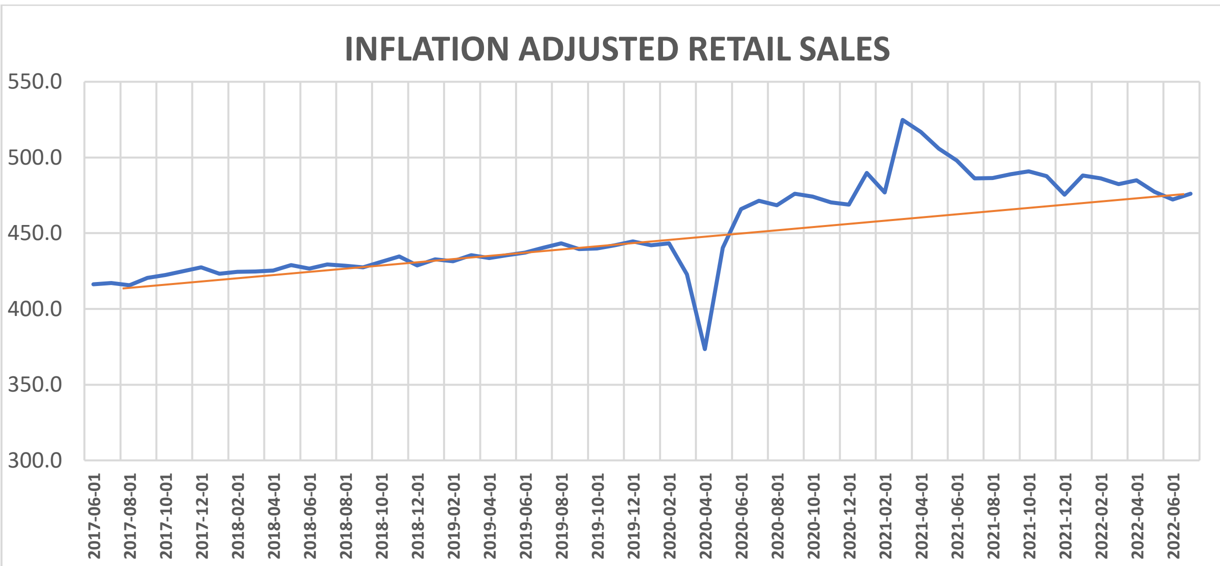
# THE TWO GLOBAL ECONOMIC LOCOMOTIVES RUN OUT OF PUFF.

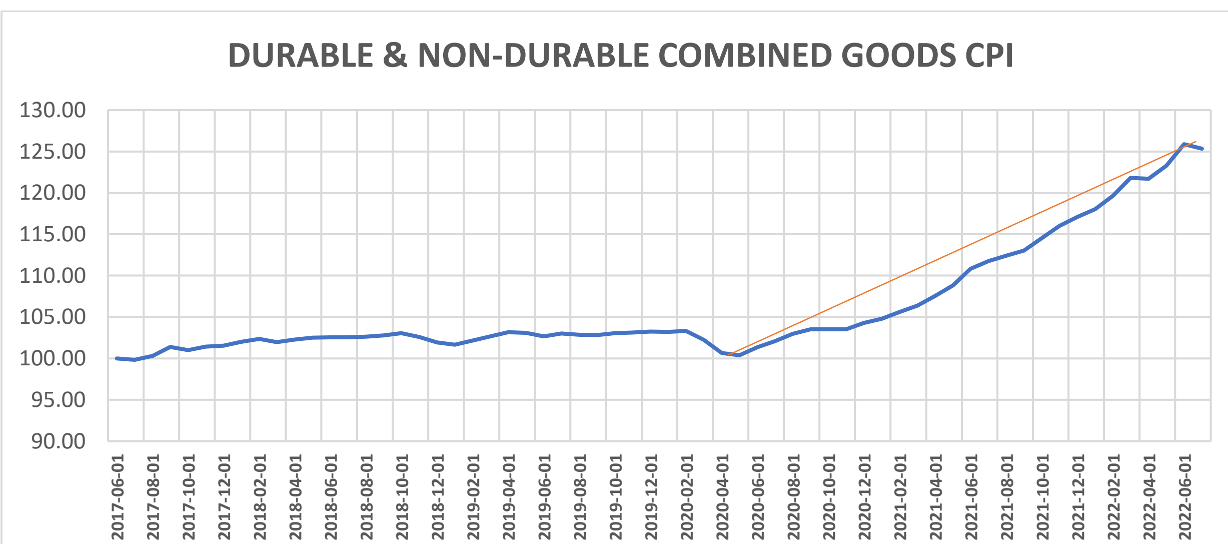
*This article focuses on the latest data from China, but first it examines sales and inventory data in the USA. It will be part of a series of articles on economic developments in China.*

US retail sales were recently released covering July. The data showed a 0% change MoM in monetary terms. However, given the fall in monthly inflation, volume increased marginally as the two graphs below show.

**Graph 1.**




**Graph 2.**




Of course those who know my views know that I am sceptical about the official data on sales believing them to be overestimated. The Census Bureau data estimates that in Q2 2022 the value of retail sales rose by 7.7% compared to Q1 2021. However my table below, intended to show the bullwhip effect of rising inventories, shows that sales of the giant corporations actually grew by only 5.5%, or 2.2% below the figure estimated by the Census Bureau. (All data is in millions of Dollars which compares the second quarter this year to the same period the previous year.)

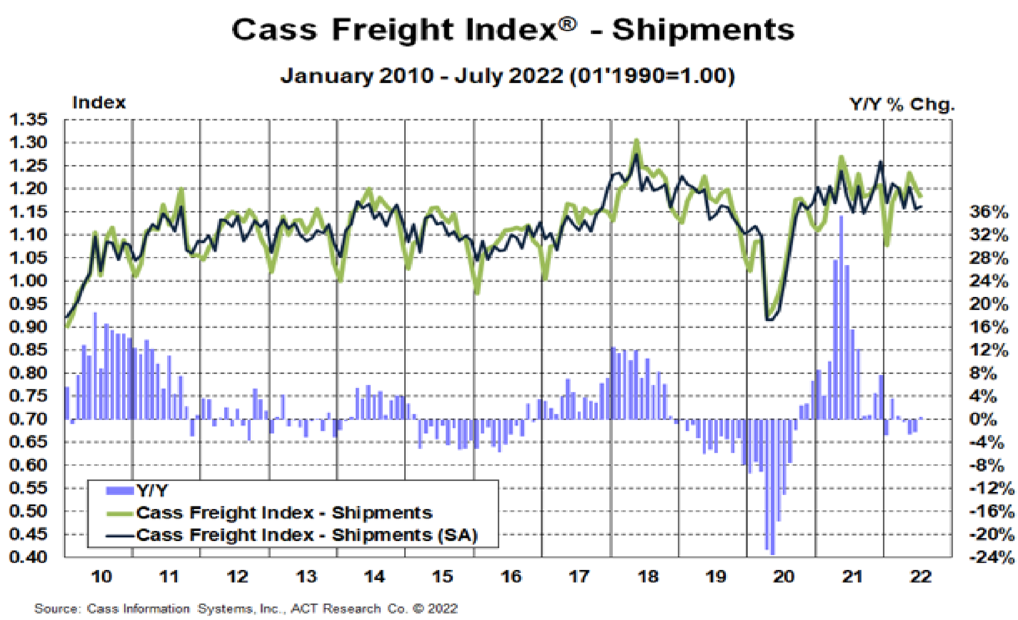
**Table 1.**

| Company | 2021 Q2 sales | 2022 Q2 sales | 2021 stock | 2022 stock | 2021 ratio % | 2022 ratio % |
|---|---|---|---|---|---|---|
| Target | 24826 | 25653 | 11259 | 15320 | 45.4 | 59.7 |
| Lowe's | 27476 | 27570 | 17322 | 19329 | 63.0 | 70.1 |
| Walmart | 139871 | 151381 | 47754 | 59921 | 34.1 | 39.6 |
| Kohl | 4447 | 4087 | 2733 | 4034 | 61.5 | 98.7 |
| Home Depot | 41118 | 43792 | 18909 | 26088 | 46.0 | 59.6 |
| Amazon | 56575 | 58004 | 32640 | 38153 | 57.7 | 65.8 |
| **TOTAL** | **294313** | **310487** | **130617** | **162845** | **51.3** | **65.6** |
| **Annual increases** | | **+5.5%** | | **+24.7%** | | **+27.9%** |

(Data taken from the financial reports issued by these corporations found on their 'investor relations' websites.)

The Table shows that inventories have risen by 24.7% and that the inventory ratio measured quarterly rose from 51.3 to 65.6, or in days measured by annual sales they rose from 40.4 days to 47.4 days, or in conventional annualised ratios they rose from 1.34 to 1.58. This jump in numbers suggest the inventory correction remains ongoing as indicated by this week's Walmart press release. "*Walmart Inc. said Tuesday that it has cancelled billions of dollars in orders as part of a continued effort to align inventory levels with projected demand and to reduce its exposure to certain products that have fallen out of favour with budget-conscious consumers." The big box behemoth added that it would still take a couple more quarters before it managed to rightsize its inventory*."

**Graph 3.**




An inventory correction always impacts production and transport. Orders are cut which leads to slower production and fewer trucks on the road. *Truckload demand fell 17% in March and April of this year* *according to the national Outbound Tender Volume Index (OTVI), which measures the amount of electronic requests by shippers to their carriers for truckload capacity.* And as the CASS Freight Index graph above shows, this year has mainly seen falls in monthly volumes.

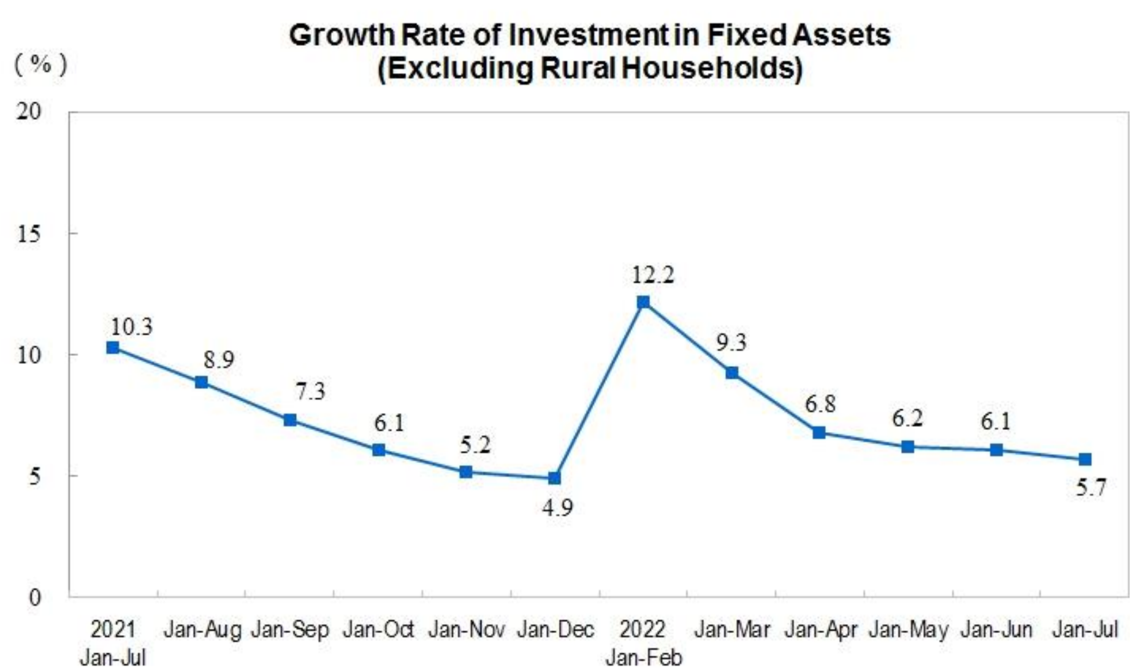
**Turning to China.**

CNBC reported on China GDP citing downgrades from both Nomura and Goldman Sachs. Nomura cut annual growth from 3.3% to 2.5% and Goldman Sachs from 3.3% to 2.8%. Earlier UBS had cut their outlook to 3%. This contrasts with the CCP target of 5.5%.

One of the ongoing reasons for GDP deceleration is the growing crisis in property. Although the official spend on property appeared to indicate only moderate falls, viz "*From January to July, the national real estate development investment was 7,946.2 billion yuan, a year-on-year decrease of 6.4 percent; Among them, the residential investment was 6,023.8 billion yuan, down 5.8 percent. Commercial decreased 10.3%"* in reality the volume of build was not reflected in these values. Comparing the period April to June 2022 to the similar period in 2021, the monthly build fell from 156 million square metres to 106 million metres, a fall close to a third. And this was not only confined to residential property as non-residential may have fallen further given it's 10.3% fall in value terms compared to 5.8% for residential investment.

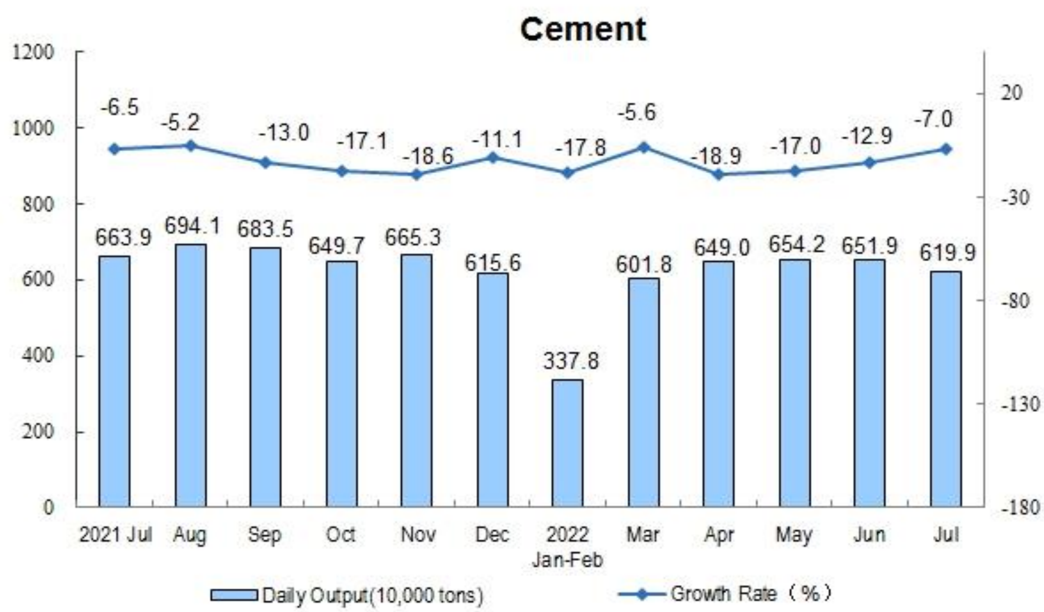
Add that fall in residential investment to the deceleration in industrial investment and these falls have global consequences as we shall see. (It should be added that manufacturing investment especially in higher tech was more robust. Manufacturing investment was up 9.9%.)

**Graph 4.**




One area which is intimately related to the construction industry is cement and iron re-bar. The graph below shows cement production to be currently down up to 200 million tons this year. To put this in perspective that is double the annual output of the USA despite all the Biden "*Build Back Betters".* (In a normal year China produces 25 times more cement than does the USA.)

**Graph 5.**




When China consumes half the world's cement, two thirds of its iron ore and two fifths of its copper, much of it going into property and infrastructure, then as I pointed out recently, any changes have an electrifying effect on the rest of the world economy. Firstly prices plunge. In the case of iron ore its price has halved and in the case of copper it is down by a quarter. Secondly, it flattens freight rates as desperate shippers seek to fill their empty ships at any price. "***The plunge in dry bulk shipping*****: Ominous signal on China's economy?** *Broker: Market for larger bulkers now 'as appetizing as a bucket of prawns on a hot day' In October, average Capesize rates topped $80,000 per day and some individual ships earned over $100,000 per day. As of Tuesday, the Baltic Capesize index assessed rates at just $8,783 per day. That's not only well below all-in cash breakeven, which includes financing costs, it's below operating expenses (crewing, stores, etc.)"*

It is really in shipping that the roller coaster world of capitalist production is best seen. Nowhere else is boom and bust so sharply contrasted and with such immediacy than in shipping freight rates.

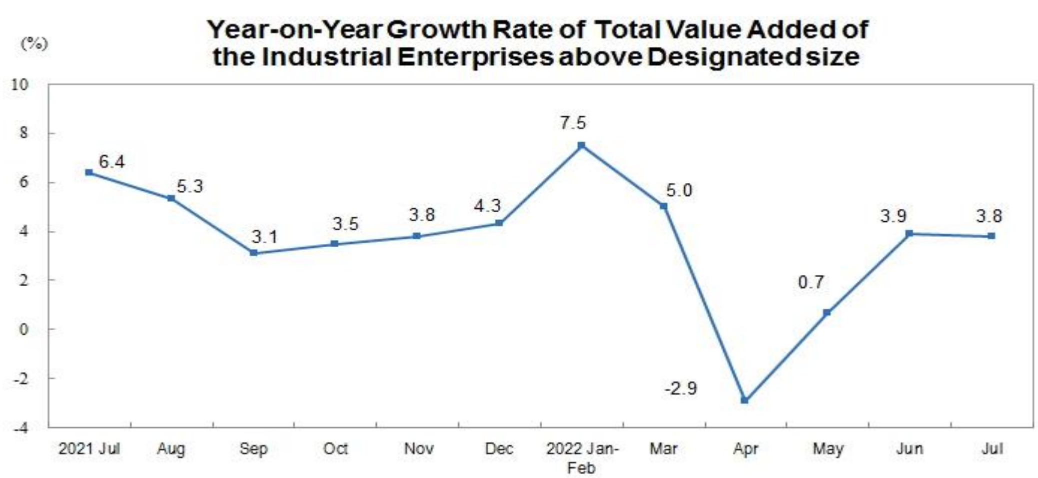
And it is not only dry bulk rates, e.g. coal, iron ore or copper ore, where freight rates are falling. They are now falling sharply in the realm of containers as well as the graph below shows. Spot rates have fallen even faster. Zim Lines which relied on spot rates and benefited most from the spike in container freight rates saw its Q2 rates decline 6.5% whereas Maersk which focused on contracted rates saw an increase in rates of 9.4%. The average container charge levied by Zim fell to $3596 while Maersk rose up to $2492 due to its focus on contracted rather than spot rates. These prices are a far cry from the $20,000 container rates earlier this year and lower than the average price found in the graph. (Different spot indexes give different rate assessments but generally show the same trends. *The Freightos Baltic Daily Index (FBX) Asia-West Coast assessment was at $6,692 per forty-foot equivalent unit on Friday last week.)* In addition given 20% inflation that $5898 is worth only $4700 translated into 2019 currency.

**Graph 6.**


The final effect from the fall in construction is the effect on local Chinese government finances due to its effect on land sales which have fallen. Taxes on land sales provide a third of the income of local governments. This year they have fallen by 31% tearing a big hole in local government finances. To compensate local governments have been issuing bonds which the central government recently sanctioned. To entice investors they have been forced to offer 9% interest compared to 3% for comparable central government bonds. (For comparison purposes in the USA, A rated 10-year Muni bonds yield around 3% currently.) Clearly 9% is unsustainable for local governments which are basically insolvent.

I have not been able to obtain the latest figures for local government debt to determine its increase. The latest statistical yearbook dates back to 2019. But even here we can see the dysfunctional results from the horizontal mode of privatisation which put local governments in charge of much of the local redistribution of property into private hands. The result is that the total expenditure by local governments exceeds that of central government by a factor of 6 whereas local government taxes are only 15% higher. This imbalance was clearly a crisis waiting to happen. The disparity between local taxes and local expenditure, smoothed over by land sales and other sales, no longer suffices and any debt crisis breaking out in property will be a simultaneous debt crisis for local government.

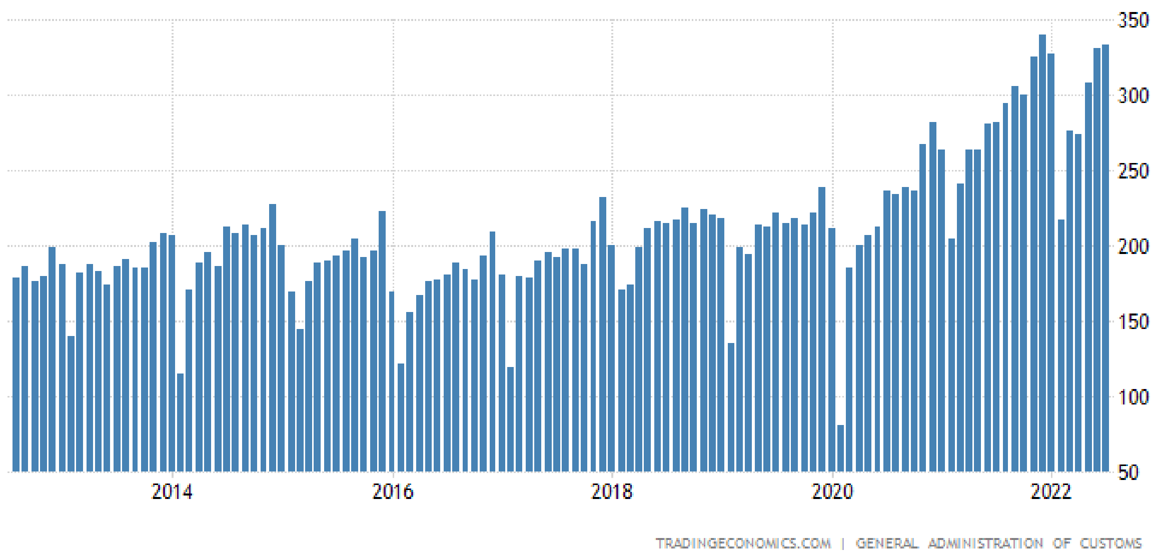
**Graph 7.**



The next observation is that industrial production measured by value has settled down to an annual growth rate of under 4% which compares to annual growth rates of [12.2% between 2016 and 2017] and 10% between 2017 and 2018. Chinese industry is increasingly reliant on the Chinese market rather than its traditional overseas markets. As has been noted China did exceptionally well on overseas markets during the pandemic when it responded more quickly to the demands that arose from the pandemic. But given the subsiding global economy and rising international tensions, it is unlikely to benefit from future export growth.

This is not clear in the data yet as China is still benefiting from lingering backed up orders following its recent lockdowns. China uniquely is still in the in betwixt and in between period where the pipeline of orders have yet to be fulfilled. Further, given the deteriorating economic conditions in China there could be an element of disguised capital flows in the form of the overpricing of export invoices.

**Chinese Exports**




On the other hand Chinese imports are down 10% from their 2021 peak reflecting lower prices for raw materials, lower volumes and import substitution. In sum the subsiding of imports reflects a weakening economy.

Two final indicators provide insight into the state of the Chinese economy. Inflation adjusted retail sales are still down 10% from their 2019 peak. Youth unemployment has risen to 20%. Here is an interesting article which also cites evidence that job seekers are leery about the private sector because of the number of recent lay-offs. It is likely that China has a growing challenge between job opportunities and job seekers particularly university students. It could soon turn into a political problem.

**Computer Chips.**

6 months ago the outlook for chips in 2022 was bright. IC Insights *"anticipated chip sales will reach a record-high of $680.6bn (£500bn) in 2022, growing by 11 per cent from 2021. Integrated circuit revenues are expected to total $565.1bn (£415bn), up 11 per cent year-on-year, and OSD – optoelectronics, sensors/actuators, and discrete components – are expected to reach $115bn (£85bn), also up 11 per cent.*

*January projection."* Gartner too originally forecast growth rates of 13.6% but now sees only 7.4%. However, the 7.4% rise itself disguises a significant volume fall given the current price inflation on which it is based.

The 7.4% outlook turned out to be optimistic. Within weeks of the 27th of July *Gartner* report, its forecasts were already out of date. Corporate Financial Reports in August from Chip producers providing forward guidance spoke of a sudden, unexpected, and sharp reduction in orders. Nvidia, Samsung, TSMC, Intel, Micron all reported their customers being overstocked with chips and cancelling orders. This was understandable given that smartphone sales are expected to fall by 150 million this year, video game consoles by 13.5% (US data) and PCs by 9%. (We will see if Apple are being honest in forecasting this fall will not affect iPhones.) Micron even announced that there were cancellations from the automobile industry. There is a saying that one should never trust a second-hand car salesman's word. Today we can add; one should never trust a new car salesman's word as he or she is trying to sell you an overpriced, fully loaded, top end model car because they insist there is a chip shortage and cars are simply not available. Tosh, it is going to blow up in their faces.

Poor Biden, he managed to get the $52.7 billion CHIPS Act through Congress just as global chip manufacturers announced plans to cut their capital expenditures by a far greater sum.

The focus on computer chips is correct. It is the new oil. Chips are found everywhere and in everything. If the demand for chips is collapsing as it is, then this is a bad omen for the global economy as well. What is decisive is a point I have been making. For the last 6 months all that has been propping up production were back orders rather than demand. In other words supply issues. Industry was still catching up. It now has caught up. The pipeline of orders is emptying because new orders, which are demand driven, are not replacing backed up older order as they are expedited. This more than anything will put the lid on inflation as discounts abound. This is already evident in the chip industry where some prices have suddenly been discounted by up to 40%.

Which means that all talk resilient economies will be past tense. This marks the definitive ending of the legacy of the pandemic, despite the war in Ukraine, marked as it was by government handouts and supply chain disruptions. The new normal is going to be ugly.

**Conclusion.**

The left is split over characterising China. Is it a mixture of state and private capitalism or is it something unique, namely a socialist society with Chinese characteristics? The most sophisticated argument put out by the CCP professors is that the Party is using capitalism to prepare the material conditions for socialism and once the capitalists have served their purpose, the Party will expropriate them, ushering in a society based on collective property. Nonsense, not so much a hypothetical two-stage Revolution as a two-stage Drivelution. Long before this could even become a possibility, if it was ever intended, the CCP will have broken its back on the law of value.

The answer I have no doubt will come soon. It won't be some theoretical revelation. Rather the opposite. What the CCP stands for will be revealed by its actions as the economic crisis deepens. Will it turn against the capitalist class expropriating them, or will it turn against the working class repressing them? Will it act as true communists or as regular capitalists? I believe the answer is self-evident, it will repress the Chinese working class and make them pay for the crisis. The forthcoming Chinese 'Hungarian Moment' will definitively answer the question as to the nature of the Chinese state, much to the embarrassment of some on the left.

I am not ruling out the possibility that the CCP may yet stimulate the economy, it will certainly try. After all it lives in fear of the huge working class which it monitors more closely than a patient in intensive care. But its ability to mount such a stimulus has diminished. Nor do I rule out the possibility that the CCP will unleash crude anti-US chauvinism to divert the working class.

However both would represent a challenge and a crisis for the CCP. In each and every way the CCP now joins the capitalist classes around the world cornered by the system which benefited them so well, but which no longer delivers.

Brian Green, 20th August 2022.