significant fall in profit margins. [CSIMarket](#) anticipates margins falling by a quarter. When it is recognised that current margin predictions are fanciful and when they are revised down sharply, thereby elevating Price to Equity ratios, expect share prices to continue to plunge in the second half of the year despite a more benign interest environment.

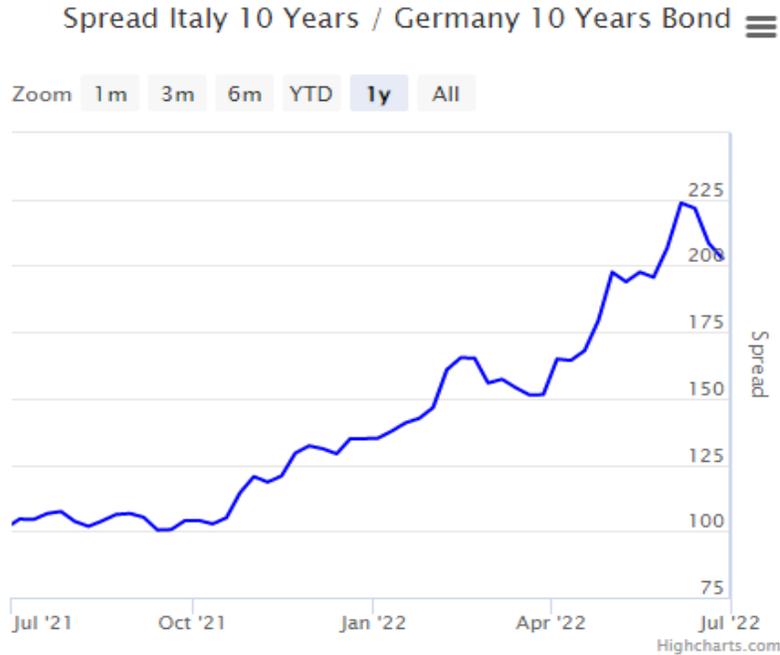
Table 2.

Performance			
SECTOR INDUSTRY	Chart Performance		
Sector Expand All Collapse All	Last % Change AS OF 02:58 PM ET 07/01/2022	Market Cap 06/30/2022	1-Year % Change 06/30/2022
+ Communication Services 5 Industries	+0.21%	\$4.54T	-29.79%
+ Consumer Discretionary 11 Industries	+1.56%	\$6.38T	-24.69%
+ Consumer Staples 6 Industries	+1.17%	\$4.10T	+4.69%
+ Energy 2 Industries	+0.72%	\$3.36T	+35.85%
+ Financials 7 Industries	+1.09%	\$7.19T	-13.89%
+ Health Care 6 Industries	+0.76%	\$7.42T	+1.68%
+ Industrials 14 Industries	+0.75%	\$4.63T	-14.04%
+ Information Technology 6 Industries	+0.05%	\$11.91T	-14.40%
+ Materials 5 Industries	+0.37%	\$2.23T	-10.20%
+ Real Estate 2 Industries	+1.40%	\$1.50T	-8.50%
+ Utilities 5 Industries	+2.09%	\$1.58T	+10.66%
S&P 500 ® Index	+0.71%	--	-11.80%

While the ECB tries to hold the Euro area together, Russia and China seek the opposite with the Dollar.

With European inflation rising above expectations to 8.6% last month (Eurostat) and with supply disruptions amplified by the previously close trading relation between Europe and Russia continuing, the remedies available to the European Central Bank (ECB) are few in number. The predicament facing the ECB is succinctly précised by [Seeking Alpha](#): *“The thing about the eurozone is that you can't really have a monetary union without a fiscal union, where you have a big central budget that automatically redistributes money from booming parts to slumping parts (like the Federal budget does in the U.S.). This creates a situation in which divergence in economic situations has no natural break and tends to become stuck in a self-reinforcing feedback loop (or actually several of these). Other fundamental problems are that you have one monetary policy fitting nobody, and the country's sovereign debt is denominated in a currency (the euro) that they can't print.”* Lagarde exercised one of the few options open to the ECB, that is to sell German Bunds to buy, for example, Italian Bonds in order to narrow the spread between more indebted and less indebted European economies. For the time being this has worked as Graph 6 below shows. The spread however is still double that pre-pandemic.

Graph 6.



The ECB has committed to raising its interest rates for the first time at its forthcoming 22nd July meeting. We shall see. Under current market conditions three weeks is a lifetime. One fact stands out. Against a backdrop of 8.6% inflation, a bank rate of -0.5% is extraordinary. Proof positive of the precarious state of the Euro area which unfortunately has not dissuaded the EU from escalating the war in the Ukraine..

Wars are often fought over currencies. Prior to the war in Ukraine, Russia and China were already developing alternatives to the US and EU dominated currency exchanges and facilitators such as SWIFT. As the Dutch Bank ING reported: *“Russia is ready to develop a [new global reserve currency](#) alongside China and other BRICS nations, in a potential challenge to the dominance of the US dollar. The speed with which western nations and its allies sanctioned Russian FX reserves (freezing around half) no doubt shocked Russian authorities,”* ING's Turner said. *Those sanctions have likely encouraged Moscow and Beijing to work on an alternative to the IMF's international reserve asset, the special drawing rights, Turner suggested.”*

China is increasingly consolidating the BRICS into a cornerstone of its new global bi-polar architecture. *“[Beijing and Moscow](#) have so far failed to repurpose the BRICS group into an anti-U.S. coalition, but they are not done trying and might yet succeed. The BRICS countries share a common dissatisfaction with the status quo, and the group is becoming increasingly important to Beijing's global agenda.”* It is interesting, given the rivalry between India and China, that their alliance has actually strengthened following the war in the Ukraine. The resulting dissatisfaction by Western Imperialism towards India because of this can be seen in the accelerated outflows of foreign investment from India. Though China is intent on expanding the BRICS, this approach was not yet accepted by the June meeting because India fears this will weaken its position in the BRICS. The West of course derides the BRICS as a talking shop. What they fail to acknowledge is that it was their common bullying and humiliating of these countries that is the actual glue holding them together.

Outside the BRICS China continues to seek ways of internationalising the Yuan but without reducing capital controls. *“China is teaming up with Indonesia, Malaysia, Hong Kong, Singapore, and Chile, with each contributing 15 billion yuan, about \$2.2 billion, to the [Renminbi Liquidity Arrangement](#),”* And of course China is pressing ahead with the Digital Yuan. *China has made its [digital yuan mobile app](#) accessible to around 10% of the country’s population...”* *“People are already so used to WeChat Pay and Alipay, so many are reluctant to get digital yuan all of a sudden. Even though it is more convenient than those when you are using it because of its simpler and easy to use app interface design.”* *“Nevertheless, courtesy of China’s first mover advantage, the country is years ahead of other major countries.”*

It is worth pointing out that the failure by China to internationalise the Yuan up to now has come at a cost. The relatively high interest rates found in China are needed to bolster capital controls. There will come a time, however, that this level of interest rates will be unsupportable, so time is not on the side of the Chinese Financial Authorities as they seek to expand the Yuan area.

Talking of which, longer term economic conditions continue to deteriorate in China. Firstly, the days when China could rely on industrial exports to drive its economy are over. High frequency data shows a sharp reduction in orders for household goods from the EU and the US. Secondly, its internal retail market is in the doldrums. *“Rather than spend or invest, 58.3% of survey respondents said they preferred to save their money, according to a [People’s Bank of China second quarter report](#)...A big driver of consumer cautiousness is worries about future income...The study’s index for the job outlook fell to 44.5%, the lowest since the first quarter of 2009’s 42.2% print, according to the CEIC database.”* All those who claim China is socialist will soon be disabused of this view when China resorts to traditional capitalist counter-vailing measures to prop up its economy. This time China will not save the world economy as it did in 2008, because it is as crisis ridden as the rest of the capitalist world.

Conclusion.

The first half of 2022 represented the leading winds of the economic hurricane buffeting the world economy. In the second half it will be the more destructive tailing winds. Indebted structures already weakened by the leading winds will not survive the tailing winds. The financial world will become unrecognisable. The crisis of capitalism is deepening and the political fall-out is spreading. The beginnings of ideological uncertainty amongst the apologists (intellectuals) for capitalism is beginning to be seen. This will intensify as uncertainty gives way to doubt and doubt to new possibilities.

Capitalism has got itself into this mess. They have been reckless, and they could be reckless only because the low level of class struggle has allowed them to be. There is a growing recognition around the world that something is amiss hence the move to the left, exemplified by Latin America. But economic conditions are brutal and the left reformists with their pathetic economic remedies to improve capitalism will be quickly caught out. These betrayals always have the effect of disorientating and demobilising the international working class opening up the political space for fascism.

As revolutionaries we have a duty to prevent this. I am convinced that for the first time since the collapse of the USSR, the 2020s will see the revival of revolutionary politics at scale.

Brian Green, 2nd July 2022.