

THE MARKET CRASH: MORE A CASE OF BLOWING OFF STEAM THAN BLOWING-UP BOILERS.

This crash was more a disappointment over expectations than an actual collapse in profits. That is the next stage, and it is imminent. This was more of a Miaow than a Roar. Unlike 2009, China will be unable to prevent a global slump, which in turn catalyzes the risk of global war.

The collapse in stock exchanges as the graphs below show is comparable to 1987.

Graph 1. (Nikkei)



Graph 2. (Nasdaq)



Graph 3. (Stoxx 600)

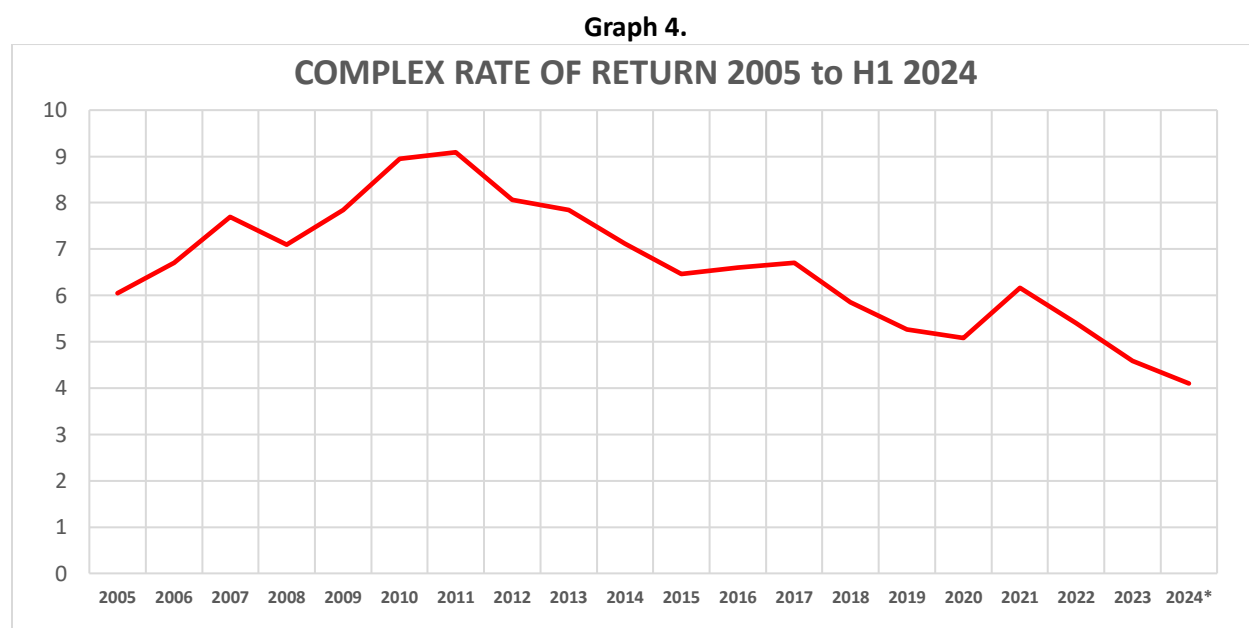


Total losses over the two days including Crypto losses amounted to close to \$5 trillion globally. This said, the real damage is likely to be below the surface because the patient is bleeding internally. I refer to the leverage which has gone into elevating share prices over the last few months and years especially with the Nikkei. No doubt there were trillions in leveraged trades that went sour, amongst which will be the carry trades where borrowing was done in low interest currencies. Much of this leverage will have occurred in the unregulated spheres such as private equity and hedge funds. Like a cloying swamp these losses will slowly percolate to the surface before releasing their rotten smell.

The global economy has been in a soft landing for 18 months, or as we Marxists say, despite the A.I. hype it has been stagnating. Now as I said in my previous article, the global economy has run out of runway. This is the significance of the crashes over Friday and Monday. It raises the prospects of a hard landing.

China, the plenum and its weakening economy.

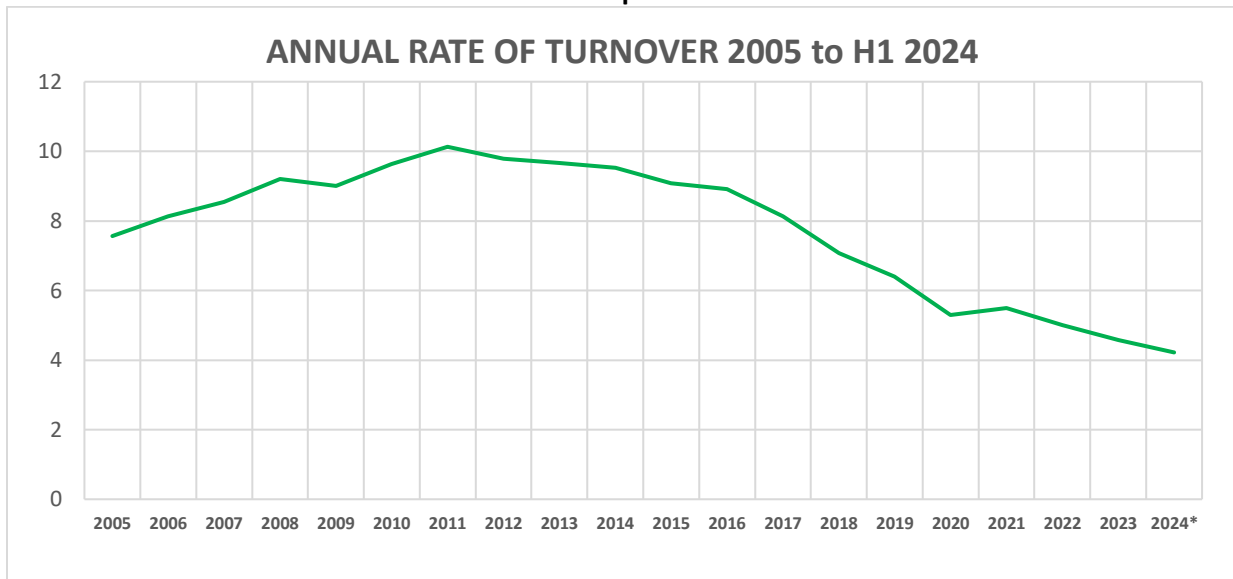
China, unlike 2009, will be unable to rescue the global economy because of its own internal economic problems which it is having difficulty dealing with. We can see this in the following graphs. The Chinese Bureau of Statistics just released its [profit data for the period ending June](#). (I have attached a copy of the report with my calculations included.) While profits grew in the private sector the absence of profit growth in the state sector meant the complex rate of return in H1 2024 continued on its downward path. (Note. the growth rate of [value added in the private sector](#) was nearly double that of the state sector.)



The complex rate of return in China differs from the normal rate of return. The normal rate of return is profits over fixed assets whereas in China it is over fixed assets plus inventory plus financial assets. This means it is difficult to compare this rate against western rates, and within China itself, it is difficult to compare the rate between private and state enterprises as state enterprises have larger financial assets primarily cross-holdings.

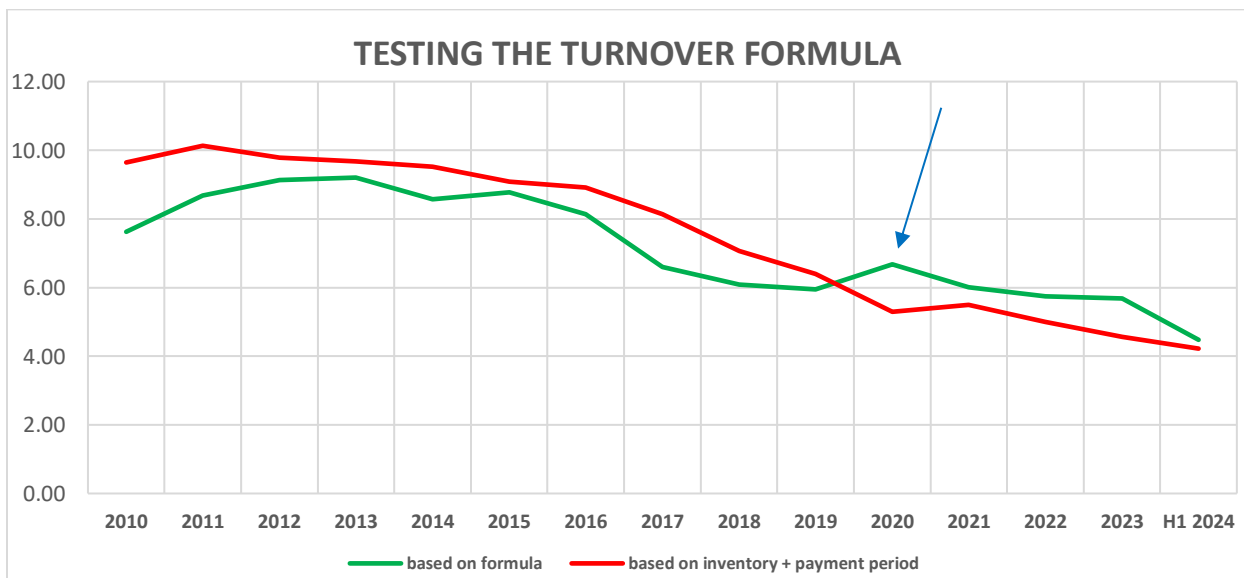
One of the key reasons for this collapse in profitability has been the deceleration in the turnover of circulating capital which has had the twin effect of raising working capital while delaying the realization of profits. This deceleration is always the harbinger of recession.

Graph 5.



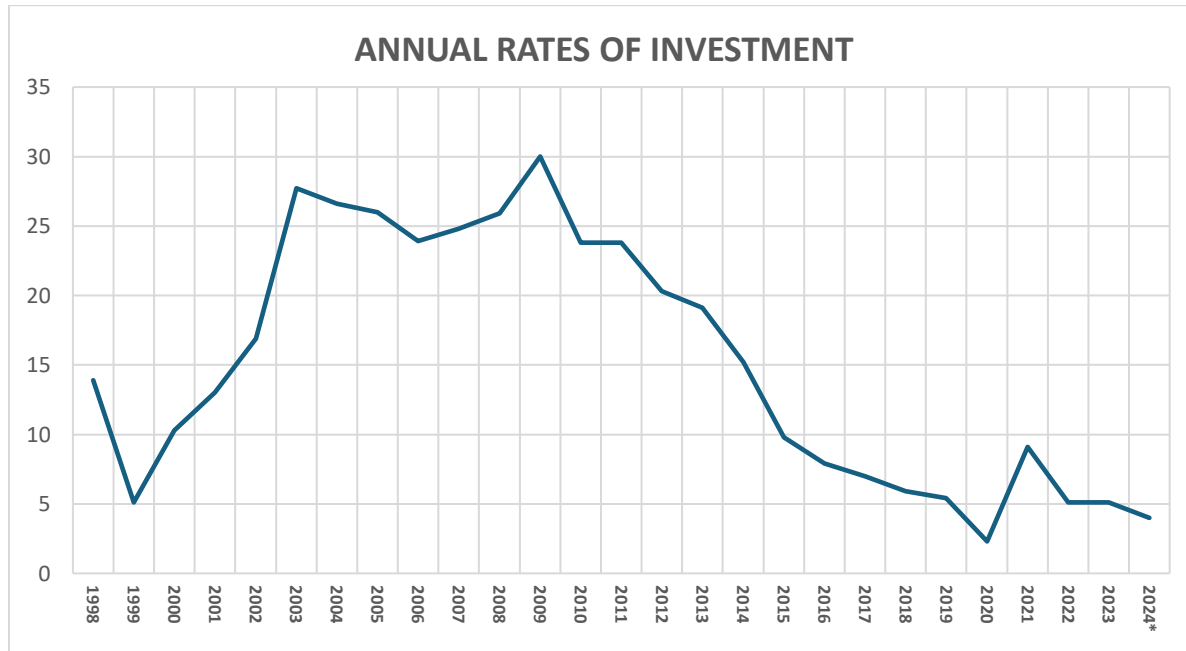
The turnover above is based on the period of production and payment, aka the days of finished inventory measured by sales revenue plus the days taken to settle outstanding trade credit. This rise in the payment period handicaps production because it robs producers of liquidity, forces them to offer discounts, and generally holds back production. I have updated turnover below to include 2024-H1 (green graph) based on the turnover formula which measures Gross Output vs Gross Value Added. I have then compared it to the turnover measured by inventory and days of payment. The green graph is a more accurate measure as shown by its response to the surge in pandemic exports in 2020 whereas the production and payment period doesn't. (See arrow.) Both are decelerating but variably. Nonetheless they are joined by the hip because of the crisis in payments, which represents a generalized market crisis, causes the actual rate of turnover to decelerate as well. Until demand improves reducing the scale of the payment period, allowing the red graph once more to accelerate above the green, there can be little respite for industry.

Graph 6.



The resulting fall in profitability has predictably held back investment, because despite the many claims that the Chinese economy is a hybrid economy, the fact is that it is a market economy responding to profitability. (Unlike the previous graphs the investment graph only covers Jan-May 2024.)

Graph 7.



(* Jan – May 2024)

What is notable is that since 2019 (excluding 2021) the growth rate of total investment has been below the growth rate of GDP implying it is no longer the driver of GDP. Preliminary GDP in H1 2024 was 5% while investment up to May was 4%.

One of the reasons for the fall in investment has been the reluctance of state banks to lend to enterprises. As the Table below shows, the amount of loans between 2018 and 2022 fell by an average of 2.5% p.a. The same trend applies to foreign investments and particularly to self-raised funds due to the slowdown and even a fall in the mass of profits. The main source of investment funds turned out to be the state. As always the state budget seeks to compensate for shortcomings in the private sector, which is the main difference with the West.

What is not different is the behaviour of the banking system. The biggest banks may be state banks, but they still act as bankers weighing up profits against risk, therefore unwilling to throw good money after bad. Those theorists like Michael Roberts who hold that China is not a capitalist economy need to reconsider. The state banks often circumnavigate the instructions they receive from the CCP. They have to balance the guidance from the CCP with being held responsible for any bank losses. Loyalty versus profits makes for uncomfortable bed fellows. The Chinese economy is not a socialist economy with *Chinese Characteristics*, it is simply a capitalist economy with large scale state intervention.

Table 1.

10-2 Growth Rate of Actual Funds Available for Investment in Total Investment in Fixed Assets in the Whole Country over Preceding Year

(%)

Year	Actual Funds Available for Investment	State Budget	Domestic Loans	Foreign Investment	Self-raised Funds	Other Funds
1990	14.1	1.4	9.0	19.7	5.2	58.9
1991	8.1	11.3	4.5	-2.3	12.5	6.5
1992	13.7	71.9	15.9	-2.5	11.5	17.7
1993	3.5	54.7	3.3	-23.3	4.4	3.5
1994	11.3	13.9	17.5	-15.5	11.5	13.2
1995	14.7	20.7	7.5	2.0	15.9	20.7
1996	18.5	24.1	22.4	20.5	20.5	7.5
1997	30.1	-15.0	36.0	24.7	37.8	21.0
1998	27.2	21.1	14.5	25.4	31.2	31.8
1999	26.9	27.6	18.4	21.1	33.5	16.0
2000	25.8	12.5	20.0	8.9	29.0	28.3
2001	26.8	25.4	17.5	18.4	28.5	31.7
2002	21.3	35.8	14.5	3.5	29.7	-2.8
2003	36.8	59.5	48.5	-13.0	29.5	62.4
2004	24.3	15.7	20.2	7.9	28.4	17.1
2005	21.1	14.1	5.3	7.6	28.3	11.2
2006	18.4	27.7	11.3	-11.7	21.1	12.9
2007	20.0	17.7	15.2	-3.3	20.3	25.3
2008	10.5	19.9	9.7	-5.2	13.5	-5.0
2009	7.5	15.6	-6.4	-29.6	9.2	10.1
2010	5.6	17.1	10.1	-20.5	-0.2	30.7
2011	4.7	7.8	8.7	-3.1	2.2	11.5
2012	3.4	0.1	-5.4	-2.3	3.7	8.7
2013	4.1	-0.9	2.0	33.3	1.4	11.4
2014	7.3	32.8	0.0	-4.4	6.7	7.5
2015	4.3	-3.8	-3.1	-10.9	5.7	7.2
2016	0.5	39.3	-6.0	-19.8	9.0	-19.8

(Source: [China Statistical Yearbook 2023 \(stats.gov.cn\)](http://stats.gov.cn))

The third plenum held mid-July.

“The CPC Central Committee with Comrade Xi Jinping at the core has united and led the whole party, the whole army, and the people of all ethnic groups in the country to break through the shackles of ideology and concepts, break through the barriers of solidified interests, dare to break through the deep water area, dare to gnaw hard bones, dare to wade into dangerous waters, resolutely eliminate the shortcomings of all aspects of the system and mechanism, and realize the transformation of reform from partial exploration and ice-breaking breakthrough to system integration and comprehensive deepening, the basic institutional framework in various fields has been basically established, and many fields have achieved historic changes and systematic reshaping.” “The guiding ideology of further deepening reform in an all-round way. Adhere to Marxism-Leninism, Mao Zedong Thought, Deng Xiaoping Theory, the important thought of the “Three

Represents", and the Scientific Outlook on Development, fully implement Xi Jinping Thought on Socialism with Chinese Characteristics for a New Era, thoroughly study and implement a series of new ideas, new views, and new assertions of General Secretary Xi Jinping on comprehensively deepening reform, completely, accurately, and comprehensively implement the new development concept, adhere to the general tone of the work of seeking progress while maintaining stability, persist in emancipating the mind, seeking truth from facts, advancing with the times, seeking truth and pragmatism, and further emancipate and develop the social productive forces." This is the Stalinist claptrap found in the communique following the plenum which the comrade delegates had to endure. These words would make perfect ingredients when presented to a compounding pharmacist enabling them to prepare a potent sleeping draught.

Its restatement also reflects the insecurity felt by any autocrat when the economic going gets difficult, which it is. And it is going to get a lot more difficult as the world economy slumps.

The communique resets the goal: *"By 2035, we will build a high-level socialist market economy in an all-round way, further improve the socialist system with Chinese characteristics, basically modernize the national governance system and governance capacity, and basically realize socialist modernization,..."* Good luck with that. The law of value is no friend of socialism and the rate of profit an unforgiving barrier.

And when it comes to contradictions, this takes the cake: *Focus on building a high-level socialist market economic system, give full play to the decisive role of the market in the allocation of resources, give better play to the role of the government, adhere to and improve the basic socialist economic system, promote high-level scientific and technological self-reliance and self-reliance, promote high-level opening-up, build a modern economic system, accelerate the construction of a new development pattern, and promote high-quality development.* Give full play to the market in order to build a socialist system. The Plenums slogan could be *all power to the market*. Deng Xiaoping would be proud. Its embarrassing. Its like putting a skirt on a fish and calling it a dancer.

But besides the exhortations little came out of the plenum other than the hint that the government will be providing a broader social net. A bit more *iron bowl* than the current Tupperware bowl which covers only basic services particularly in healthcare. The CCP recognises that to boost personal consumption they need to reduce personal savings and to reduce personal savings the government needs to provide more of the services and pensions which insecure Chinese workers are saving up for. This ties in with Xi's remarks after the plenum which emphasises the need to boost personal consumption thereby reviving the insipid Chinese market. Of course as I have pointed out in a true socialist society, savings take the form of collective savings provided by the common or social fund which resources all educational, all caring and all sickness functions as well as providing no loss pensions. In such a society any personal saving becomes counter-productive.

Other than that there was the expected emphasis on high quality production rather than high speed production, with associated words such as technology being mentioned 160 times while property was only mentioned 4 times. There was focus on the problems besetting local government finances and much space was devoted to the international pressures on China, and with it, the need to build self-sufficient economic resilience.

One wonders how impressed the PBOC (The Peoples Bank of China) was with the plenum because shortly afterwards it unexpectedly reduced key interest rates. The plenum was notable for not being notable.

The geopolitical situation.

Israel continues to stoke, not only the Nakba, but the Rapture as well, by baiting Iran. This time assassinating the leader of Hamas in Tehran during the inauguration of the new President. It seems that the US was not informed in advance and rumour has it they were displeased. But while Israel is recognised to be a liability the one thing the USA cannot countenance is the humiliation and defeat of its main ally in the region. That is why a high level military delegation from Washington has arrived in Tel Aviv. Simultaneously a high level military delegation from Moscow has arrived in Tehran. Both the US and Russia are deploying military assets on either side. It appears Moscow is making good its military commitment to Iran, no doubt with China's blessing. Altogether, this is becoming a much more generalized conflict dragging in all the major powers, as desired by the Zionists, who facing defeat both in Gaza and on the Lebanese border, are seeking to broaden the war.

Clearly the only way out is for Israel and war is for it to be driven to the negotiating table by the USA, which while not impossible appears increasing unlikely.

In Ukraine, the Ukrainian army is reeling, its defenses are crumbling, and its manpower is being obliterated. It is likely that by now its casualties amount to 800,000, an unforgivable number but one bound to rise because the masters of this war are not politically responsible to the citizens of Ukraine as they reside in Washington, London, Berlin and Paris. Having external paymasters and commanders makes for the cruelest of wars. This said the war is likely to end this year as the Ukraine cannot continue to sustain such casualties and because NATO is not intending to turn this proxy war into an actual war by deploying forces to Ukraine.

Conclusion.

If history is any guide, the markets will recover some of their losses momentarily, and then continue an extended decline which will be more orderly unless a black swan appears on the horizon. The markets are counting on the monetary policies executed by the FED, PBOC and the ECB to be more accommodative and therefore supportive. Certainly the timorous BOJ, having raised interest rates by a mere 0.25%, barely above the parapet, has turned round after the crash and said never again, allowing the Nikkei to regain its composure. But as the ugly auction today of US 10-year bonds shows, not all the cards are in the hands of central banks. The risk premium is growing in the markets as investors demand more insurance before parting with their money. Clearly the drift is towards cash and gold making them king and queen once more.

The excesses, particularly that of debt, built up since the financial crises due to the repression of recessions at the end of 2015 and 2019 are now coming home to roost. The capitalist class may come to rue the day they interrupted the regular cycle of boom and bust, which can only end in an even bigger bust. This is the economic perspective which the financial media is now owning up to having put a hard landing back on the table. It is also now more voluble about insolvencies, bankruptcies and delinquencies than it was just a few months ago. Concern about bad debts keeps growing.

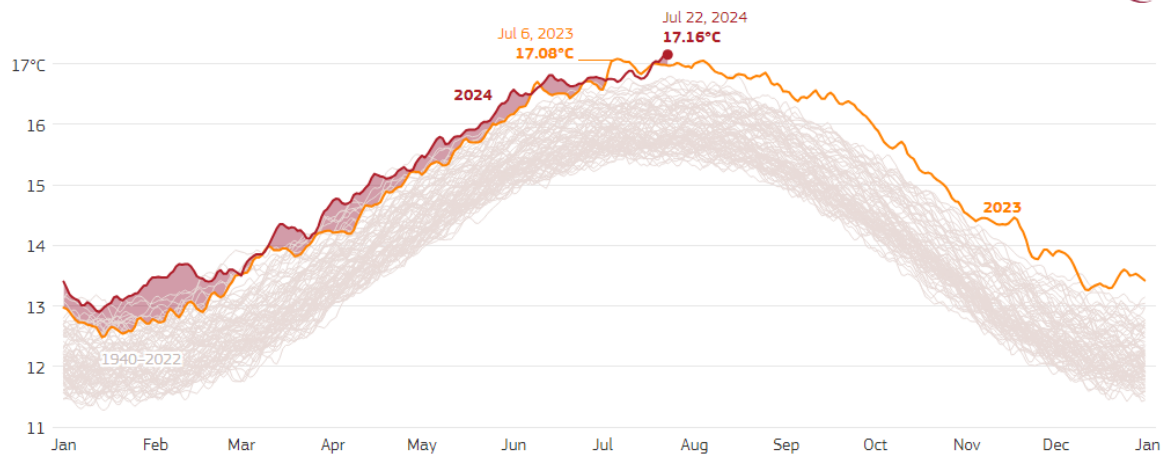
On the plus side the real catalyst for slump, the collapse in profits has yet to occur though it is on the horizon. US data is difficult to reconcile with real movements and this applies to the profit picture as well. It is unexpected to find profit margins rising in an environment where worker remuneration is rising faster than selling prices meaning margins should be compressed by cost prices rising faster than selling prices.

The seasonal earnings reports do show selling prices under pressure, but they also show falling cost prices, both in the form of input prices, and this quarter, SGA (office) expenses as well. This normally only occurs in a recessionary period, which is associated with falling profits not rising profits. Time will tell. Until a global profit crisis breaks out, the economic crisis cannot mature.

And of course the climate continues to deteriorate. [Copernicus EU](#) reported record daily temperatures in late July with the expectation of more to come.

Graph 8.

Daily global surface air temperature



What separates this period from the financial crisis in 2008 is that there is no longer any reserves nor drivers in the world economy. In particular China can no longer play this role. Nor will the investment in A.I. be sufficient to act as a global driver. The needed surge in green investment could, but this is blocked by the fossil fuel industry.

With social unrest breaking out everywhere and war beckoning, it is clear that capitalism has boxed itself in with its greed and shortsightedness. As the economic slump progresses, all that has come before will be intensified, and a society already corroded and made brittle will be tested as never before.

Brian Green, 10th August 2024.