

YES, THERE IS A GLOBAL SLUMP AND YES IT BEGAN IN SEPTEMBER.

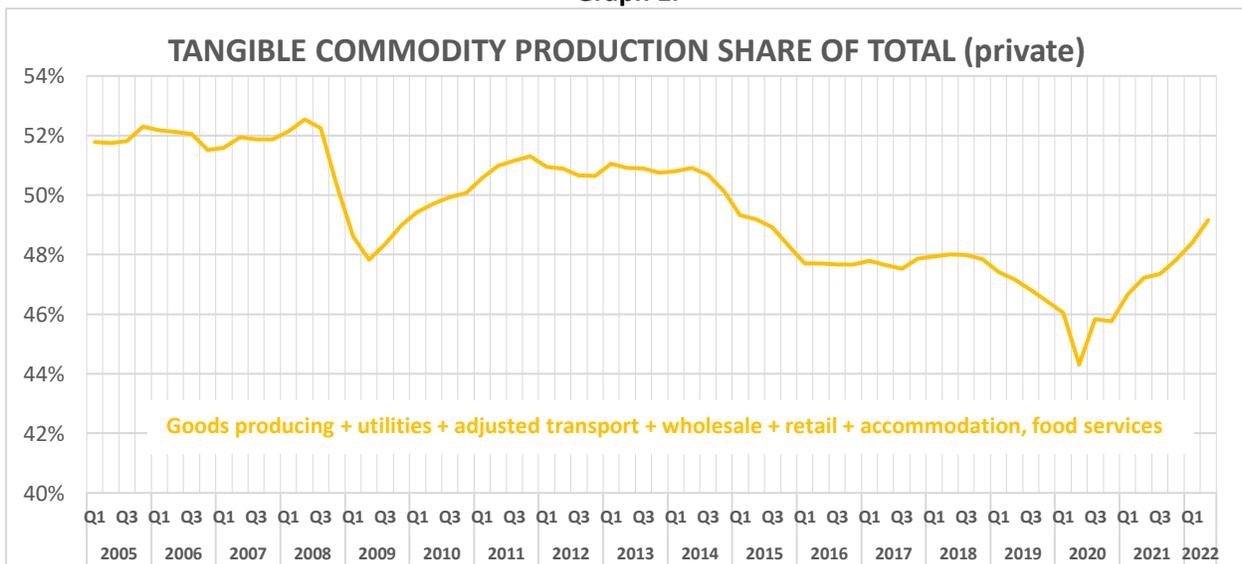
Since 2009 the world economy has been kept alive on the drip of cheap money. It was always going to be the case that once that drip was removed the world economy was going to deteriorate. September was the month stagnation gave way to slump.

To understand the contours of this approaching slump it is necessary to observe it from the industrial heartlands which means Asia and in particular China, for this area has become the workshop of the world. It is a myth to say that services have overtaken industry and commerce. Much of the revenue found in the service industry originates in industry. It is therefore transferred value. It is also the case that the largest segment of customers for the financial sector are based in the broader goods producing sector. Most of the profits produced in the S&P 500 arise in the goods producing sector which includes the energy sector.

To demonstrate this I have prepared the graph below. It is based on total sales (Gross Output) and not on the value of final sales making up GDP. The importance of using Gross Output is that it gives a better impression of the transfers of value which take place between sectors. The value of final sales on the other hand relates only to the residual value within a sector after the transfers have been deducted.

There is not enough attention paid to Gross Output by Marxist theoreticians. This is a pity because it gives far greater insight into the power of industry and commerce within the economy as a whole. I have included the goods production sector comprising Agriculture, Mining, Construction and Manufacturing industries, to this I have added Utilities which is left out because the commodity it produces is consumed immediately (it will be interesting to see how the BEA treats stored electricity in the goodness of time), transportation/warehousing other than human transportation as they are concerned with transporting goods in one form or another, wholesale and retail as their margin is formed from the discounts given to them by producers, and finally accommodation and food services as they add to what has been produced already. Clearly there are other areas worthy of consideration such as arts and entertainment or information and so on and so forth. But the graph makes the point. These industries produce 50% of the total sales found in the non-government economy or nearly 60% if we excise imputed (fictitious) sales.

Graph 1.



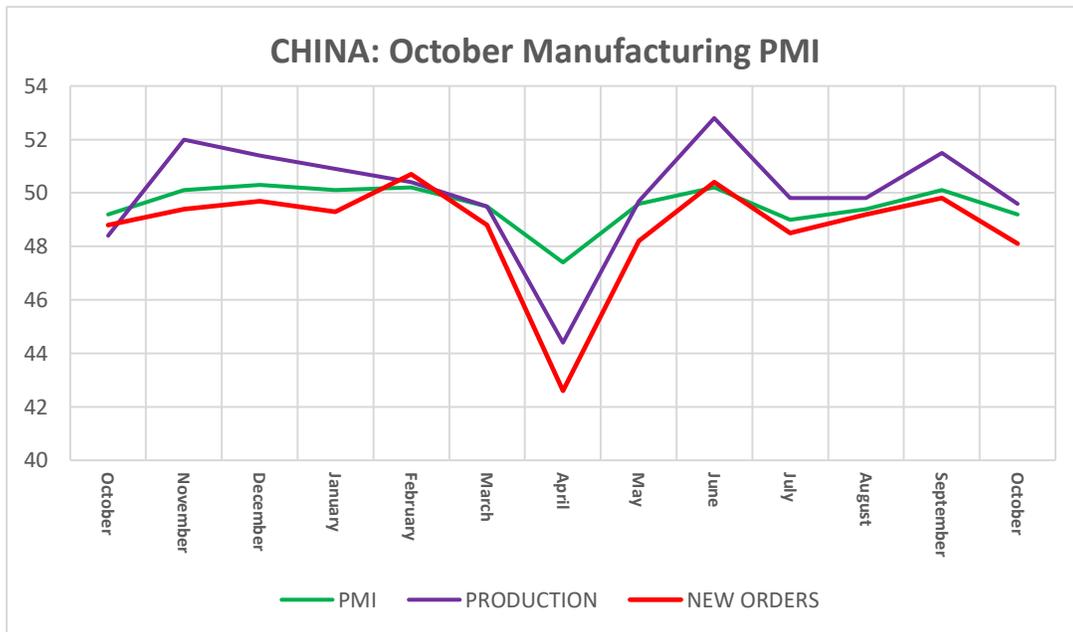
(Source: BEA Interactive Tables, GDP-by-industry, Gross Output series.)

There have been a string of purchasing manager surveys reviewing conditions in manufacturing which is the core of industry. The most recent has been JP Morgan’s global PMI. It fell to 49.4 in October from 49.8 in September, cumulatively the steepest fall in 11 years. Of the 32 countries surveyed 25 showed declines. In the Pacific only Singapore and India bucked the trend.

China.

The latest [PMI for Chinese Manufacturing](#) came in at 49.2 and notably the new order index weakened. *“The new order index was 48.1 percent, decrease 1.7 percentage points from the previous month, indicating that the market demand of the manufacturing industry continued to decline.”* In a Thursday article in the [Financial Times](#) about basic manufacturers closing in China, the four reporters spoke of the hopelessness felt by their owners in the face of lockdowns and collapsing export orders. They spoke of foreign orders down 30 to 50%.

Graph 2.



All the above helped Chinese exports fall in Dollar terms YoY and even in CNY when adjusted by the Producer Price Index. In other words the current volume of Chinese exports has now fallen YoY. Little wonder Maersk is starting to cancel sailings across the Pacific towards the EU and the USA. Interestingly enough, Chinese exports, mainly industrial to Asian partners, is actually up.

A bellwether for global shipments is airfreight which took off once seaborne trade tightened and container rates soared. In [September airfreight volumes](#) fell by 5%, and in October by 8% bringing them down 3.3% to 3.6% below the volumes found in 2019. Little wonder [FEDEX](#) is grounding planes and firing workers. This is what [FEDEX](#) had to say: *“First quarter consolidated operating results were adversely impacted by global volume softness that accelerated in the final weeks of the quarter due to weakening economic conditions. FedEx Express operating income declined 69% due to an 11% year-over-year reduction in global package and freight volume.”* Nor was [UPS](#) the world’s biggest delivery firm unscathed. Though it fared better than FEDEX it reported international volumes down 4.7% and in the USA down 1.6%.

Graph 2.



In this article we will be paying particular attention to prices as they circulate within production commonly called Producer Price Indexes. Slumps are always associated with deflation not inflation, and it is also surprising how quickly, historically, inflation can turn into deflation. Deflation is often detected in the supply chain as demand falters, unsold inventory piles up creating a negative cascade for orders. And so it is with [China's PPI](#) which fell 1.3% YoY in October. China Prices of Important Means of Production saw two thirds of individual means fall in price in the October [release](#).

Subtracting the inflation born of the pandemic, producer prices in China are now no higher than in 2019. In short, the global economy has exited the conditions provoked by the Pandemic notwithstanding lockdowns in China.

Although we are dealing here with China it does not hurt to observe what is happening in the USA. There the Producer Price Index up to October is also subsiding.

Graph 3.



The rest of the Asian economies.

After China the economies of Taiwan, South Korea and Japan are the tech powerhouses. In particular this is true for Taiwan home to TSMC which dominates the foundry world of chip production. 7nm chips has become the new workhorse found in the more advanced products replacing 14 nm. But having geared up production, TSMC has been haemorrhaging orders. “[Capacity utilization](#) rates for TSMC's 7nm process platform and its process variants N6, N7 have fallen below 50%, according to industry sources.” No doubt TSMC will be cutting back further on its capital expenditure. Nor will the Biden Administration’s fiscal support make much difference except to antagonise the EU and others due to it favouring US manufacturers at the expense of foreign competitors.

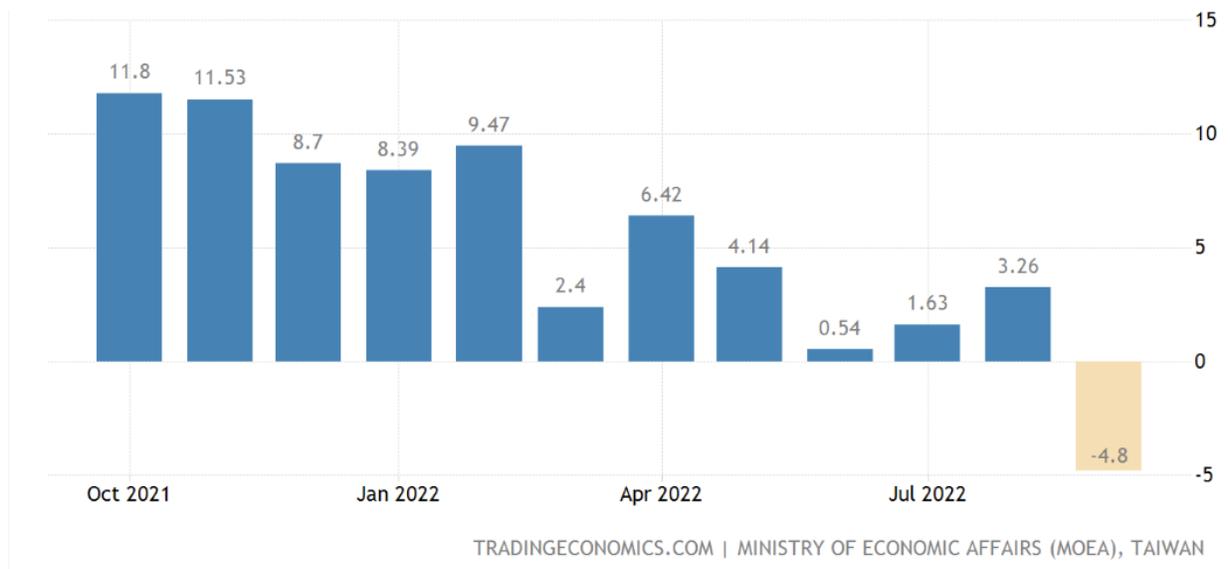
Within the space of a few months, the chip industry which was struggling to fulfil orders, is now tripping over unsold stocks. Observing the chip industry is key to examining the unfolding slump in world industry. And nowhere better than to view one of its heaviest users, smartphones. “[The global smartphone market growth saw a decline of 9% YoY and 10% QoQ to 294.5 million units in Q2 2022. This was the first time quarterly shipments dropped below 300 million units since Q2 2020 during the early part of the COVID-19 pandemic.](#)” And in the third quarter when Apple launched its iPhone 14 global sales barely moved up. “[The global smartphone market remained under pressure given deteriorating economic conditions with shipments declining by 12% year-on-year, reaching 301 million units in Q3 2022, according to the latest research from Counterpoint’s Market Monitor service.](#)” These are the lowest unit sales over 6 months since 2014 (though today’s smartphones on average contain more chips). This data is confirmed by [IDC](#) “[Worldwide smartphone shipments declined 9.7% year over year to 301.9 million units in the third quarter of 2022 \(3Q22\), according to preliminary data from the International Data Corporation \(IDC\) Worldwide Quarterly Mobile Phone Tracker. The drop marks the largest-ever third quarter decline and the fifth consecutive quarter of decline for the smartphone market as shipments continue to struggle.](#)”

According to the [Semi-conductor Industry Association](#), global monthly chip sales in September fell for the first time since 2020 by 3%. The QoQ fall was 6.3% and given the likely [acceleration of the fall in Q4](#), the volume of shipments are likely to be back to 2019 levels before falling further. Given the recent increase in capacity crashing into plummeting demand, it was to be expected that chip prices would start

imploding. Already in September prices had fallen by 20% over two months. “Among them, [the price of most consumer electronics chips has fallen more than 20 percent in the last two months, and some chips have fallen more than 80 percent.](#)” . It is almost unbelievable to remember that just a few months ago companies like TSMC and Samsung were raising chip prices with impunity.

Though Apple emerged the least scathed it will be interesting to see how the \$2 trillion collapse of the Crypto market affects its sales. The selling conditions are even worse in other markets consuming chips such as laptops, PCs (-19.5% YoY source [Gartner](#)), game stations, servers (especially with the collapse of Crypto a heavy user), a slowdown in the growth of cloud computing and soon cars. Taking all this into account, it is no wonder that Taiwan’s latest PMI fell to 41.5 in October from 42.2 in September with new orders in free fall. As a result production in Taiwan fell sharply in October wiping out the previous three month of gains.

Graph 4.

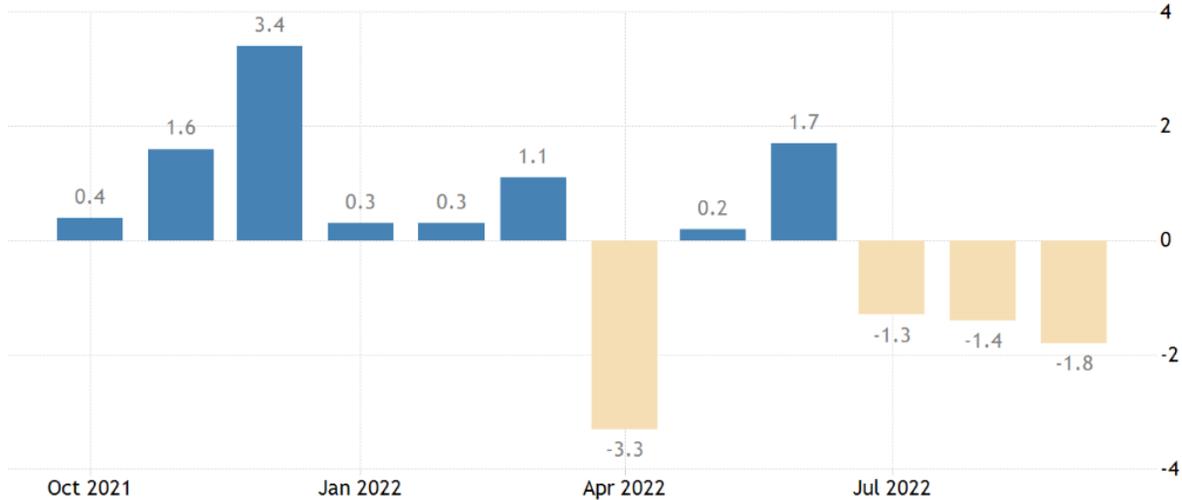


And it is not only the fall in chip prices, but the fall in the value of the shares of the corporations that produce them. This fall now exceeds \$1 trillion when we include the Big Tech names in the USA such as Apple and Microsoft. These corporations were once the driver of share prices, now they have turned into their brake.

Before leaving Taiwan, it is expected this country will be one of the hardest hit by the growing slump affecting all the manufacturing countries given its dependency on chips. Could it be the case in the future, that rather than invade Taiwan, China will have to bail it out?!

South Korea is following in the tracks of Taiwan. Its October exports have fallen 5.7% YoY. Its manufacturing PMI has fallen four months in a row but rising from a low of 47.3 in September to 48.2 in October, still well into contraction territory. Accordingly industrial production in South Korea has been weak over recent months as shown in Graph 5 below covering the period up to September. (Data for October has not been released yet.)

Graph 5.



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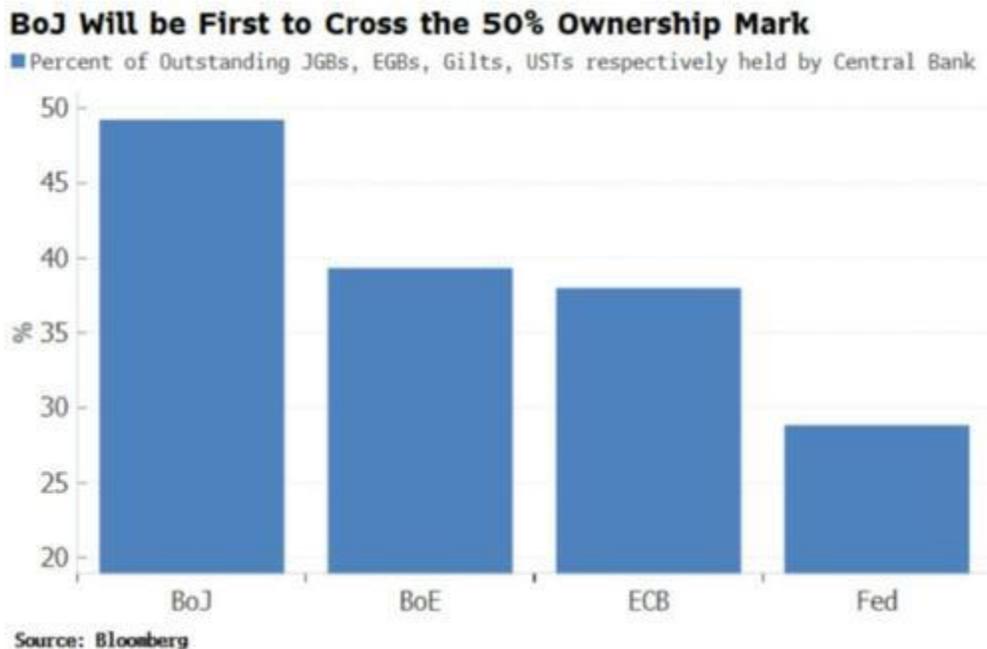
Turning to Japan. “Yen-denominated merchandise exports rose 13.0% year-on-year in September, following August’s 26.2% increase. While September’s result marked the seventh consecutive month of double-digit export growth, the reading was still the weakest result since February.” However, both of September’s readings were aided by a healthy base effect, with September 2020 having coincided with a sizeable pandemic-induced decline in trade volumes.” Additionally, this Yen increase needs to be adjusted by the fall in the [trade-weighted index](#) of the Yen over the same period amounting to 30%, implying a significant fall in the volume of trade. Given that Japan has now benefited from the ending of lock-down which has spurred internal consumption including retail sales boosted by government subsidies, this fall in exports has yet to register in the production figures which rose 5.8% YoY. Nevertheless, forward looking surveys such as the manufacturing PMI for October fell for the 4th month to 50.7, registering falls in both output and orders. In August machinery orders fell sharply reversing the previous two months gains and ending up at a 6 month low.

Japan has its own peculiar Dragons to Slay borne from the slump in the 1990s. Of all the major Central Banks, The Bank of Japan (BOJ) alone continues to pursue Quantitative Easing in order to maintain government borrowing costs at 0%. The result has been a collapse in the Yen to a 32 year low, despite a cumulative \$62 billion intervention by the BOJ to stabilise the fall in the Yen. In turn, the fall in the Yen has boosted inflation due to the rise in import prices many of them denominated in Dollars.

The collapsing Yen has implications for the US Bond market where Japan is one of the major buyers. The problem for the BOJ is that purchasing US bonds means buying Dollars further pressurising the Yen. This could be one reason why foreign buying during the last 10-Year US Treasury Auction on the 9th November was the lowest since March 2021. The only assistance to the BOJ will be a fall in US interest rates.

As of June 2022, the Japanese public debt is estimated to be approximately US\$8.7 trillion US Dollars (1.28 quadrillion yen), or 266% of GDP, and is the highest of any developed nation. 43.3% of this debt is held by the Bank of Japan. In June this year the [BOJ owned more than 50% of bonds](#) higher than any other Bank.

Graph 6.



Bloomberg said crossing this 50% Rubicon leads to uncharted waters. As the BOJ becomes the majority owner of its own bonds, it now takes fewer purchases to repress interest rates because there are fewer bonds remaining in private hands. This QE did not lead to inflation within Japan until the Yen collapsed due to interest rates rising elsewhere in the world economy, resulting in higher import prices being passed onto consumers. This seems a paradox in terms of MMT. Why should trillions of dollars fed into the financial world by BOJ purchases of bonds and shares not spark rampant inflation. If one was a monetarist, this is exactly what should have occurred.

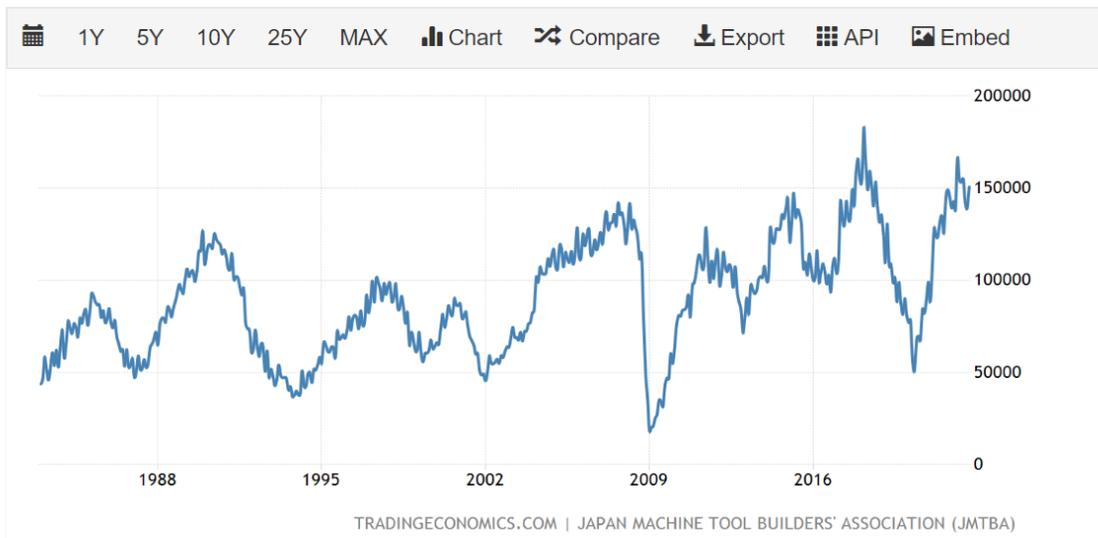
The answer is most of that money has been hoarded by the banks and corporations and not used for investment which would have sparked inflation. The amount of money deposited with the [Bank of Japan](#) is \$4.31 trillion dollars equal to 492.1 trillion Yen. In the USA the total deposited with the FED is \$4.6 trillion currently, not much higher despite the US economy being at least triple the size of the Japanese economy. It is also likely that were the BOJ to pay a realistic rate of interest on these deposits it would soon be bankrupt given their magnitude. One more reason why interest rates cannot be allowed to rise. The BOJ is trapped.

Likewise with non-financial corporations. "[U.S. non-financial corporations](#) are sitting on just over \$4 trillion dollars in cash, according to the latest Flow of Funds estimates, up from \$2.7 trillion a decade ago and just \$1.6 trillion in 2000." In contrast listed [Japanese Corporations](#) sit on \$4.8 trillion. (That \$18 trillion could kickstart the process of reversing global warming which is why I insist that we have the capacity to reverse climate change, the only problem being the question of who owns and controls that capacity.)

The flip side of these stupendous hoards of money is the paucity of investment. Within Japan (as opposed to its foreign direct investments abroad) [machinery orders](#) are no higher today than they were in the late 1980s in real terms, as the graph below shows. During that time Japanese GDP grew by 10% adjusted for inflation.

Graph 7.

Machine Tool Orders in Japan increased to 150848 JPY Million in September from 139327 JPY Million in August of 2022. source: Japan Machine Tool Builders' Association (JMTBA)



In every way Japan proves conclusively that boosting the money supply does not generate price rises. In every way Japan shows what happens when profit does not promote investment despite cheap money. In every way Japan points to the stagnant future of capitalism with or without a slump in the interim.

Cryptos turn into Craptos

Crypto currencies are not money. They have no claim over any stream of produced value, past, present or future. State currency does, it has a direct claim via taxation and an indirect claim because it monetizes previous streams of value, what I call [legacy value](#), in the form of unspent revenues which it denominates.

The price of Crypto currencies are set purely by the demand for them. Previously this demand was invigorated by cheap money, borderline zero interest rates and to a lesser extent, by the hunt for yield. At its peak Cryptos were worth \$3 trillion, big enough to lure in foolish ex-politicians like Clinton and Blaire. At \$3 trillion, Cryptos were as large as the high yield (speculative) US corporate bond market.

However as soon as interest rates started to rise this ensured Cryptos were no longer cost-free, guaranteeing that the days of Crypto currencies were numbered. A rise in interest rates always leads to a repricing of risk including Cryptos. By Wednesday Cryptos had lost \$2 trillion, resulting in fears of contagion amidst allegations of fraud. On Friday one of the biggest dealers, FTX finally declared bankruptcy with up to \$50 billion in debt. Had the high yield corporate market lost \$2 trillion so abruptly and brutally, this would be considered a global financial emergency.

The effect of changing interest rates seems to escape the attention of many Marxists dazzled as they are by the rate of profit. But slumps are not only caused by falling rates of profit, but additionally, the rise in the rate of interest which a fall in profitability initially provokes because by its fall it increases debt, debt which in turn needs to be financed under conditions of distress.

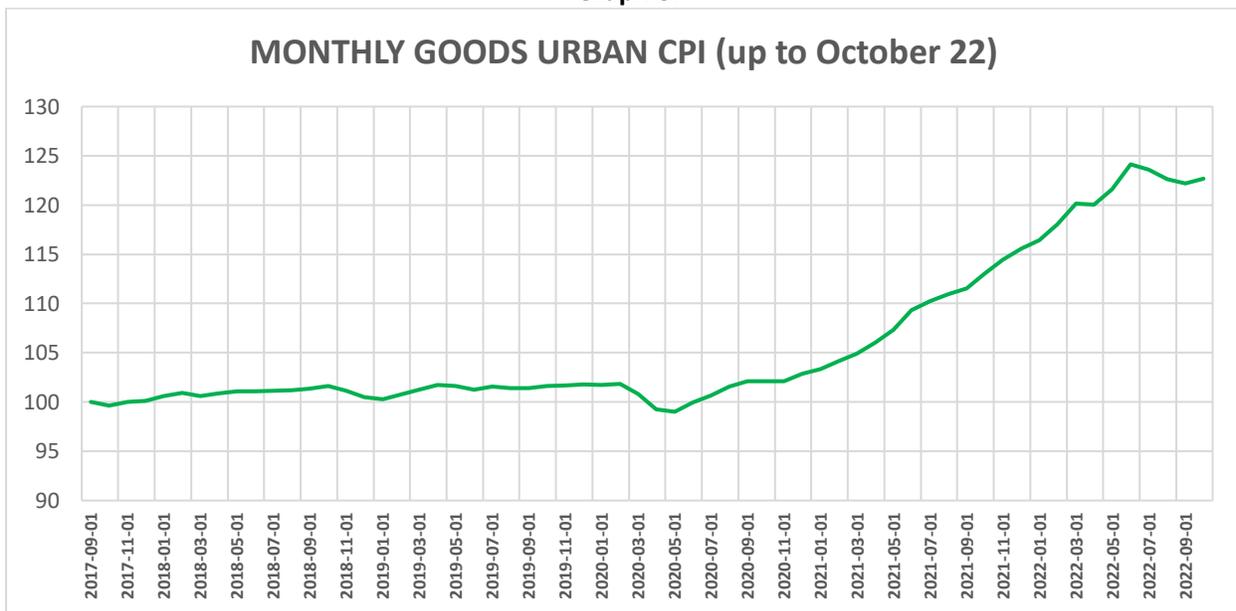
Cryptos may be technically novel, but novel does not rule out Ponzi schemes. The price of Cryptos always depended on how much new money was being sucked in versus how much old money was being taken

out. As soon as Crypto investors headed for the cyberspace-exit and there were no new entrants, prices had to plunge. In this sense, Cryptos are a barometer of the slump. They more than any other fictitious instrument are prone to centrifugal forces, unlike say shares, which are anchored by claims on future surplus value. It cannot be ruled out that during the depths of the slump, Cryptos including Bitcoin could become worthless. At least the collapse in Crypto mining has reduced the output of greenhouse gasses which surpassed the whole of the Philippine’s emissions in 2021, while producing 37,000 tons of e-waste.

THE CPI in the USA (a quick diversion).

The markets loved the CPI print on Thursday. Peak inflation had been reached. Actually it had been reached already were one to strip out owner-occupier rents. Core inflation rose by 0.18% month on month taking out these rents as well as energy costs. Annualised this amounts to 2.2%, hey FED Powell you’ve hit your target, back down. Below is the goods CPI which ticked up 0.4% MoM due to the rise in gasoline prices, but it is still down 2% from its mid-year peak.

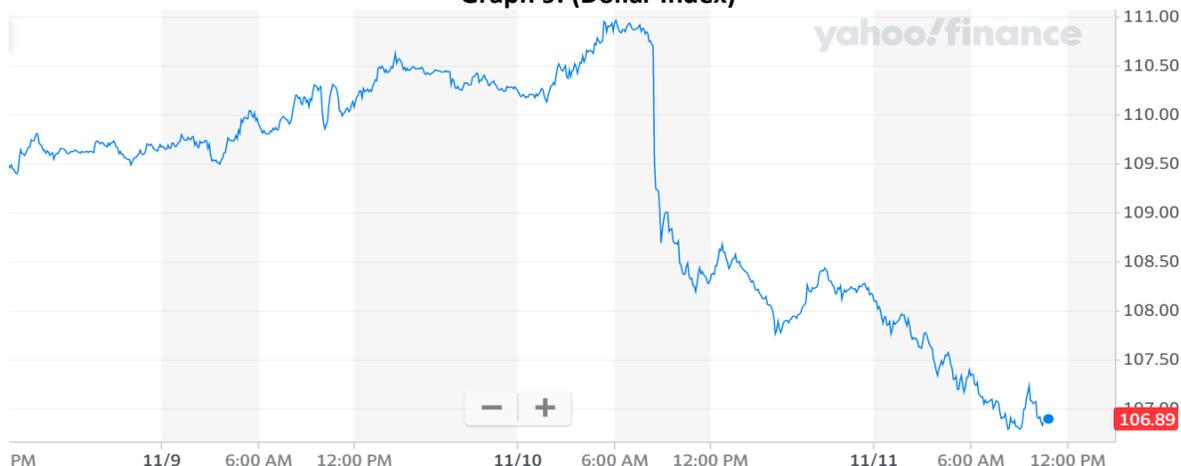
Graph 8.



The markets loved the mid-term election results, more political paralysis as the White House and Congress cancel each other out resulting in absent referees on the financial playing fields. But this was as nought compared to the inflation surprise. Watching the wonder on the faces of the Bloomberg presenters when the CPI came out weaker than expected was novel. Watching them becoming hypoxic as the markets rose and rose was revelatory. Yes, the markets had their best day for over two years and yes, daily bond interest rates fell by the most since 2009, but does it change anything? Is a soft landing now more likely than a hard one? Is it likely the jump in share prices, a so-called relief rally will endure?

It seems investors can frame only one idea at a time. Yes, peak inflation has come and gone. For them the overwhelming concern is interest rates. After the CPI report came out the bets on the December FED rate rise fell from 0.75% to 0.5%. A lower interest rate rise projection also reduced the outlook for Dollar strength. After the CPI print the dollar fell by an unprecedented and jaw dropping >4 cents. That took trillion of \$s in derivatives to effect. Seems US interest rates will no longer be storming ahead of the pack.

Graph 9. (Dollar Index)



Of course the fall in the dollar will be good for the profitability of those US corporations with sizeable sales abroad, not so much for the rest, as a weaker dollar implies higher import prices.

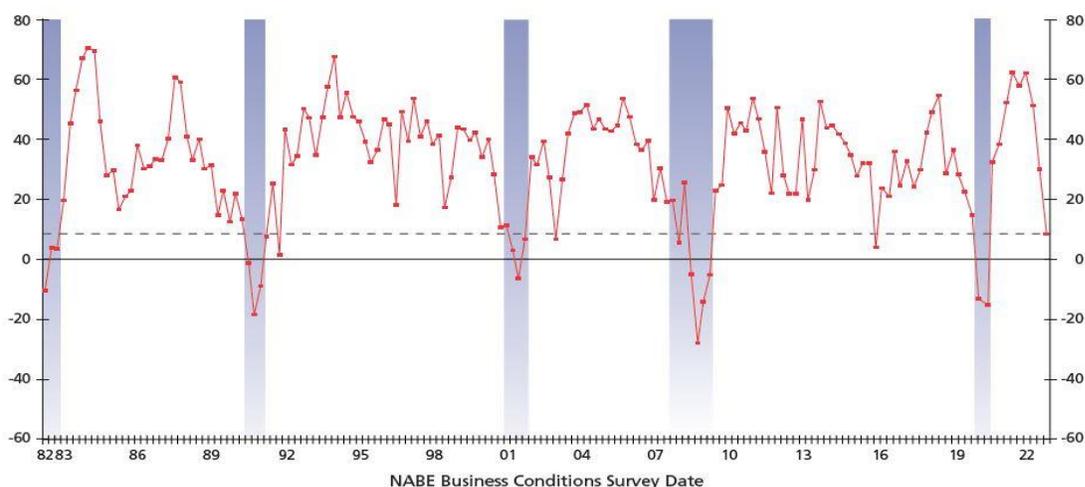
The CPI release may have created a sugar rush, but the insulin is not far behind. Firstly, the fortune tellers, aka analysts, have sobered up and are now being more realistic about future earnings. This week's [FactSet's Earnings Insight](#) report projects a 1.7% fall in S&P profits for this quarter. Secondly, because the business news outside the hallowed dealing rooms is becoming grimmer by the day.

Recessions first appear in the freight industry when inventories accumulate leading to cancelled orders. [C.H. Robinson](#) one of the largest truckers in the USA has just fired 1,100 workers, one of the largest firings in this industry outside bankruptcy. The is what the boss said, (my emphasis). *'Got ahead of ourselves' in head count, didn't expect freight markets to cool this fast.*" And they aren't the only freight company to announce layoffs. Nor is this the only industry. Layoffs are occurring everywhere especially in Hi-Tech now that Twitter has opened the floodgates. As [CNBC](#) reported this is due to sales and profits collapsing.

Graph 10.

Figure 1 – Sales Net Rising Index

(% of respondents reporting increasing sales minus % reporting decreasing sales)

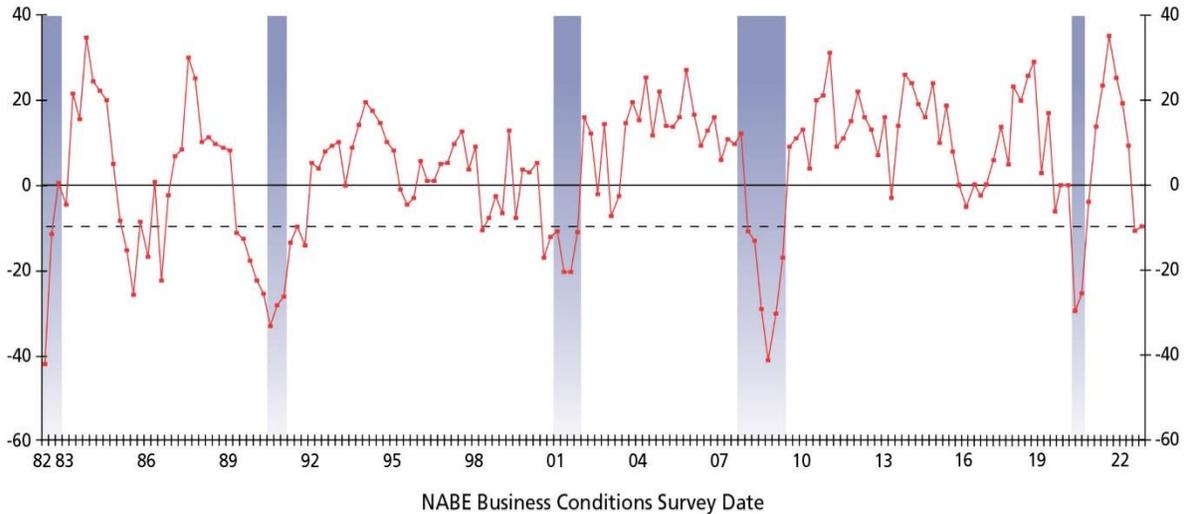


Note: In this and all figures, shaded areas represent recessions.

Graph 11.

Figure 2 – Profit Margins Net Rising Index

(% of respondents reporting increasing profit margins minus % reporting decreasing profit margins)



And consumers agree. The Umich index on Friday fell from 59.9 to 54.7 when 59.5 was expected, dragged down by pessimism over current conditions.

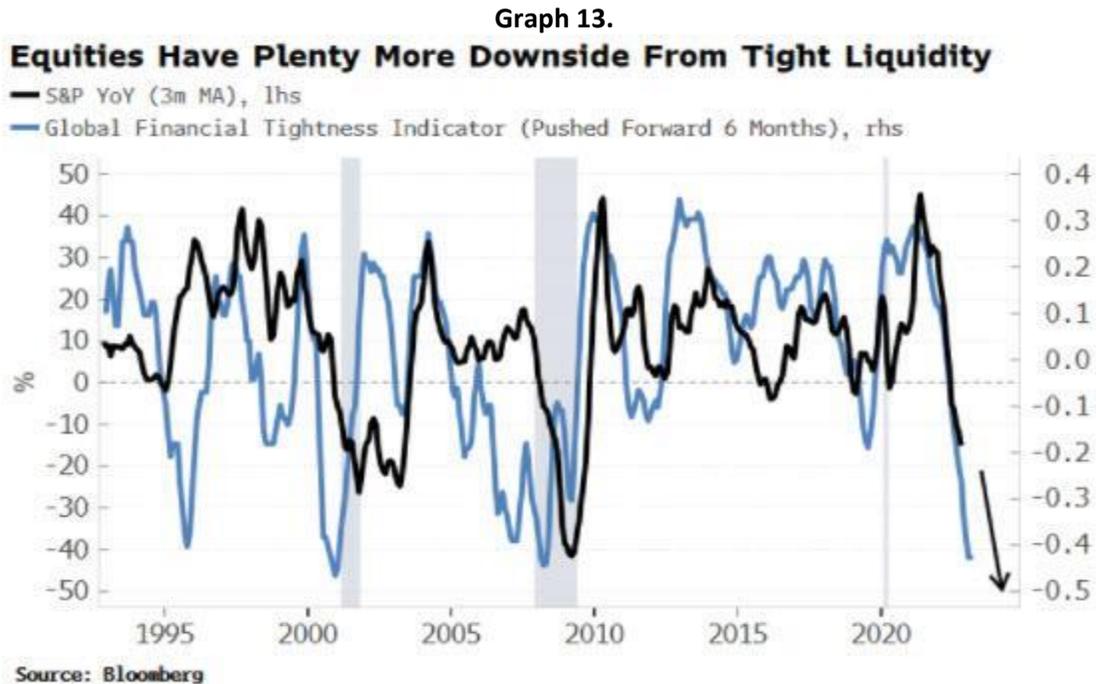
Graph 12.



Taking in the round, it is likely the euphoria over the future course of interest rates will soon be blown away by the reality on the ground, especially when retailers such as Walmart and Target report next week. Remember, the US economy engorged by capital gains and cheap money, grew on the basis of personal consumption not capital investment. Whatever the outlook for interest rates, a recession is baked in. An analogy will suffice. Investors can be compared to a cancer patient in the oncologists office. Good news

says the oncologist, “you are in remission”. Patient, “but why are you not smiling”? Oncologist, “because unfortunately the chemo has destroyed your heart and there are no donors available”. For chemo read interest rates, for heart read the real economy.

Despite the market bounce yesterday, liquidity conditions have tightened due to the tens of trillions in losses since January for share, bond and now the housing market.



Conclusion.

It was always going to be the case that China would relax its strict Covid rules, especially when the virus became more transmissible requiring increasingly draconian measures to succeed. In reality, there are only 3 options. A healthy population providing resilience to the virus due to airy living conditions, a healthy diet, the absence of over-work and financial security, none of which applies to Coputalist China. Or, lockdowns, or mass vaccinations. China has discovered that in a competitive world economy, lockdowns can become counter-productive driving investment away, but with the approval of a new innovative nasal vaccination they may have the option for the first time of using mass vaccinations to blunt the virus.

The easing of lockdowns will not reverse the fortunes of the Chinese economy merely make them less worse. China is no longer able to act as the engine for world growth. The latest loan data proves this to be the case. Nevertheless, it is likely that the slump in the Asian economies will be shallower than the deeper slump in the West and Japan because fewer excesses have built up in their economies.

This slump must not be compared to 2008 as it is more fundamental and broad based. Nor is there an exit as was the case in 2009 when China embarked on the greatest capitalist investment wave in history. Rather this time the slump needs to be compared to the 1930s which only ended due to War in the 1940s. Today globalisation has fractured undermining supply chains and giving way to economic nationalism.

Brian Green, 11th November 2022.