

IS THE CHINESE ECONOMY STRENGTHENING AND CAN THIS TREND BE SUSTAINED?

In my last report which showed the sharp fall in the Chinese rate of profit I was cautious about drawing firm conclusions based on the January/February data given the holiday week and the recent lifting of lockdowns. I was right to be cautious. March turned out to be stronger than expected, but fundamentally all is not well, and how durable the upturn will be, is questionable.

According to a [Financial Times](#) report, the Chinese Politburo commented that the economy was still weak and demand insufficient because of external factors. And this comment was made in the context of the earlier surge in retail sales (see below). It seems the Chinese Communist Party is sensitive to the state of the world market recognising that *dual circulation* is not yet up to the task of compensating for the external doldrums. (See my report from Maersk at the end.)

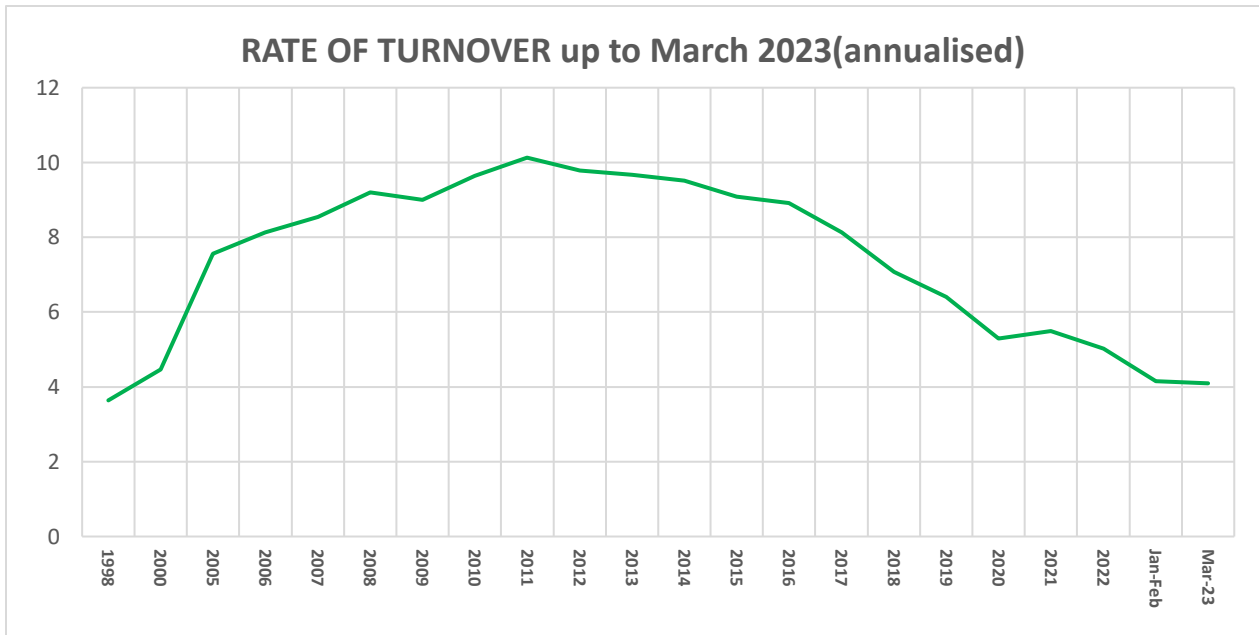
In addition, the State Council is calling for the firing of 5% of its workforce in both central and local authorities. Local authorities, where most public spending and investment occurs, has suffered a dual complication. Lockdowns and mass testing has been prohibitively expensive draining local authority reserves. On the other side, income has been falling, particularly the income from land sales which provides 25% of revenue.

This 5% cut will apply to white collar jobs, the ones most in demand, particularly by university graduates. Youth unemployment remains high at around 20% which translates into 11 million unemployed youth in the cities. The youth, 2nd and 3rd generation urban dwellers, are reluctant to take on industrial jobs as they have experienced just how hard their parents toiled on the assembly lines of Foxcon or Petagron, and they do not want to repeat the experience. Appeals by the party are falling on deaf ears, as the youth would rather pedal delivery cycles for lower pay than work in factories. It is in this context that Xi's appeal for the unemployed youth to return to the countryside to work is unlikely to succeed and shows how out of touch he is with them. "The announcement followed [President Xi Jinping's](#) call last December for urban youth to seek jobs in rural areas in an effort to 'revitalize the rural economy'". And this Maoist 'call to spades' shows he is also out of touch with history. Xi has a youth problem because he has an economy problem.

The rates of turnover & profit.

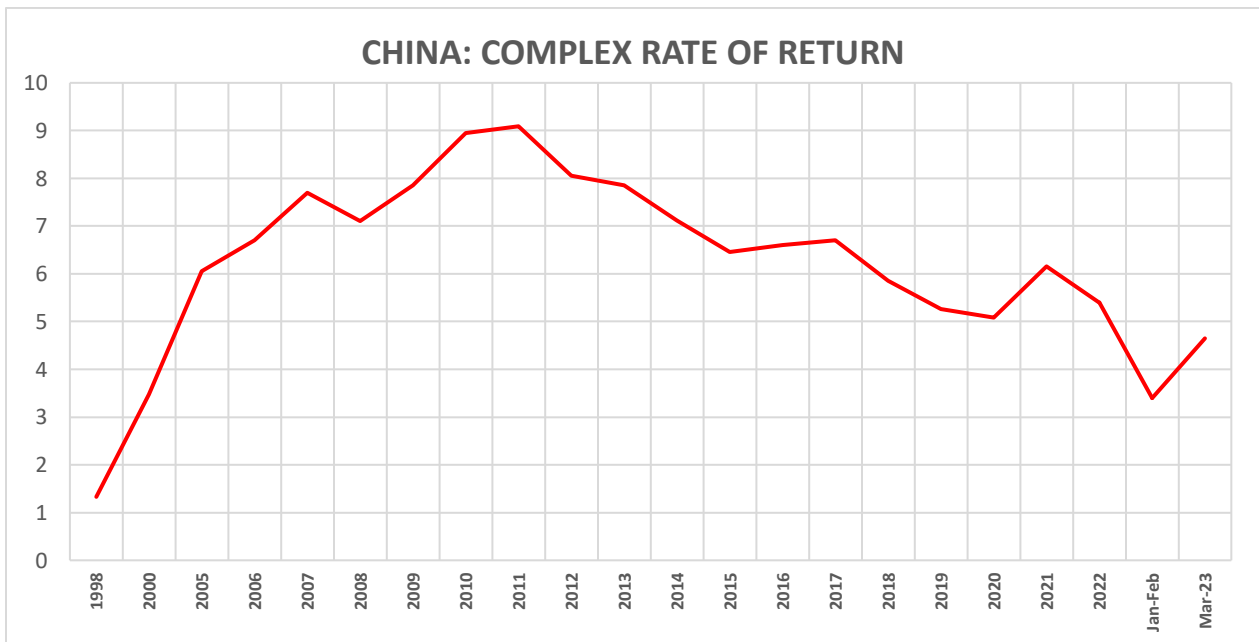
In March profitability improved but not turnover. The fact that the rate of turnover remains depressed forms a lid on the future prospects for profit as the rate of profit is an annual rate which is influenced by how many times profit is reproduced within that year. Currently the pulse of profit is every 98.5 days given the rate of turnover is 4.1 compared to its heyday in 2011 when it took a mere 37 days. Of course we must bear in mind that in 2011 China had a far less sophisticated economy focusing on assembly. These days China is producing much more complex commodities such as airliners which have a longer production period with many more parts. However the changed structure of production itself cannot account for the slowdown in the rate of turnover. The dominant factor in the slowdown is the period between sales and payment which has extended to 53 days, longer than the entire turnover period in 2011. Any extension in the payment period is always a sign of distress and given that the payment period increased by 4 days over the equivalent month in 2022, this raises the spectre of illiquidity and even insolvency. This is not yet evidenced by the latest data on official insolvencies up to December which shows it to be stable at 1.6%.

Graph 1.



The complex rate of return rebounded in March but still stood below its depressed 2019 level. That was due to operating profits falling in March by 21.9% yoy because profits in early 2022 were boosted by the ongoing surge in higher priced exports courtesy of EU and US Covid support funds. Profitability now stands at 4.65% compared to 3.4% in the first two months of this year. Clearly, the fillip given to profits by higher priced exports in 2021/2 is now well and truly over. (A reminder, I use the term ‘complex’ to denote that the denominator used comprises total assets which includes financial assets and inventories. Thus while the Chinese rate of return appears to be lower than in the USA, they are not comparable.)

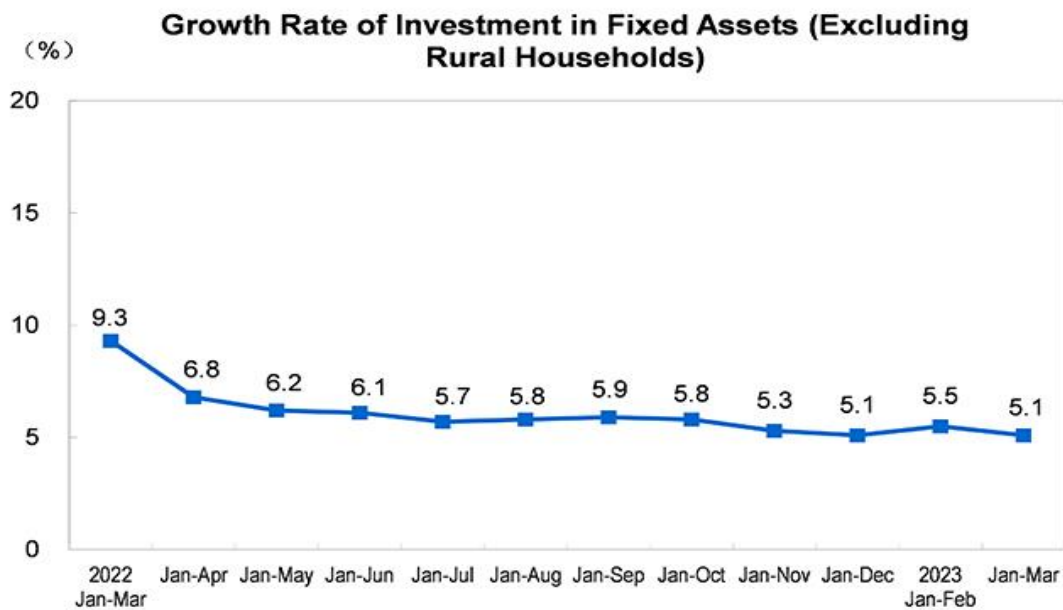
Graph 2.



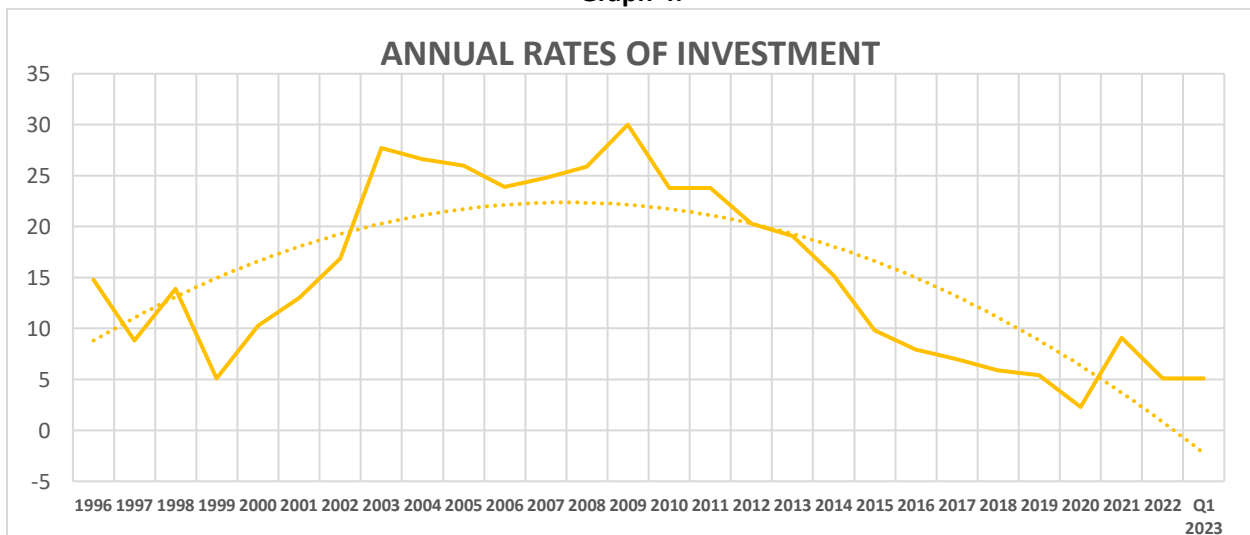
Profit determines investment and not the other way around. Capitalists are encouraged to invest by a rising rate of profit and discouraged by a falling rate of profit. In any case, a falling rate of profit signifies there are fewer new investable funds relative to the mass of capital. The fall in the complex rate of return has had a negative effect on investment as the two graphs below show. Graph 4 shows that once returns fell below 7%, or by a quarter, the growth rate in the annual rate of investment fell into single figures.

Currently: "From January to March, the [national fixed assets investment](#) (excluding rural households) was 10,728.2 billion yuan, a year-on-year increase of 5.1 percent. Among them, private fixed assets investment was 5,853.2 billion yuan, a year-on-year increase of 0.6 percent." (my emphasis) Manufacturing investment was more robust running at 7.0% The collapse in private investment may be the primary reason why the Communist Party is cosyng up to the private sector and rowing back on its anti-business rhetoric.

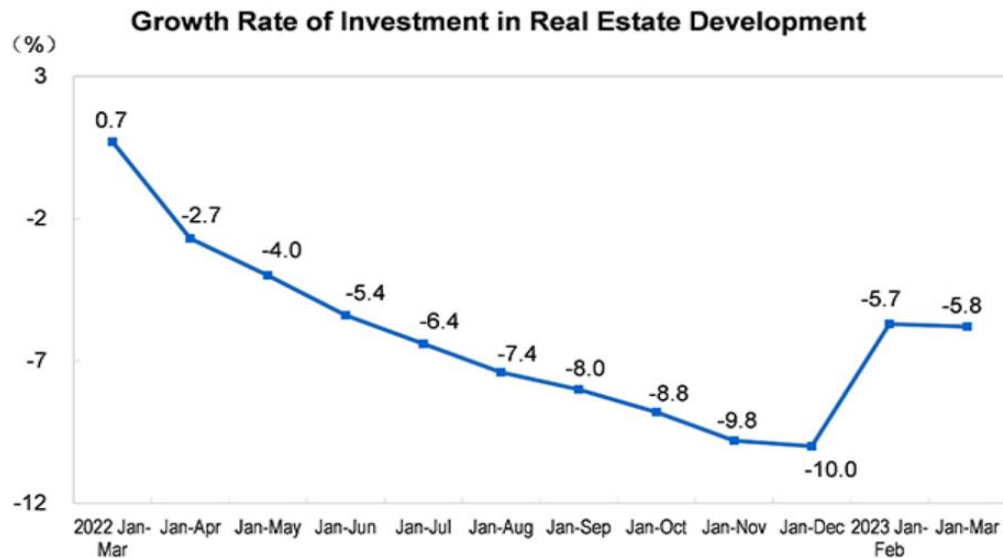
Graph 3.



Graph 4.



Graph 5.



Turning to investment in the property sector: “The floor space of [buildings newly started](#) was 241.21 million square meters, down 19.2 percent. Among them, the floor space of residential buildings newly started was 177.19 million square meters, down 17.8 percent.” Thus we can see that the seeding of new buildings was much worse than the volume of floor space sold. Whether the disparity between builds and sales resolves in favour of an increase in builds depends on how much unsold properties there is. According to this article, residential floor space available for sale rose 15.1% in March whereas sales rose only by 1.4% implying there is a large overhang of unsold properties. At this rate it will take at least 6 months to work through this overhang, before sales directly boosts new construction.

The problem is not due to tight monetary conditions but over-supply and the nursing of losses. Of all the major economies other than Japan, China alone is increasing credit. [Total credit](#) grew by 11.9% in the year up to February. This cumulative increase in credit to a level double that found in the USA, has resulted in a money supply which at \$36.9 trillion is 50% larger than the US figure of \$21 trillion, and unlike the US, there has been no recent significant fall in the money supply. Conversely, from the other side, when examining the ratio between credit and money supply, it shows that much of this income is unspent.

Chinese GDP.

Chinese GDP at 4.5% grew faster than expected driven by higher retail sales or what is the same thing personal consumption. The details lodged in the GDP data can be seen in this interesting [Financial Times](#) analysis which shows that real estate remains a drag (see above). However, in line with boyant luxury goods sales in China, it appears that sales of more expensive properties increased otherwise a fall in the volume of property sales would not have resulted in a rise in the value of property sales amounting to an above inflation figure of 4.1%. The breakdown of GDP can be viewed in the table below. It shows that manufacturing which still represents nearly a quarter of GDP grew by only 2.8% in contrast to information and software which increased by 11.2%

Table 1.**Preliminary Accounting Results of GDP for the First Quarter of 2023**

	Absolute Value (100 million yuan)	Growth Rate over the Same Period Last Year (%)
	Q1	Q1
Gross Domestic Products	284997	4.5
Primary Industry	11575	3.7
Secondary Industry	107947	3.3
Tertiary Industry	165475	5.4
Farming, Forestry, Animal Husbandry, and Fishery	12257	3.8
Industry	94823	2.9
#Manufacturing	79567	2.8
Construction	13574	6.7
Wholesale and Retail Trades	27667	5.5
Transport, Storage, and Post	12092	4.8
Accommodation and Restaurants	4511	13.6
Finance	26640	6.9
Real Estate	19611	1.3
Information Transmission, Software and Information Technology Services	13520	11.2
Renting and Leasing Activities and Business Services	9692	6.0
Others	50611	4.0

(Source: [National Bureau of Statistics of China](#))

Industrial production.

[Industrial production](#) picked up in March to 3.9% barely above the 3.0% achieved during March to December 2022 when lockdowns proliferated. *“In March, the added value of industries above designated size increased by 3.9 percent year-on-year (the growth rates of added value are the actual growth rates after deducting price factors). On a month-on-month basis, in March, the added value of industries above designated size increased by 0.12 percent over the previous month. From January to March, the added value of industries above designated size increased by 3.0 percent year-on-year.”* The month on month increase between February and March at 0.12% represents a growth rate of only 1.5%. Once again industrial expansion occurred mainly in the state sector.

One bright spot was the increase in motor vehicle production. Additionally, there is growing evidence of significant new investment by foreign auto manufacturers into China seeking to claw back their share of sales which have fallen back to 50% in what is the largest and most profitable auto market in the world. In this sector we see German corporations seeking to sidestep the US antagonism towards China by holding onto one of their biggest markets. Finally, not only is China beginning to dominate global electric vehicle production and battery production, but in 2023 it is slated to become the world’s biggest exporter of cars.

Retail sales.

This was the bright spot in the data. It increased by an unexpected 10.6% yoy. This was sufficient to bring annualised retail sales back to the same level in dollar terms as found in the USA. It is a common misconception that the US is the world's largest consumer market. China is the largest market when adjusted for price differentials (purchasing power parity or PPP). Adopting this metric the Chinese retail market is roughly 20% bigger and that can be seen quite clearly when looking at volume measures, e.g. there are 50% more cars being sold in China which more than compensates for the different mix of cars (including SUVs) sold. The fact that the US is the world’s biggest importer of consumer goods does not describe the size of its market rather it describes its withered goods producing sector.

Graph 6.



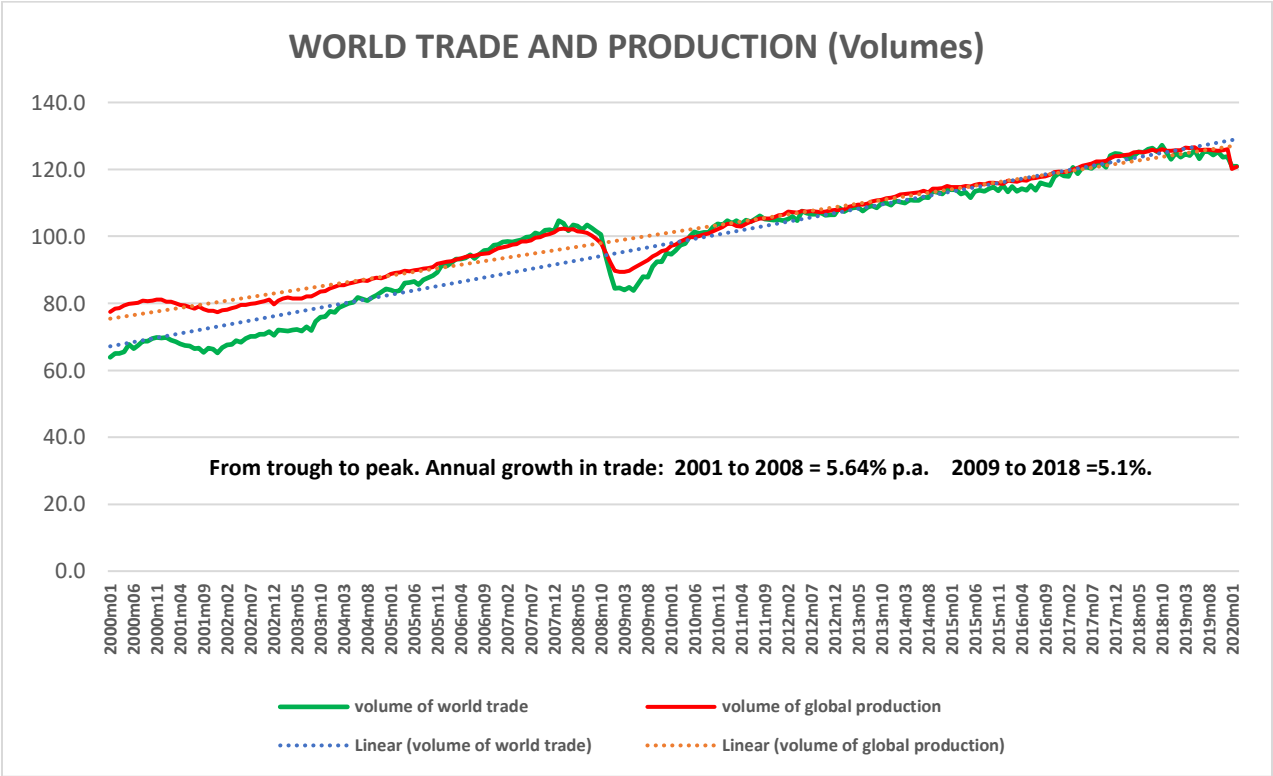
Whatever global growth there will be in 2023, should come from the Pacific.

“[Growth in developing Asia](#) is forecast at 4.8% this year and in 2024, up from 4.2% last year. The People's Republic of China's (PRC) recovery and healthy domestic demand in India will be the region's main growth supports this year and next.” “India is forecast to grow by 6.4% this year and 6.7% next year on healthy domestic demand.” This assessment was prepared by the Asian Development Bank which raised its outlook. It also expects Asia to provide 70% of the increase in global growth this year. This compares to the IMF's assessment that only 50% will come from this region. “[The baseline forecast](#), which assumes that the recent financial sector stresses are contained, is for growth to fall from 3.4 percent in 2022 to 2.8 percent in 2023, before rising slowly and settling at 3.0 percent five years out—the lowest medium-term forecast in decades. Advanced economies are expected to see an especially pronounced growth slowdown, from 2.7 percent in 2022 to 1.3 percent in 2023.”

The reason I have pounced on this once again is to cut through the western-centric view of the global economy. Far too much has been made about the fallout from the 2008 Financial Crash. It hurt the US and European economies far more than the Asian economies. Most importantly, while it interrupted globalisation, it did not end it. The proof: the global mass of profits and with it the rate of profit peaked in the years 2012-3 and not in 2006 (which was heavily influenced by financial profits) before the 2008 crash. The greatest, most concentrated investment wave in capitalist history post-2008, which rebooted the world economy and was located in China, also set off the commodity super cycle ending in 2014, something only seen in an expanding world economy. The net effect was to accelerate the shift in the global economic centre of gravity away from the West to the East, a shift which was more abrupt than ever seen before, and which by its magnitude, set off economic shockwaves culminating in the US reaction to this shift in 2018 when Trump began to embargo China.

The [CPB World Trade Monitor](#) is one of the most authoritative data bases collating the volume of global trade and production. I have prepared a graph to show how the rise in output in the East compensated for the undoubted fall in output in Europe and USA resulting from 2008. To ensure we are comparing like periods, I have taken as my base years the troughs in the two business cycles and my end points their peak. As these two graphs are based on monthly figures the start and end points can be gauged accurately. Our start points respectively are November 2001 and May 2009 and our end points are August 2008 and March 2019 (the world economy narrowly avoided recession later in 2019). Using these periods we find global trade and production was only 10% slower in the second cycle. Much of this had to do with the psuedo recession which occurred at the end of 2015 and the beginning of 2016 which I have described before. Unlike 2008 this was a traditional slow down caused by the global industrial rate of profit having fallen for 18 consecutive months, which generally ends in recession. It was narrowly avoided because central banks continued to repress interest rates, and because in China, the epicentre, the Peoples Bank of China ensured that credit expanded rather than contracted as happens during end-of-cycle financial conditions.

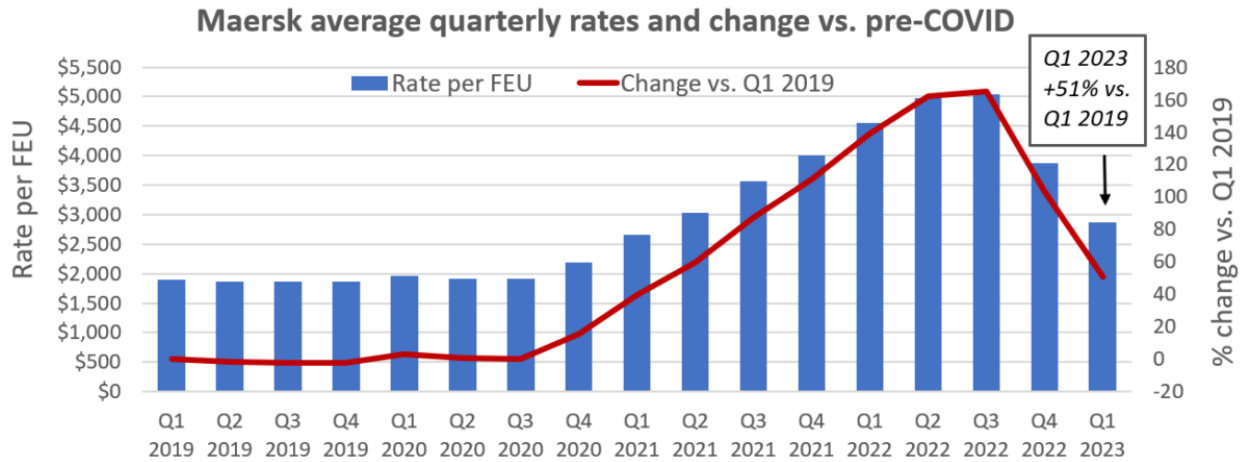
Graph 7.



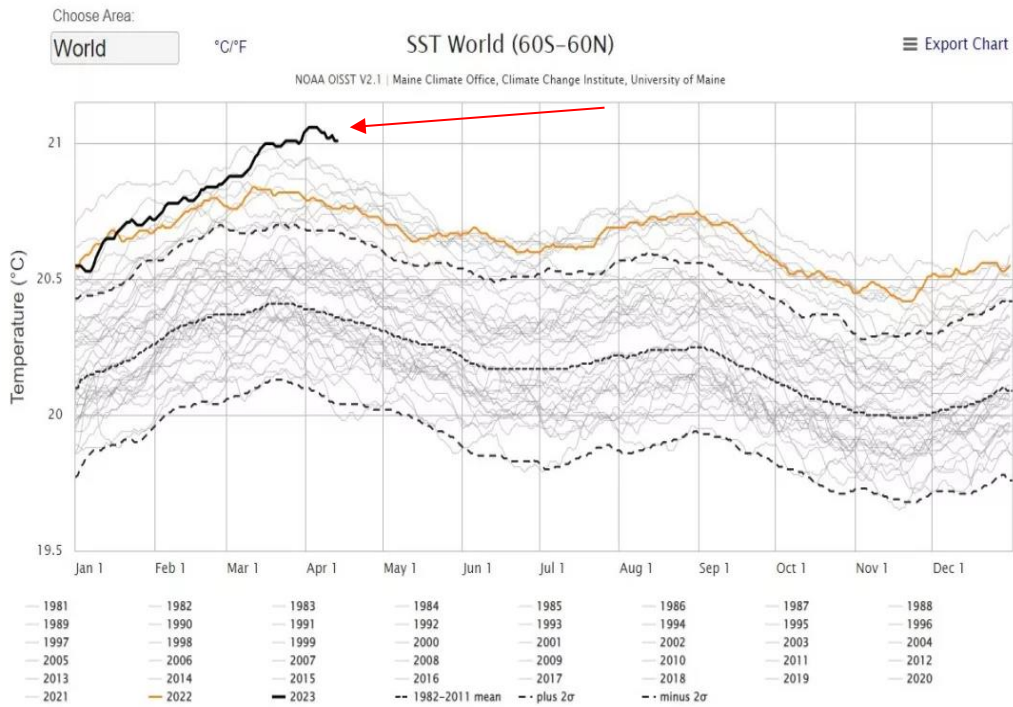
Conclusion.

I look to Maersk, the world’s second biggest but best managed shipper of containerised goods, as the barometer for world trade. It just brought out it’s [Q1 2023 results](#). In its figures below we can clearly see the downturn in the world economy beginning in the final quarter of 2022. This translates into a shocking fall in ocean revenues from €15,570 millions in Q1 2022 to only € 9,873 millions in Q1 2023 a fall of 36%, despite locked in rates but testimony to the profit gouging which took place in 2022. Maersk does not see conditions improving in quarter 2. Therefore the bounce in Chinese exports in March may not be replicated in the second quarter hence the caution on the part of the Chinese Politburo.

Graph 8.



While I believe that the Chinese upturn is fragile, I will not proffer any forecasts, not when [average ocean temperatures](#) in early April exceeded 21°C for the first time in recorded history, already hotter than in the record year of 2016.



What I will say is this, both the USA and China have glass jaws, the economic conflict between the two, initiated by the USA, could not have come at a worse time, both in terms of the falling rate of profit in their respective economies and in terms of the rising rate of climate change. In China, it is unlikely that the complex rate of return will rise much higher. This being so, it will ensure that production remains subdued. In addition, China is suffering from the relocation of supply chains.

The only positive is the progress it is making in producing chips. If the current reports pan out that [Shanghai Microelectronics](#) has finally produced a certified 28nm lithography machine, it means that for all intents and purposes, China has solved most of the steps needed to produce its own indigenous chips using DUV. A 28 nm DUV machine costing much less than its Dutch counter-part and able to produce chips down to 7nm, or in short the bulk of chips used in products today outside smartphones and servers, threatens to upend the global chip market.

From the viewpoint of workers all this duplication is a colossal waste of the labour time of the international working class. This labour time instead should be diverted towards restoring our planet. But private property and its bastard child, profit prevents this. Competition may have uplifted society, but it is now unaffordable because it threatens to undo all that the working class has achieved over two centuries with their blood and sweat. We are approaching critical times where weather forecasts are more important than economic forecasts.

Brian Green, 5th April 2023.