ALL ICING, NO CAKE.

On Wednesday, 25th June, new coronavirus cases in the USA spiked to 45,557, (NBC news). This was the highest since the pandemic broke. Investors thought Covid was in the rear-view mirror when It was always in front of the windscreen, but these investors, driving with their headlights off and too short to look over the dashboard, were nonetheless confident that their FED GPS screen was directing them securely down the money highway. What a crash is in the making.

The US is awash with liquidity. There are almost as many dollars as viruses, the only difference being that the viruses are circulating ever faster at the moment, particularly in those Southern States which took the least precautions. Super spreader Trump continues to relegate the importance of measures to control the virus. At the same time, behind the pandemic, Trump is trying to dismantle as many environmental protections as he can before his office expires. Given his slurring and odd muscle movements, it appears he may be the victim of his own success in releasing toxins and pollution into river systems, the ground, and the air.

The contrast with China could not be starker. On the one side a decisive Premier, on the other two brain fading contenders tainted to their cores. This is how an Empire die, in ignominy and farce. The Chinese must be laughing all the way to their bunkers.

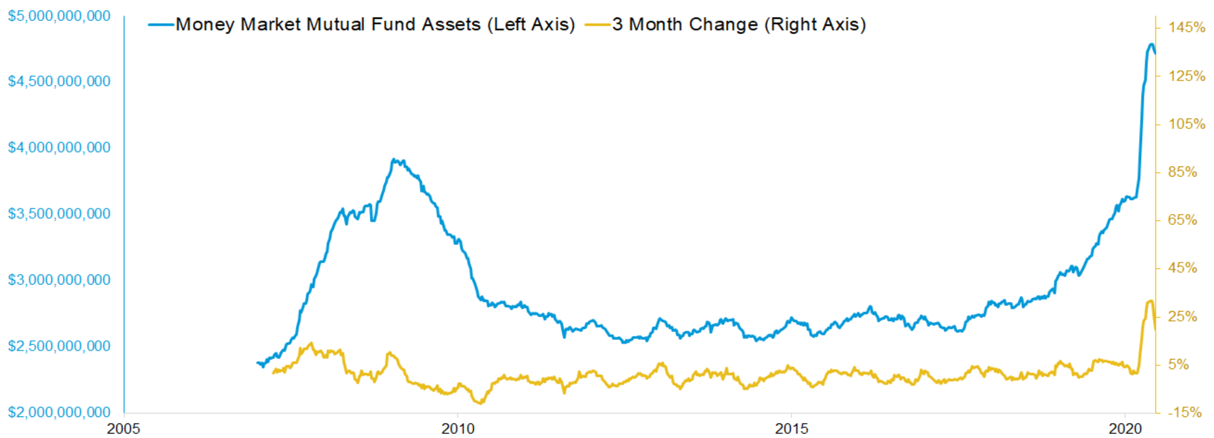
The flood of liquidity.

I will parade a series of graphs which represent the scale of the injections into the world economy to keep it afloat, and to more importantly, preserve the fictitious wealth of the capitalist class. Bank deposits have grown by $2 trillion. Part of this is due to workers spending less but the bulk has come from the corporate and financial world, the main beneficiaries of the largesse by governments and central banks. https://www.cnbc.com/2020/06/21/banks-have-grown-by-2-trillion-in-deposits-since-coronavirus-first-hit.html This flood of liquidity is evident in the graph below.

Graph 1.

In addition, money market funds have soared by nearly $5 trillion. "*The flood into money markets pushed the sector's assets to the highest on record, peaking at $4.672 trillion during the week of May 13, according to Refinitiv Lipper"*, quoted by CNBC.

Graph 1.

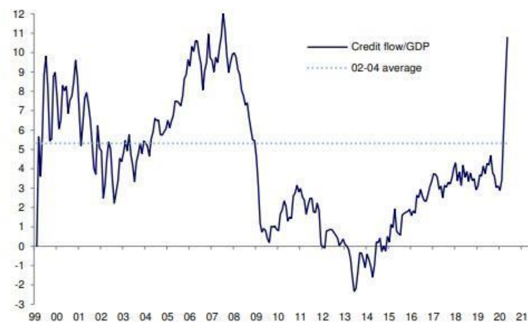


https://www.cnbc.com/2020/06/22/theres-nearly-5-trillion-parked-in-money-markets-as-many-investors-are-still-afraid-of-stocks.html

The same applies to the rest of the world. We have witnessed the biggest credit impulse in history relative to GDP growth, far eclipsing the impulse around 2008 and 2009.

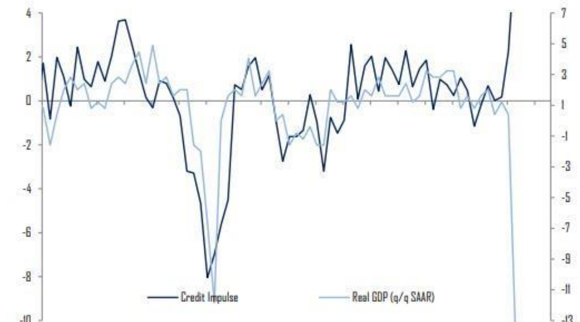
Graph 3.

Figure 21: Credit growth surged in Europe too



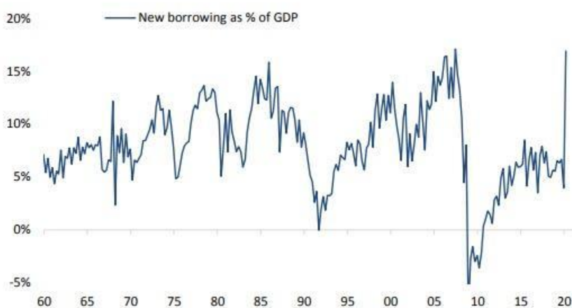
Source : Deutsche Bank, ECB, eurostat, Haver

Figure 22: and has historically implied a pick-up in GDP



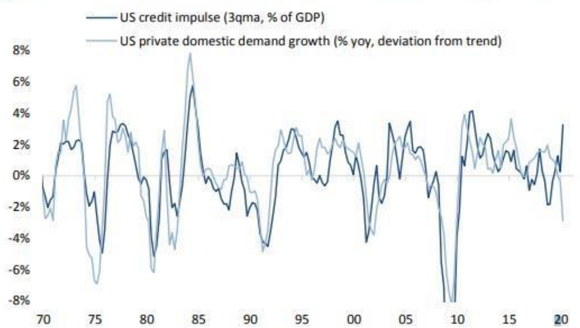
Source : Deutsche Bank, ECB, eurostat, Haver

Figure 17: Surge in credit growth in the US



Source : Deutsche Bank, Federal Reserve, BEA, Haver

Figure 18: ... has historically been reflected in higher GDP

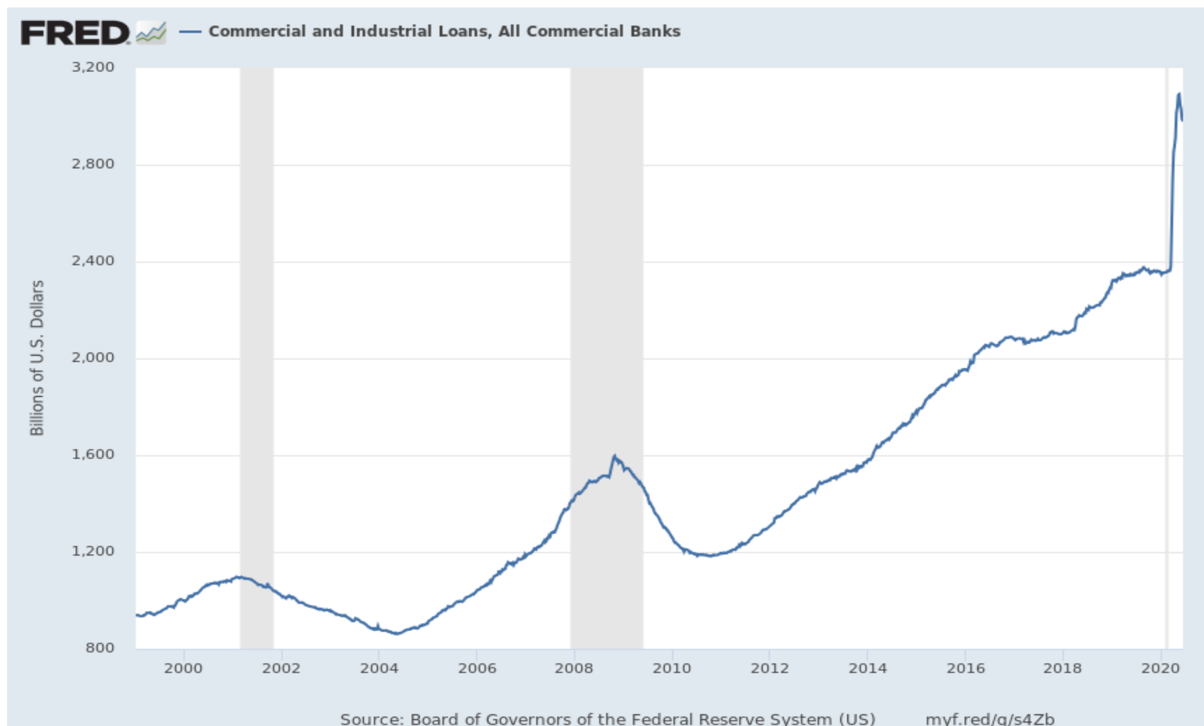


Source : Deutsche Bank, Federal Reserve, BEA, CBO, Haver

In the estimate of *Bank of America* chief investment officer, Michael Hartnett: *"Over $18 trillion in global stimulus equal to 21% of global GDP. According to BoA calculations, in addition to the record 134 rate cuts YTD, the amount of* ***total global stimulus, both fiscal and monetary, is now a "staggering" $18.4 trillion in 2020 consisting of $10.4 trillion in fiscal stimulus and $7.9tn in monetary stimulus - for a grand total of 20.8% of global GDP, injected mostly in just the past 3 months****!" (*quoted in Zero Hedge*)* And its not over, more injections will be needed soon.

On the other side of the coin the collapse in the rate of turnover has led to a spike in the need for additional credit to cover the resulting increase in working capital.

Graph 4.



This liquidity was already becoming more ineffective before the pandemic as the table below shows. The primary reason for this is that the stream of credit has been increasingly diverted towards the financial sector. This is not only true for the advanced capitalist countries with their over developed credit and share markets, but also the so-called emerging markets. By 2016 capital flows to these countries had shifted from investment into the productive sphere, to investment into the financial sphere. What Covid has not done, is to reverse these flows, instead it has accentuated them. Take the global STOXX 1800, it peaked at 297 in mid-February then fell to 197 on March 23rd, only to bounce back to over 260 currently. The fall of 34% was partially reversed by the subsequent rise of 22%, amounting to about $18 trillion world-wide, or equal to the "staggering injection" of liquidity into the world economy quoted above.

Table 1.

Latest Evidence of Diminishing Returns: GDP Generating Capacity of Global Debt: All Major Economies

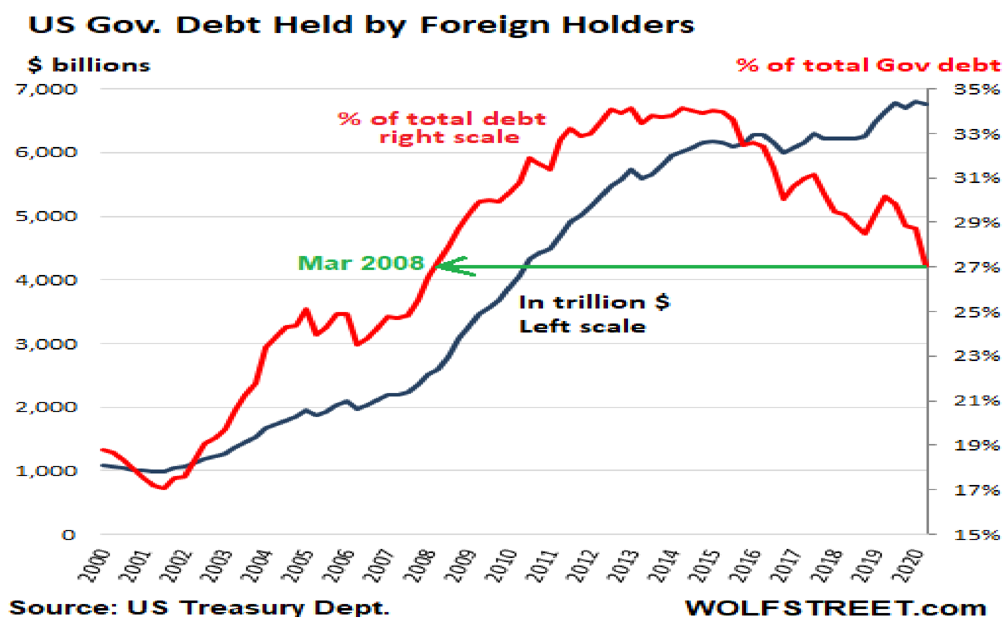
		(2007-2009 avg.) Ratio of GDP to Debt	(2017-Q1 2019 avg.) Ratio of GDP to Debt	% change
		A	B	C
1.	Euro Area	0.44	0.38	-13.5%
2.	United Kingdom	0.42	0.36	-14.3%
3.	Japan	0.32	0.27	-14.8%
4.	United States	0.43	0.40	-5.6%
5.	China	0.65	0.34*	-38.2%*
6.	All reporting countries (aggregate)	0.47	0.42	-11.1%

Source: Bank of International Settlements. * China adjusted based upon "A forensic examination of China's national accounts," Brookings Institute on March 7, 2019, by Wei Chen, Xilu Chen, Chang-Tai Hsieh (University of Chicago), and Zheng (Michael) Song (Chinese University of Hong Kong). "China's economy is about 12 per cent smaller than official figures indicate and its real growth has been overstated by about 2 percentage points annually in recent years".

Investors may not be able to see above the dashboard, but from here on, the road gets bumpier. The medical news is getting increasingly grim and the reporting season is imminent, and most important of all, winter in the northern hemisphere is just 4 months away. I repeat what I said earlier, unless an effective vaccine appears before year end, it is likely we are facing system collapse.

The problem for the dollar and US bond issuance, is that foreign bond holders and buyers are reducing their exposure to US Treasuries.

Graph 5.



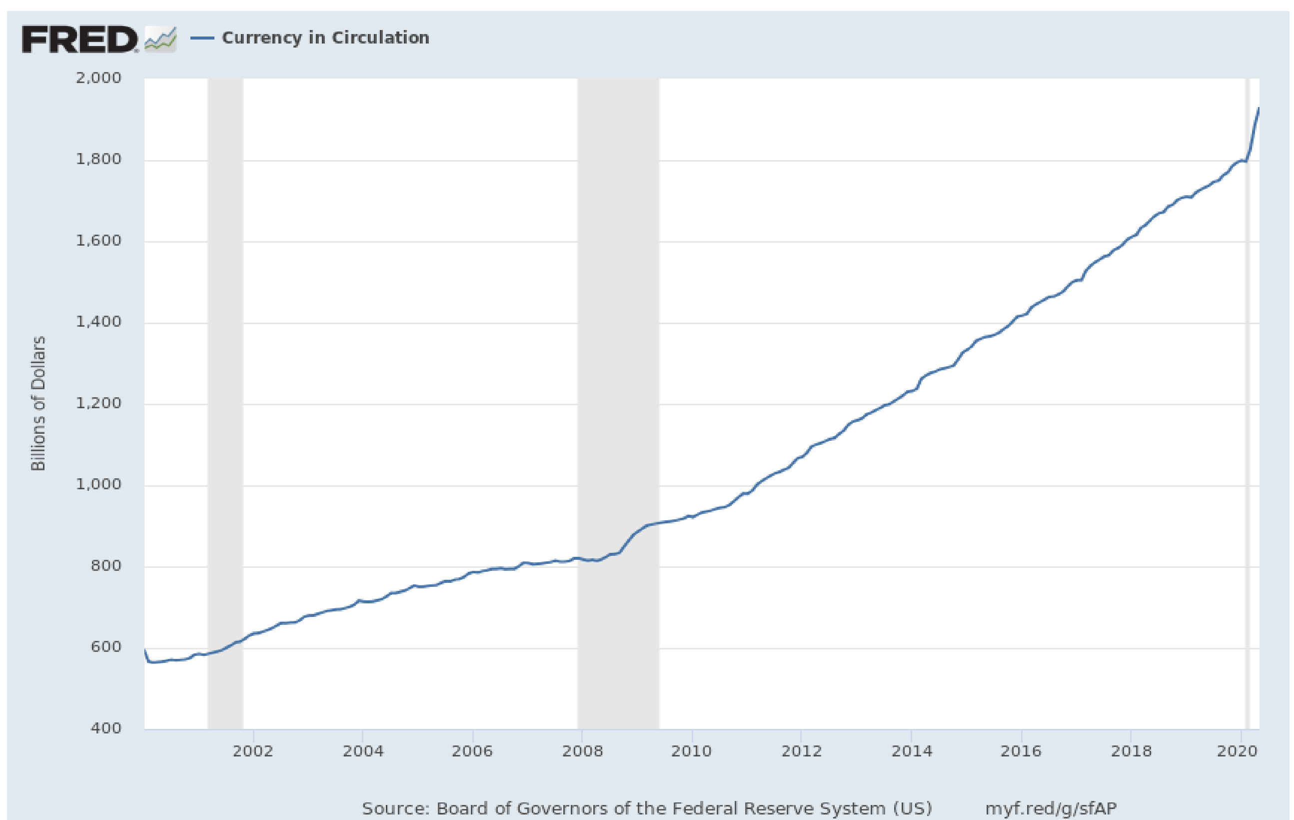
It could be argued that this is of little concern because the FED could monetise the issuance of Treasuries. In fact, up to now this has been the case. The bond buying by the FED has approximated the issuance of Covid linked treasuries. The same cannot be said for the dollar. The lack of foreign buyers will most certainly weigh on the fortunes of the dollar. A dollar crisis could be unfolding.

This is being recognised by the more serious investors and banks who are encouraging their clients to buy or invest in gold as a safe haven. Currently, gold as an investment asset comprises about 1% of investment portfolios according to the gold council (or $2 trillion). https://www.gold.org/about-gold/gold-demand/sectors-of-demand The price of gold outside jewellery (53% of the total) equates to about $8 trillion at today's prices, but not all of it consists of gold hoards. https://www.gold.org/about-gold/gold-supply/gold-mining/how-much-gold

In comparison there are less than $2 trillion dollars in circulation. Does that mean there is enough physical gold to substitute for the dollar? That there is some way back to a gold standard. The answer is no. Gold may be a safe haven at a time of a financial emergency, but it will never again function as money. Tokens will continue to act as the intermediary between commodities, acting as the means of circulation.

What is likely to replace the Dollar is a global currency based on a basket of currencies. Most of the weight of this basket would comprise the major currencies and the new currency would be modulated by the exchange rates within the basket and the changing weights of the primary currencies. Unlike at the time of Bretton Woods, when US power was at its Zenith, the US will not have the luxury of saying no this time. This is a solution favoured by the Chinese. The success of such a currency, should capitalism survive, like the EURO, will depend on the fiscal discipline of the participating countries.

Graph 6.



US retail sales.

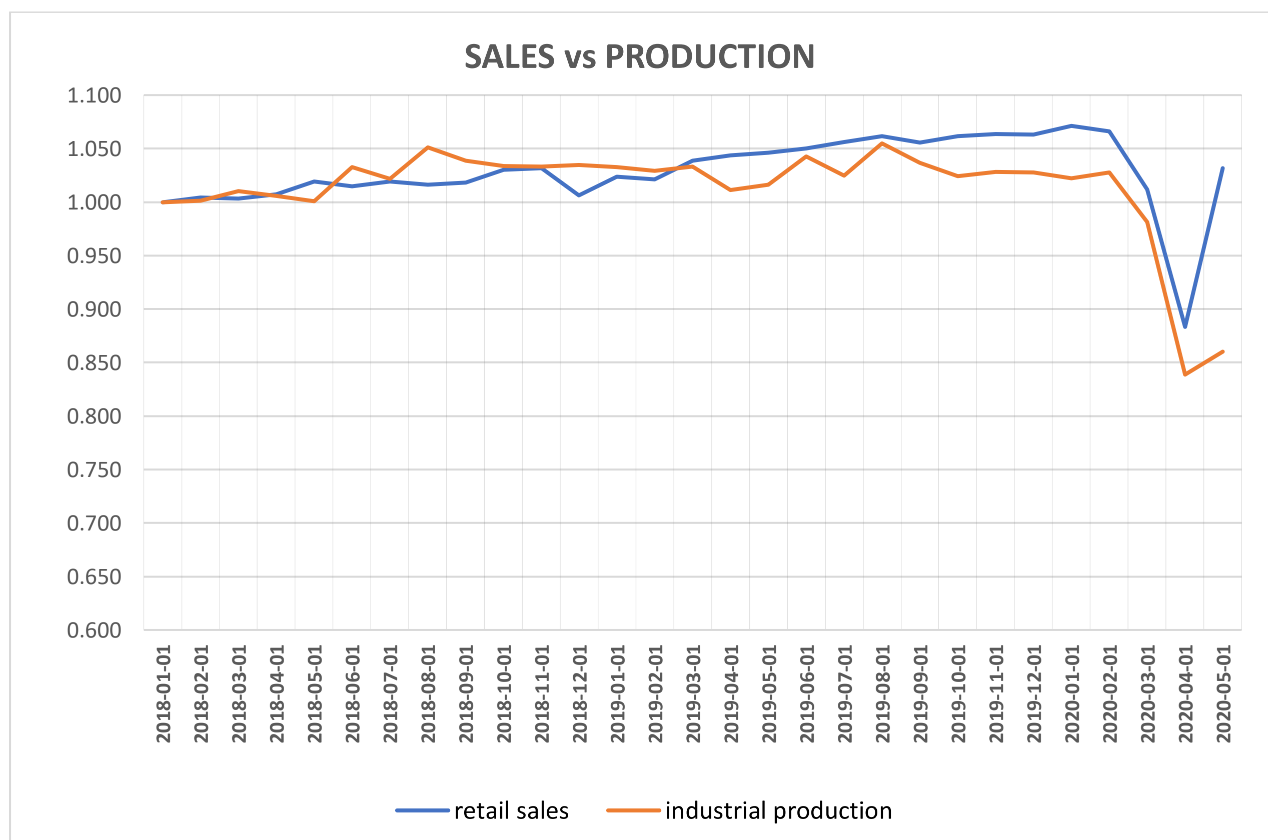
Fraud always precedes recessions. Unfortunately, that applies to economic data emanating from the US since tensions erupted with China. The employment data which brought such joy to the markets last month is recognised today as being inflated by 4 to 6 million. You see, the BLS employees on the end of the phone were asking the wrong question when carrying out the household survey. That is why the Labour Bureau's data on claims outstanding and the BLS unemployment rate diverged by around 7 million when the surveys were done in the first half of May.

The same applies to retail sales. I was waiting for the release of May's retail inventory levels in order to reconcile production data with sales data. These are not yet available. What is available for May is FRED's diffusion indexes for New York and Philadelphia (**Tables: IVFDINA066MNFRBNY & IVCDFNA066MNFRBPHI)** In these two markets there appears to be no significant run down in inventories. Nor is the issue of imports and exports a major concern. Data for May is absent but given the depressed state of both these flows, it is unlikely they will play a significant role in reconciling production with sales.

The reader will recall that retails sales jumped 17.7% in May having fallen 14.7% in April. The result was that over the 5 months, retail sales were down just 4.7% compared to the equivalent period in 2018. https://www.census.gov/retail/marts/www/marts_current.pdf

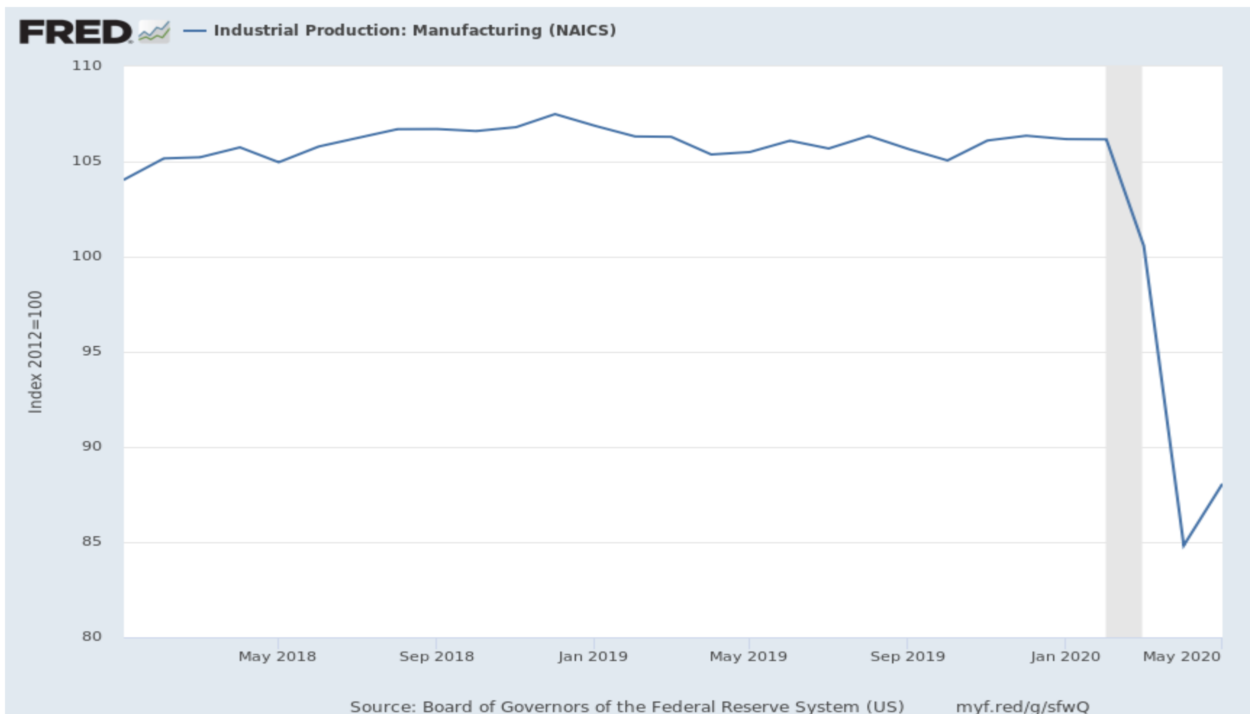
The problem with this enthusiastic figure is that it does not square with production when examining either industrial or manufacturing, as the two graphs below show.

Graph 7.



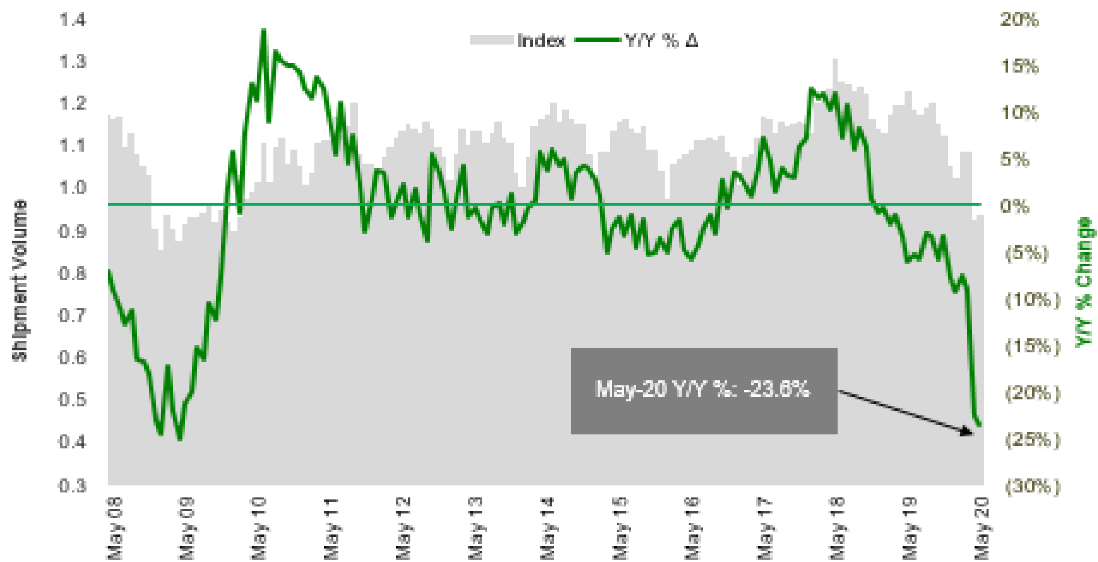
(FRED Tables RSXFS for retail sales & IPB50001N for industrial production. Both series indexed.)

Graph 8.



The combined falls in April matches, but the rises in May are mismatched. In both cases production rises by only 3% or one sixth of the rise in retail sales. Nor does the Freight data support this rise in retail sales. In the following graph, the fall in shipments in April and May were commensurate. Movements barely increased in May rising by only 1.6%.

Graph 9.



https://www.cassinfo.com/freight-audit-payment/cass-transportation-indexes/may-2020

When we dig deeper into the figures, to remove things like railway and air freight, we find little difference in truck movements between the two months. Here the month on month change was a

mere 0.7%. Once again this is not consistent with retail sales rebounding by nearly 18% even taking into account the weight of sales of light motor vehicles.

TRUCKLOAD LINEHAUL INDEX

May	Year over Year	2 month stacked change	month on month change
130.6	-5.0%	-4.5%	0.7%

Great Britain or Break Britain?

Britain approaches the June 30th cliff edge like a rabid bulldog. This is the date when either Britain asks for an extension to the transitional period, or, a draft trade proposal which can be voted on must be in place. Gove on 16th June stated categorically there will be no extension of the deal. In turn Angela Merkel has responded that Brexit is not her main priority, the pandemic is, which means Germany is less likely to accede to UK demands. It is therefore going to be touch and go whether a trade proposal is arrived at in time. https://www.msn.com/en-gb/news/brexit/angela-merkel-uk-must-live-with-consequences-of-weaker-ties-to-eu/ar-BB160AYg?ocid=msedgdhp

The Dominique Gove dominated government's grasp of reality seems to be less secure than their grasp of adverbs and adjectives, or what is the same thing their constant use of hollow rhetoric and bombast. What is that old saying, oh yes, empty vessels make the most noise. The British Capitalist class is only too aware of what the cost of a "No deal Brexit" will entail: *"Dame Carolyn Fairbairn said companies are not strong enough to cope with crashing out of the European Union's single market in December after the battering they are taking from the pandemic shutdown. "The resilience of British business is absolutely on the floor," said the Confederation of British Industry's director-general.* https://www.standard.co.uk/news/politics/no-deal-brexit-after-coronavirus-carolyn-fairbairn-boris-johnson-a4466091.html

Nor are the British public sanguine about a "No deal". *"The* **European Social Survey**, *conducted every two years, found that 57 per cent of Brits said they would vote to be inside the EU, compared to 50 per cent who said the same in the previous survey released in 2018. By contrast, just 35 per cent said they would vote to be outside the EU, compared with the 52 per cent of people who voted to leave in 2016."*
https://www.thelondoneconomic.com/politics/support-for-brexit-is-collapsing-poll/26/06/

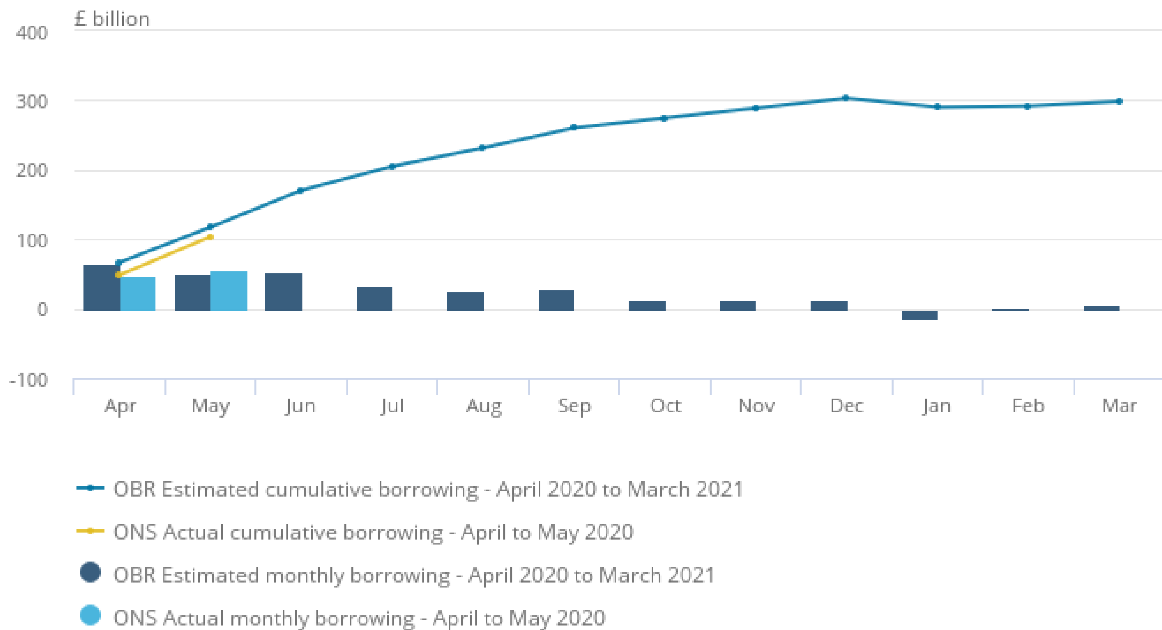
Nor are serious investors at ease. They now see the UK Pound as more akin to an emerging market currency than one of the world's leading currencies. *"Kamal Sharma and Myria Kyriacou of Bank of America also note that the "liquidity" of the currency – the difference between the rates at which traders are willing to buy and sell – seems worse than for other major currencies and that traders are also pricing in a higher risk of future volatility. This has led them to argue that the UK's currency should best be seen as an emerging market (EM) currency – such as South Africa's rand or Turkey's lira – rather than compared to traditional peers such as the US dollar or the euro or other members of the G10 group of industrialised economies. They see the government's fiscal deficit at 6 per cent of GDP in 2021 and the current account – the amount the country as a whole borrows from abroad – at 4 per cent. This would put the UK's "dual deficit" – a combination of the two measures – higher than the G20 average and also wider than that of South Africa and Turkey."* https://www.independent.co.uk/news/business/pound-sterling-developing-country-currency-brexit-a9583106.html

And so they should. As the two graphs below show, the UK's fiscal position is in a parlous state. And it will be more precarious by year end. Britain's dependence on foreign lenders has increased not decreased. The age of low interest rates may be passing.

Graph 10.

Figure 1: Latest published data from Office for Budget Responsibility^1^ suggests borrowing could increase to £298.4 billion for the financial year ending March 2021

Public sector net borrowing excluding public sector banks, UK, cumulative financial year-to-date (April to May 2020) compared with official borrowing estimates for the financial year ending March 2021 (April 2020 to March 2021)

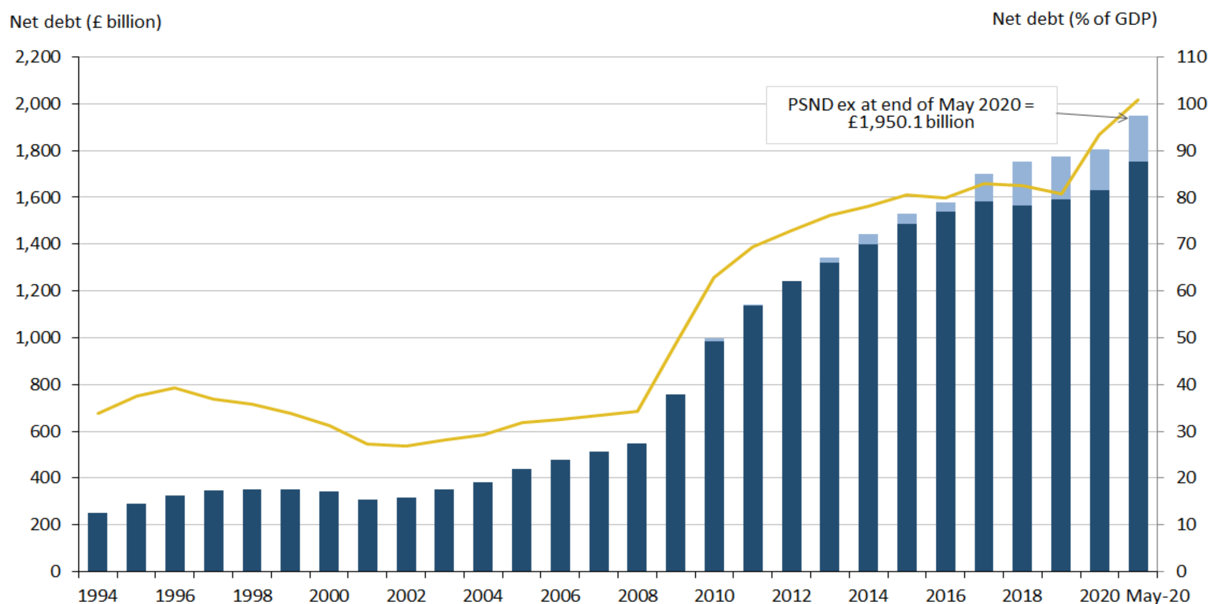


Source: Office for National Statistics – Public Sector Finances

Graph 11.

PSND ex less BoE as at March of each year [2] Bank of England contribution to PSND ex [1]

PSND ex as a percentage of GDP (right-hand axis)



The second graph shows that UK government debt now exceeds 100%. The first graph shows the expected growth in the deficit. Once again, this is an underestimate, because it does not include any contingency for a second winter wave of infections when it is highly likely another lockdown will be needed. (The presence of a viable vaccine by then is currently considered to be remote.) A second lockdown will be more severe, because it will begin at the onset of winter rather than at its end, and, because it will be hitting an economy which has not recovered from the first lockdown. It will also be less generous because government finances are bust.

Finally, the British Standards Institute has blown the cover, that once Britain leaves, it will be taking back control. They have warned the govt that a deal with the US would result in the UK having to abide by lower US standards rather than EU standards to satisfy the US. In turn, this would bar exports to the EU. The EU will not allow Britain to profit from cost cutting exports.

The British Capitalist Class may rue the day they put their weight behind a Johnson government rather than a Corbyn government. A Labour government would have dealt more efficiently and wisely with the pandemic than the "disruptor" Cummings and his private sector mates ever could. And, a Corbyn led government would have arrived at an agreeable accommodation with the EU. In the end the capitalists got what they deserved, and it has cost them trillions, trillions which we must ensure they pay for, not the British working class.

Conclusion.

The eye of the storm is advancing. The tail winds are beginning to make themselves felt. The sharp uptick in cases in those US states which opened up prematurely, has tripped up the markets. This week has seen the market break its winning streak, falling 2.5% for the week, with volatility up. From now on the potholes are going to get deeper, and should drivers be bounced above their dashboards, seeing what lies ahead for the first time, they are likely to unbuckle and jump.

Brian Green, 27th June 2020.