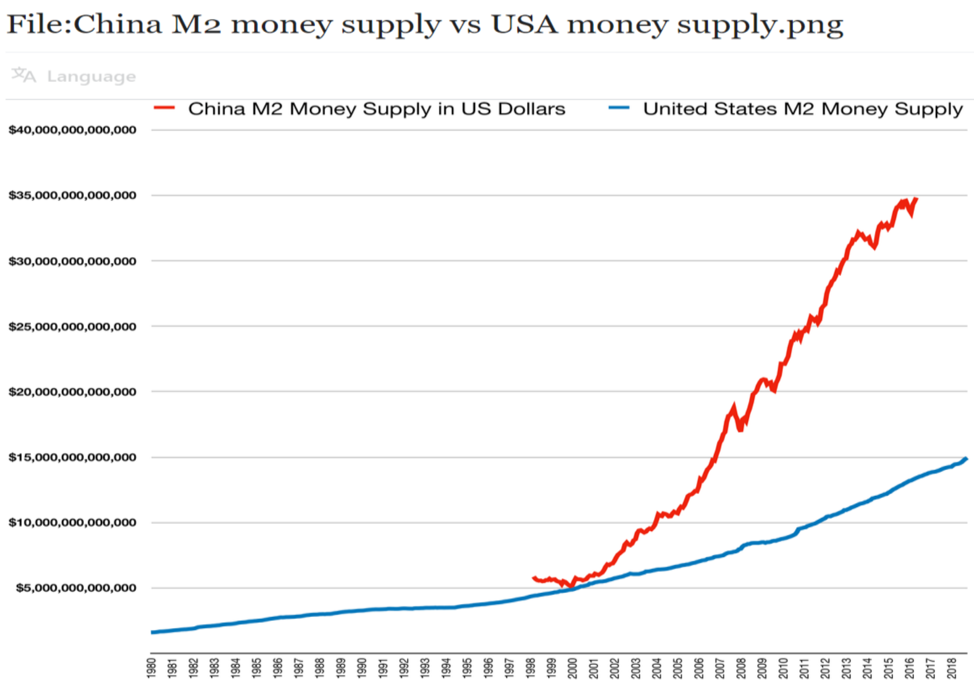
THE DISPARITY BETWEEN THE USA AND CHINA WIDENS BUT THIS IS ONLY TEMPORARY.

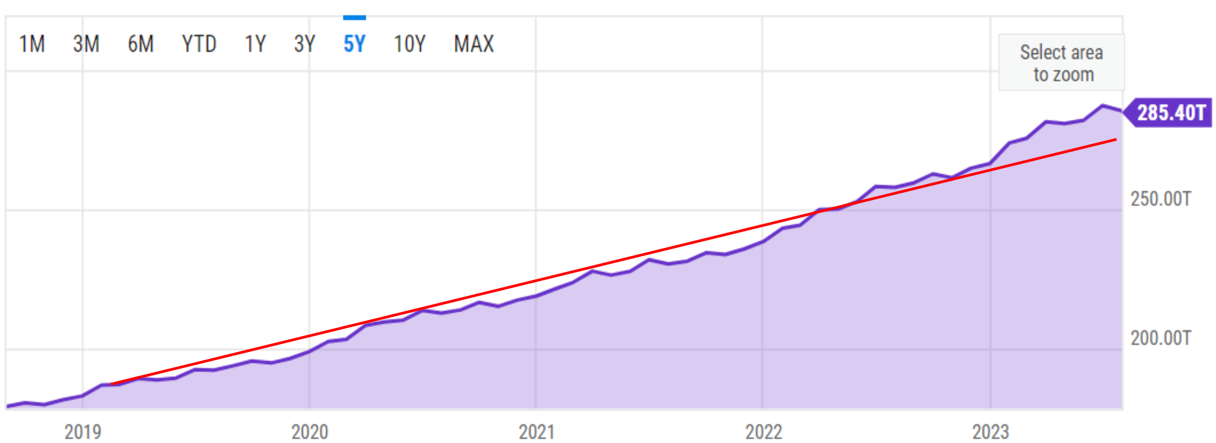
While the August data to date for China are softer than expected, that for the USA is hotter. Does this mean the US is winning the war against China? The answer is that this disparity is a temporary phenomenon driven by unsustainable factors in the USA.

I will begin with China. There were many headlines that China was now beset by deflation as both the consumer price index (CPI)as well as the producer price index (PPI) have now fallen simultaneously, the former by 0.3% and the latter by 4.4%. This was the first annual fall in the CPI since February 2021. The reverse side of this deflation can be seen in the money supply which has exploded because unspent revenues are piling up. The first graph unfortunately ends in 2019 but it does show the more rapid rise in Chinese M2. The second graph shows the current increase to be 12.8 p.a.

Graph 1.



Graph 2.

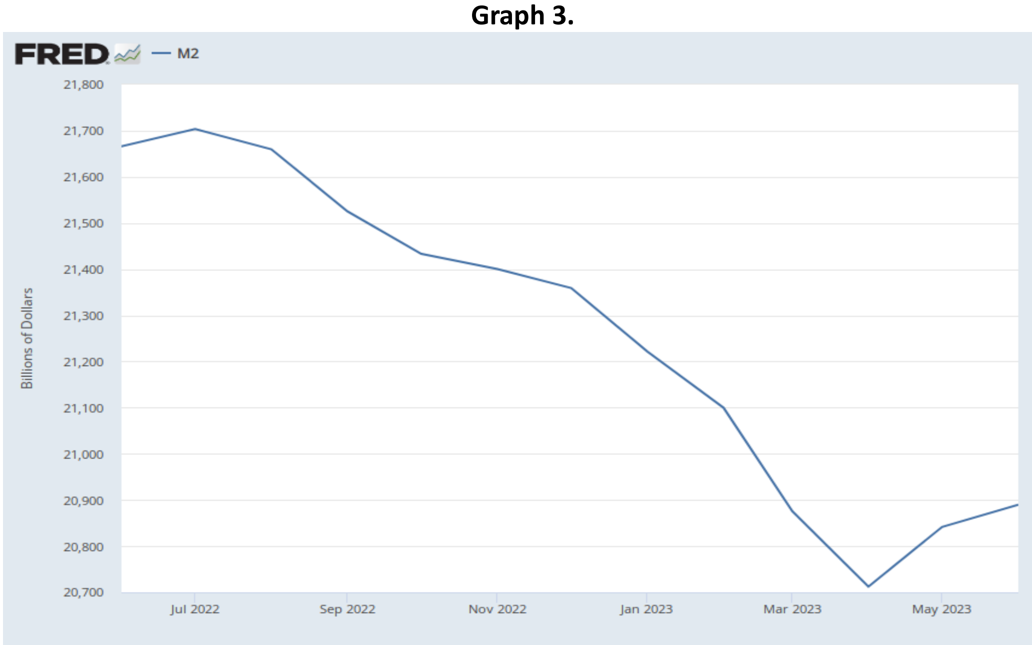


I pay less attention to the savings rate in the System of National Accounts as it is a balancing item therefore not a real number. I pay much more attention to the actual growth in M2, the liquid money supply where the bulk of unspent revenues are found. For readers who have not investigated my posts on Modern Marxist Monetary Theory please do as you will find that it is legacy value in the form of past unspent revenue which mainly circulates current value and given that the portion of unspent value normally resides around 91% of M2 it acts as the ballast stabilising prices.

So let us turn to comparisons between the USA and China. In the US, M2 the common measure of money, stands at 80% of GDP, while in China it stands at 220% implying a much faster velocity of circulation in the USA. The current rise in the velocity in the USA is a function of the fall in the money supply against the rise in Nominal GDP. However, that velocity is not our main concern, the changes to M2 are, as this lays the framework for analysing the amount of unspent revenue in M2. In China over the last year M2 expanded by 12% or ¥31.6 to ¥285 trillion, within that the budget deficit expanded ¥0.6 trillion while total credit increased by ¥2.1 trillion. Together they total ¥2.7 trillion or 8.5% of ¥31.6 trillion. Thus unspent revenue amounts to around 91.5% of M2 serving to stabilise prices. As unspent revenue is larger than GDP, were Chinese consumers to go on a spending spree the result would be more inflation and triple *circulation*.

What about the USA. Here the change in bank credit is $650 billion while the fiscal deficit adjusted for QT amounts to $1350 billion. Link that to the $800 billion contraction in the money supply (graphed below) and the amount of unspent revenue declines to a minimum of 86.7%. Anything under 90% historically has been inflationary because a smaller amount of legacy value is circulating current value compared to the larger amount of debt. Hence the ongoing rise in inflation in the USA.

Graph 3.



On the next page I have prepared a synopsis of Chinese August data. It is important to note that when comparing these nominal figures and annual increments, the fact that inflation has collapsed in China whereas it is still 4 – 5% in the USA, means that the nominal growth in China is higher when adjusted for price changes. Thus whereas retail sales grew by 2.5% in China, adjusted for inflation they rose by 2.8%. Whereas in the USA where retail sales rose by 2.8% against inflation of 3.2% they were negative by 0.4%*.

"[In the first seven months](), the investment in fixed assets (excluding rural households) reached 28,589.8 billion yuan, up by 3.4 percent year on year. Specifically, the investment in infrastructure grew by 6.8 percent year on year, that in manufacturing grew by 5.7 percent, and that in real estate development dropped by 8.5 percent." "In July, the total retail sales of consumer goods reached 3,676.1 billion yuan, up by 2.5 percent year on year, or down by 0.06 percent month on month." "In July, the total value added of industrial enterprises above the designated size grew by 3.7 percent year on year, or up by 0.01 percent month on month. In terms of sectors, the value added of mining increased by 1.3 percent year on year, manufacturing went up by 3.9 percent." "In July, the total value of imports and exports of goods was 3,456.3 billion yuan, a decline of 8.3 percent year on year. Specifically, the total value of exports was 2,016.0 billion yuan, down by 9.2 percent; the total value of imports was 1,440.3 billion yuan, down by 6.9 percent."

The report ends with the following comment*: "Generally speaking, in July, the national economy continued to recover with the high-quality development making solid progress. However, we should be aware that the international political and economic situation is intricate and complicated, while the domestic demand remains insufficient and the foundation for economic recovery needs to be further consolidated."*

China has relied on dual circulation which combines its growing internal market with its export market. From the data above both are decelerating. Exports have fallen sharply and the meagre growth in retail sales amounting to 2.8%, coupled to poor profitability, a crisis ridden property market and a depressed stock market, has removed growth drivers weighing down on investment and production.

We are reaching the stage where the compact between the Chinese Communist Party and the 'masses' is being severely stressed. No doubt the Yankee Imperialists are rubbing their hands in glee at this. That compact comprises rising standards of living and secure jobs, or dual security for the rule of the Chinese Coputalist Party. The failure to provide youth unemployment figures and growing concerns amongst graduates over the prospects of getting a job of their choice must be setting off alarm bells in the corridors of power in Beijing and the beach at Beidaihe. Analysts talk of the economic crisis of middle-age besetting developing economies, that may be, but autocratic rulers have always faced problems with third generation urbanised youth following the exodus from the countryside by their grandparents. Finally, given the crisis of profitability which cannot be ignored it is unlikely that wages are rising despite the official figures.

As a result of sagging conditions a number of measures were introduced. Key interest rates were lowered while the PBOC injected liquidity into the banking system, the band in which the Renminbi can fluctuate was reduced and state banks were encouraged to use their dollar holdings to buy the Renminbi. These moves can be viewed [here](). In addition Bloomberg has announced the outward flows of capital has accelerated while inward investment has decelerated. Despite this, there have been no large policy announcements, but this could change now the beach meeting of CCP leaders in their Beidaihe Yellow Sea resort has concluded. An announcement could be made before the upcoming and important BRICS+ meeting in South Africa.

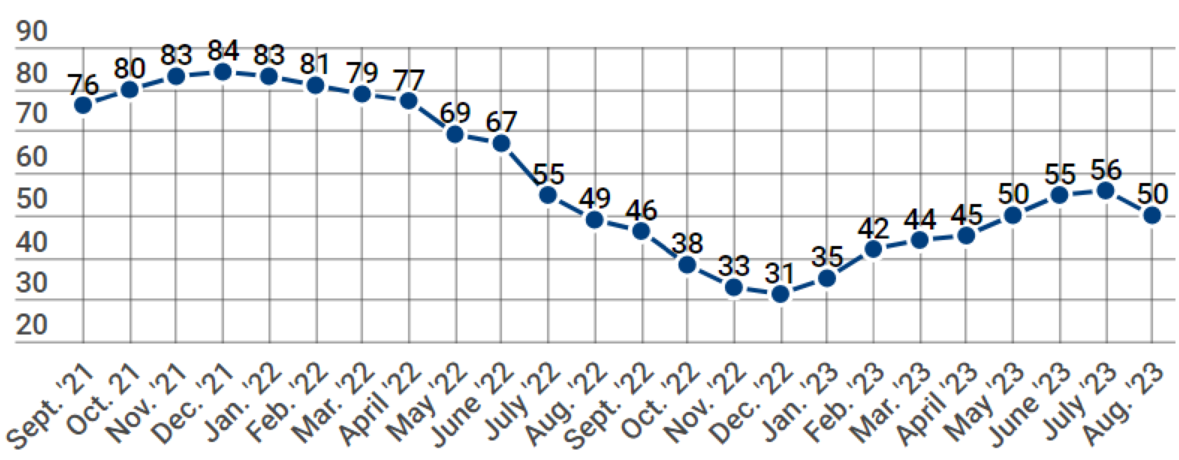
In the meantime rifts are opening in the [shadow banking sector](). This article compares *Zhongrong International Trust* to a mini-*Blackrock,* which is now missing payments due. As 70% of household wealth is invested in property not only via direct ownership but also via Trusts the threat of contagion within the shadow banking system was always highly likely. And this will not only affect Chinese investors but foreign investors as well because the Chinese property market is the biggest asset class in the world. This was seen on Friday when *Evergrande* filed for bankruptcy laden with $300 billion of debts, many international.

It is often argued that the solution is simple. Why does the Chinese State not simply take over these empty and still under construction properties and turn them into social housing? Perhaps the more scientific question should be why has it balked from doing so? The reason why it has not done so is that from a financial point of view it would turn a bad situation into a disaster, it would cause property prices to fall even faster. A surge in social housing in a stratified society creates the following effect: *their goes the neighbourhood* as well as undermining the rental market. In every case and in all countries, the condition for financialising the property market has been to curb social housing. The Chinese Coputalist Party is learning the hard way that riding the market, especially a leveraged one, is not like riding a horse that you can jump on and off from.

But it would be unwise to single out China. The US has its problems too. Especially in Commercial Property other than warehousing. However according to data from the Federal Reserve up to the first quarter of this year total charge offs and delinquencies remained below 2019 levels. But they are building so to speak, and they will start to get nasty in 2024 which is one reason why the advantage enjoyed by the USA will be short-lived.

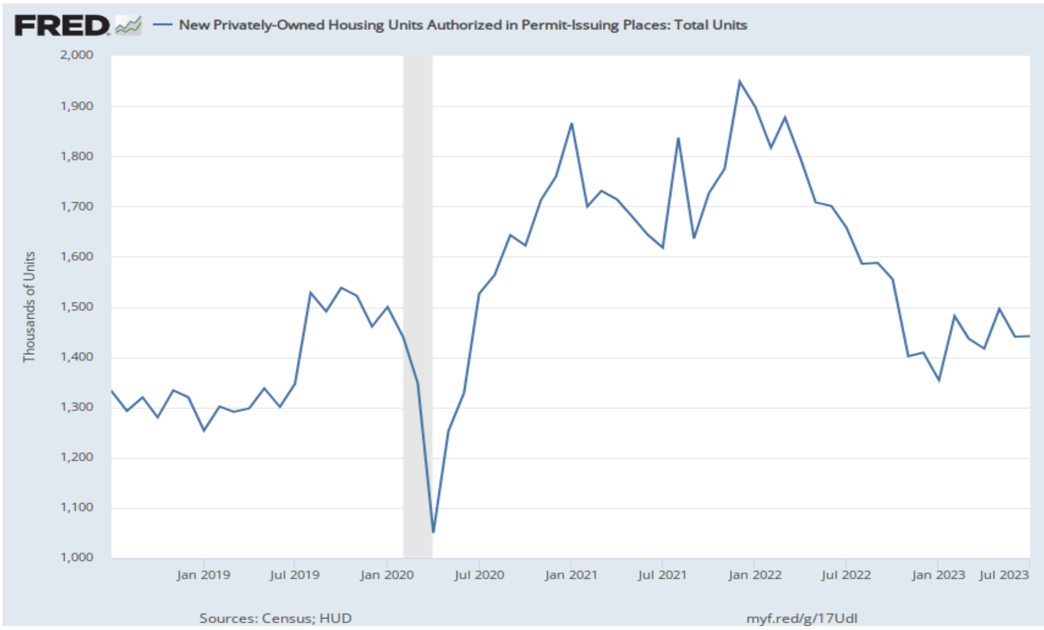
The residential housing market has been buttressed by the majority of outstanding mortgages being of long duration up to 30 years. As a result the average mortgagee is paying 3.6% compared to 7.1% for a new mortgage today. Following an upward blip in June, July data housing data continued downwards. A good overall observation for this is the one provided by the Wells Fargo Housing Market Index below. August data erased all the improvements in June and July.

Graph 4.

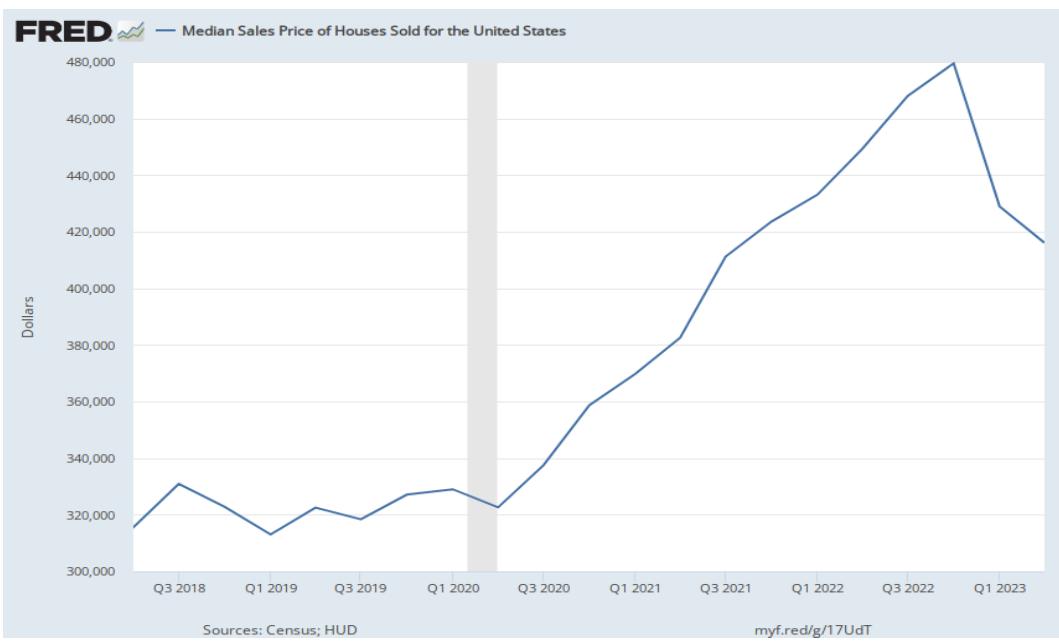


The same resumption of trend can be seen in housing starts now back to 2019 levels but with this proviso, smaller homes are being built with cheaper materials no doubt. This can be established by the fall in the median price of homes. Over the course of this year prices in real terms have fallen by 15%. However, adjusted by the deflator found in NIPA Table 1.14 house prices are still 8% higher than in 2019 though building activity has subsided (so to speak) down to 2019 levels. Finally permits issued, a forward-looking indicator, indicates further weakness in housing. My opinion is the housing market crisis will mature in the latter part of the year.

Graph 5.



Graph 6.

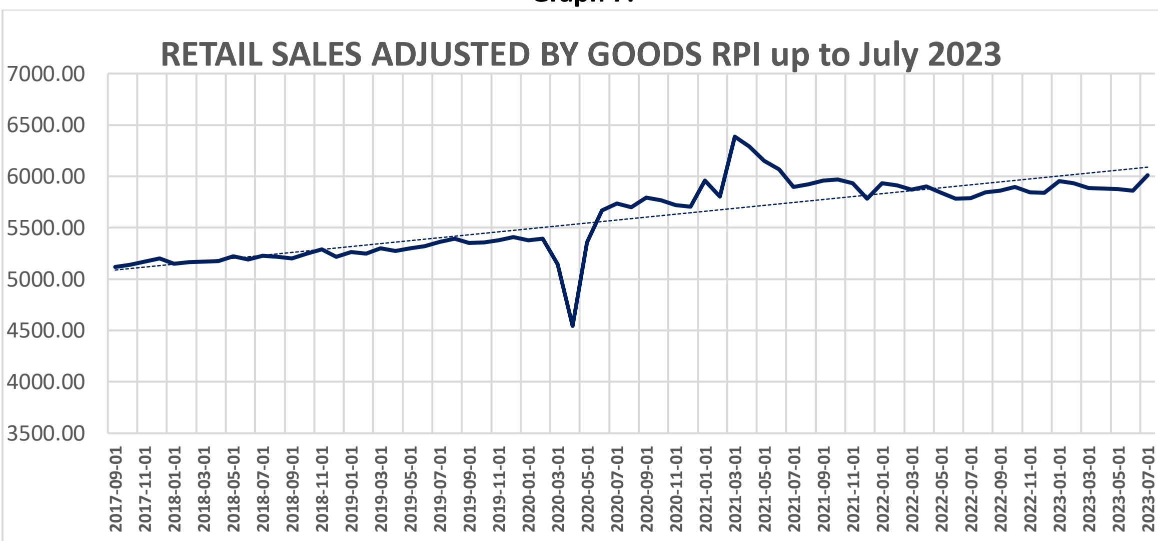


It is incontestable.

US Retail sales show the effect of positive wages, i.e. recent average wage rises are likely to be around 5% with the BLS putting it at 3.7% for the previous quarter and ADP putting it at +6.5% and 6.2% currently for [job stayers](). For our purposes, the ADP data based on 10 million jobs is the more important because at a granular level, the strongest segment in retail has been the middle bit, that is around average pay and above. Both the high end and the low end were much weaker. Every luxury goods manufacturer, especially the large Europeans, reported that the weakest region for sales was North America despite the US allegedly motoring ahead down the road of resilience. In addition, many multinational consumer facing companies, aka household names including US ones, reported in the second quarter that the US market was weaker than markets abroad and that included Apple Corp.

The general rise in US retail sales is clearly seen in the graph below. It is now above July 2021. This graph represents the volume of sales because it has been adjusted by the price data for consumer goods weighted by durable and non-durable sales. (Sources: FRED Tables CUSR0000SAN and CUSR0000SAD) I have used this method to exclude service sector inflation which is currently higher and were I to use the CPI which includes service sector retail, the volume figures would thus be understated.*

Graph 7.



Stock Markets shed their E.I. for A.I.

E.I. here stands for exuberant investors. Markets have been falling for weeks. This week falls will mark the biggest global falls since March. There are three factors, cooling ardour for the potential of A.I., the growing budget deficit in the US and concerns about China.

More and more CHATGPT or large language learning models are being seen as a florist creating beautiful bouquets out of stolen flowers. More and more artists, authors and composers are beginning to identify their work in the algorithms. Their work represents the flowers. Without the flowers no bouquet, so why should the florist take all the profit. Expect the florists to be inundated with even more lawyers seeking to protect copyright. Large language models are wonderful and can create a collective intellect, but there is one problem, they cannot coexist with private property and all the legal hurdles it produces. Little wonder that Microsoft and OPENAI in their small print put all legal responsibility on the user not the provider of these programs. Expect that this escape clause will be heading all the way up to the Supreme Court.

It is likely the A.I. bubble is subsiding with the result that the Tech sector is leading the stock market retreat. But the more important cause is the Federal Budget Deficit. The decline coincided with Fitch downgrading

US public debt; “*Fitch is the latest rating agency to strip the US of its triple A rating, downgrading it to a more humdrum AA+.*” At first it seemed to have no effect, but then it did. Fitch was concerned by the projection of interest payments on this debt. “*Fitch sees gross government interest payments as a share of revenue rising to 10% in 2025 from 7% last year, and the non-partisan Congressional Budget Office (CBO) predicts net interest payments will reach 3% of GDP by 2028…*” 3% was the average whole budget deficit before the pandemic, never mind just for interest payments.

FED Powell may studiously ignore the fiscal situation in his press conferences due to his cultivated political manners, but the cruder stock market is no longer doing so, especially when it was hit in the face with a projected $1 trillion in new bond issuance this quarter. This had the dual effect of driving up interest rates while driving down share prices, thereby re-establishing their missing relationship. Expect a much more rancorous debt ceiling skirmish in Congress towards the end of the year. The fact is that the gap between tax receipts and outlays is over 20%. To substantiate these figures and avoid any confounding base effects left over from Covid Tax Legislation, I have taken the time to compare May – July 2023 with May-July 2022. The results approximate the results for the first 10 months of this fiscal year which began in October 2022. (View Table 2.)

Table 1.

TAX RECEIPTS	May	June	July	Total	difference	percentage
Year 2022	389	461	272	1122		
Year 2023	308	421	276	1005	-117	-11.6%*
OUTLAYS						
Year 2022	452	548	484	1484		
Year 2023	544	646	499	1689	+205	+13.8%
BUDGET DEFICIT					322 (1288 annual)	
Share of GDP						7.0% annualised

(*Shifts of payments from May into April 2022 decreased outlays by $65 billion in May 2022 the increase in the deficit reduced from 1288 down to 1028 or from 13.8% down to 9.4%. This 9.4% figure is proximate to the 10% for the year to date reported below in Table 2.)

Table 2.

Table 1.

Budget Totals, October–July

Billions of Dollars

	Actual, FY 2022	Preliminary, FY 2023	Estimated Change	Estimated Change With Adjustments for Timing Shifts in Outlays[a]: Billions of Dollars	Percent
Receipts	4,105	3,687	−418	−418	−10
Outlays	4,831	5,304	473	536	11
Deficit (−)	−726	−1,617	−891	−954	131

Data sources: Congressional Budget Office; Department of the Treasury. Based on the *Monthly Treasury Statement* for June 2023 and the *Daily Treasury Statements* for July 2023.

As a result of this growing chasm between receipts and outlays the: "*CBO now expects that the total deficit for 2023 will be $1.7 trillion, or about $200 billion larger than the estimate it published in May.*" This equates to a deficit of 6.5% though I expect it will be revised up closer to 7% based on current trends. This lax fiscal stance has two consequences, firstly it is driving up demand and secondly it is negating monetary policy. This is the difference with China, the US is engaging in large scale fiscal stimuli, China is not.

One of the objectives of fiscal spending is to reduce US manufacturing reliance on China. The US is seeking to reshore electric vehicle production, battery production, solar and wind, and above all, chip production back to the USA. It is seeking to develop a comprehensive manufacturing base in the event of a conflict with China reminiscent of the Second World War..

While this will stimulate US manufacturing and construction in the short run, in the longer term it is counter-productive as far as profits go. The cost price of producing these items in the USA, relative to Asia is prohibitive. And in a world with over-capacity growing by the day, in which market prices will be determined by the most efficient producers not the least efficient, most if not all of these subsidies inflating the deficits both at Federal and State level, will have been wasted.

TSMC's plant in Pheonix exemplifies this nonsense. Who builds a factory needing copious amounts of water on the edge of a dessert in an area now designated "*uninhabitable in summer without air-conditioning*" and where new housing has been put on hold because groundwater has been maxed out. Only companies which have been bullied into doing something they would not have done out of their own volition. Companies and countries are finding out the hard way how costly it is to be corralled by the US in its hegemonic struggle with China.

While the new division of labour force fed by the USA may backfire China has its own plans. It is working to corner the legacy chip market, that is low end chips above 28nm. The consequences of China dominating this sector as it has done say with car batteries is that it will effectively control most electronic devices. For example, as this article from Fortune Magazine reports the delays to cars and the iPhone 13 were not caused by the lack of advanced chips, but by legacy chips.

The market for legacy chips is huge but currently less profitable. Two thirds of all chips produced belong to this category and up to 95% of chips in the automotive industry are these chips. Thus if China corners this market, add in batteries and China has the foundation for dominating the future global automotive industry. This week China took a bold step in this direction by frustrating Intel's $5.4 billion takeover bid for Tower Corp a legacy chip producer. This is one more reason why I believe the US's current advantage will be short-lived.

In this regard the focus on A.I. is misplaced. The highest end chips will remain a niche market and one full of sinkholes. Already TSMC is having to renegotiate prices for the most advanced 3nm chips with the likes of Apple because of rising costs which Apple is hesitant to consider because it is also under pressure due to falling handset volumes which have become more price sensitive. The real action is likely to be in the realm of 14nm plus which powers most of the world's industries and equipment and if the much cheaper Chinese 28 nm lithography machine lives up to expectations, China will end up dominating the global chip industry except for the finer nm, but even here the law of diminishing returns applies as cost begins to erode performance in a more competitive and price sensitive environment.

The Ukraine.

According to Seymour Hersh the Jeddah peace circus led by the clown Zelensky was preplanned to coincide with an anticipated successful outcome to the Ukrainian offensive which would bring Russia to its knees and reduce its stature amongst countries in the South. Perhaps General Zaluzhnyi Ukraine's chief of staff should change his name to General Deluzhni. As of the time of writing, the final stage of the Ukrainian offensive, involving the remnants of their reserves has commenced, the timing forced upon the Ukrainians by concerns that the weather will turn at the end of the month. But after marginal gains, it has once more been contained by the Russian forces, and the overall assessment of the counter-offensive is a failure to achieve any of its key objectives. This hands the initiative to the Russians given the huge losses suffered by the Ukrainian forces and the depletion of their capacity.

The Jeddah Peace Conference underscored Ukraine's determination not to concede any territory to Russia despite the facts on the ground. Its timing was fortuitous because the following week NATO stabbed Zelensky in the back. Stian Jenssen, Jens Stoltenberg the NATO chief's sidekick announced NATO would consider territorial concessions if Russia conceded that Ukraine would join NATO. Jenssen would never have broken the taboo and uttered the dreaded words 'territorial concessions' without the nod from Stoltenberg himself. To cover his tracks Jenssen also added, but it was up to the Ukraine ultimately to decide the time and the terms for ending the conflict not NATO. As if.

This statement was designed to test the political waters. And it created a storm, but not before it had the potential in the age of social media to demoralise Ukrainian troops who now must be wondering why they are spilling their blood fighting over territory which could be handed back to the Russians. It elicited a savage response from the Biden Administration, the Ukrainian Government and disinterest from the Russian Government which has stated point blank that nothing would dissuade them from opposing by all means the further expansion of NATO. Two days later Jenssen rolled back his statement saying that it was an error in the first place to have broken the taboo on territorial concessions.

I find Alexander Mercouris to be one of the most incisive and thoughtful commentators on the Ukrainian conflict with his YouTube podcasts. Over the course of the week he has both analysed the Jeddah Peace Conference, the position of Russia and how the different factions in Washington spend most of their time negotiating with each other trying to hammer out their approach to Russia. We may categorise what is going on in Washington as a dispute between the delussionals (neocons) and the realists. No doubt as the Russians advance and the Ukrainians are pushed back, the balance will tilt towards the realists. There is already evidence for this. Rep. Andy Harris a co-chair of the congressional Ukraine Caucus declared this week *"I'll Be Blunt, It's Failed,"* referring to the Ukrainian offensive and he expressed doubt about Ukraine winning the war. He also called upon the Biden Administration to push Zelensky into peace talks. As things stand, and taking Trump's stance into consideration, there is likely to be stronger Congressional push-back against further aid to Ukraine. No doubt the facts on the ground will influence the ongoing informal talks between ex-US officials and their Russian counterparts seeking some form of resolution to the crisis.

One of the effects of the war, besides weaking NATO militarily through the depletion of their armouries, is the time given the Chinese to arm themselves against US aggression. According to Scott Ritter, ex-US army and peace inspector, the Pentagon has recently conducted two separate analyses of the outcome of a China US conflict in the Pacific and concluded that the US can no longer prevail in such a war. Previously the view was that it would take up to 2030 for China to gain the upper hand. As a result the world has become a safer place, but peace between nations can only be guaranteed by an international workers revolution, by workers in the various nations joining hands having removed their capitalist handcuffs.

Conclusion.

The contrast between the two economies is stark. The US stock market remains Bullish, the Chinese Bearish, the FED is concerned with inflation the PBOC with deflation, US data surprises on the upside while Chinese data disappoints on the downside. The contrast will not last. The fracturing of the world economy will in the end impact the US as much as China.

And it is also clear that politically both countries are becoming more unstable. On the one side the previous US President faces jail due to his conduct in office, while the current President is ensnared in growing corruption which he can no longer swat away. In China the social compact is breaking down as the Chinese start to feel poorer as wages stagnate, the job market grows tighter, housing looses its value and the Stock Market droops. The US may have a more flexible form of rule with more escape routes, while China may have a more brittle form of rule with fewer escape routes, but whatever the case, both are politically challenged.

And all the time this heated conflict between the powers driven by the venomous profit motive is occurring while the planet is itself heating up. A number of climatologists have concluded that current climate models are broken as the rises in atmospheric and ocean temperatures surge ahead of predictions. I believe the main reason for this modelling crisis to be due to these models failing to factor for irradiance which is surging during Solar 25. In Year 4 of the current cycle as measured between 1st December 2022 and the 16th of July 2023, sunspot activity is up 43% per day compared to the corresponding period in cycle 24. Given the contraction in the amount of ice reflecting sunlight, given the exhaustion of the buffers normally absorbing extra sunlight such as forests, any incremental increase in irradiance matters, and the sun’s output climaxes in 2024.

It goes without saying that repeated heatwaves, and there are two today, one in the USA the other in Europe, will cause crops to wilt as they are about to be harvested. In turn this sticky weather will lead to sticky food prices.

The international working class is caught between a rock and a hard place, between big capital and a dying planet, it has no choice but to act. Should it fail to do so, humanity will be put at risk. This much will become clear in the Southern Hemisphere as summer approaches there, and it will become clear in 2024 when summer scorches the Northern Hemisphere.

> *****Deflators are an issue. I consider the CPI and RPI used in this article to be understated. I base this on the analysis of financial reports covering Q2 released by the large consumer facing US based corporations. They indicate inflation to be higher. Whether I am correct or not will not be known until the second release of GDP data on the 30th of this month. Only then will the non- financial corporate deflator for Q2 found in NIPA Table 1.14 be released, which I consider the best barometer for prices. I will report then.

Brian Green, 19th August 2023.