Global Monetary Viewpoint

Thursday, 08 July 2021

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THE SPECTRE OF A CRASH UNDER MONOPOLY CAPITALISM AND MONETARY REPRESSION

Fall in US long-term rates highlights late-cycle dangers

How Washington has strengthened the OPEC cartel

Around 28 per cent of the total value of the US stock market ($9tn out of $34tn) is represented by the five most giant monopolies – Alphabet, Apple, Amazon, Facebook, and Microsoft. The discounting of vast and growing monopoly rents has a big role to play, at least arithmetically, in the fact that the stock market to GDP ratio is now more than 150 per cent of GDP rather than close to the long-run "norm" of 100 per cent.

In turn, the advance of monopoly capitalism, of which these extraordinary valuations are evidence, is a source of economic sclerosis. A withering of the inherent dynamism of free-market capitalism – which explains the ability of governments led by the US to raise record amounts of monetary repression tax; low bond yields, reflecting sclerosis, and a flight of investors to avoid the tax in turn power sky-high valuations across a range of asset classes.

A key issue is whether this prominence of monopoly in the overall "value space", built on monetary inflation as described in our previous publication, together with related monetary repression, means that the next episode of asset deflation and recession will be different from the past.

The main conclusion here is that the great monopolies could be especially vulnerable to value liquidation during a crash where the focus would be on a great recession to follow. And the harm which monopoly capitalism has done to the free market economic system will mean that the recession is indeed likely to be all the more severe in consequence.

Storms in a blue sky

There is the saying that market crashes come from nowhere, like a storm from a blue sky.

Why did the stock market index plunge 30 per cent say in just that particular week rather than the week before or several weeks later?

That is mainly indeterminate even though market commentators might find contemporaneously or with hindsight some catalytic report. For example, on the morning of the 1929 Crash, there was a story in the Wall Street Journal about

Executive Summary

The sharp fall in long-maturity US interest rates is consistent with fading optimism about a vibrant post-pandemic global economy during the rest of 2021 and into 2022/2023.

There are multiple reasons for caution – the course of the virus itself, the sombre prospects across many emerging market economies, the hefty tax rises from the OPEC cartel, the extent to which the advance of monopoly capitalism is smothering economic dynamism, and the accumulation of mal-investment.

How the tremendous monetary inflation, which started in the early 2010s, will make its way to the next Great Crash and Great Recession is subject to huge indeterminacy. But we can assemble critical elements in the process from a review of history and the analysis of the monetary inflation applied to the present long cycle.

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trade protectionist legislation, the forerunner of the Smoot-Hawley tariff, which a Senate subcommittee had approved.

Lack of conviction about the immediate trigger does not mean a lack of evidence about weightier factors that lie behind the emergence of a crash but whose effect in time is indeterminate to some degree. Though the sky is blue today, we know that a storm is very likely to come due to well-identified disequilibrium systems built up.

A sense of foreboding can grow based on one, or likely several, of the following: Increasing evidence that good economic times are waning; A collection of speculative narratives which have been running hot may have encountered rough going with evidence accumulating against them; Or a long-running asset inflation process which has pushed prices across many asset categories to generally recognised very high levels (as Robert Shiller demonstrates, before a Crash there is a considerable amount of talk about bubbles). Everyone and their dog acknowledge that there are grounds to fear that long-running monetary inflation will end in a severe economic downturn, whatever the propaganda is coming from the central banks and governments.

Four storm alerts and what they tell us now, 1929, 1937, 1973 and 2007

Let's apply this list above possible storm alerts to four of the Great Crashes of the past century – 1929, 1937, 1973-4, and 2007-8.

1929

Ahead of the October 1929 crash, we had had seven years of Federal Reserve monetary inflation, most evident in accumulating asset inflation. One significant element from 1924 onwards had been the foreign lending boom/bubble into the Weimar Republic. Ahead of the Crash, the German economic boom peaked already in Autumn 1928 since a recession had set in, albeit blurred by a frigid winter and snap-back in early Spring. The giant real estate and construction boom in the US had already started to go into reverse from autumn 1928. Also, the Federal Reserve had been tightening monetary policy since mid-1928, growingly alarmed at the speculative frenzy in Wall Street. Regarding speculative narratives, much has been made in the literature about the speculation in electric utilities (regional monopolists but subject to some loose regulation), which went sour on the eve of the crash with a ruling of a Massachusetts regulator against further stock splits.

1937

Next to the Crash of Summer 1937. Much has been made of a slight tightening of monetary policy through late 1936 and early 37 (in effect, the reversal of QE and a tiny uptick in money market rates from zero), though forcefully reversed for many months before the Crash erupted. Much more important was an apparent fading of the rapid recovery of the US economy out of the Great Depression, accompanied by a darkening domestic political climate (high taxes, trade union militancy) and geopolitical shadow (Japanese invasion of China). Asset inflation had been rampant both in commodity and equity markets through 1935-6 amidst the radical monetary expansion and dollar devaluation of the New Deal. There had been much talk through 1936 about the hot speculative climate in stocks and growingly in commodities. Given the recency of the Great Depression and low business confidence amidst the distrust of the

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New Deal, it was well within the realm of possibility that any economic downturn would be severe as capital spending could plunge. That is what occurred through 1937-8.; on some metrics, the 1937-8 recession was more painful than 1929-30.

1973

Fast forward to the Great Crash of 1973-4 and the Great Recession of 1973-5. The immediate triggers to the Crash included the tightening monetary squeeze through 1973 in response to the ascent of goods and services inflation. This had been preceded by a decade of virulent monetary inflation featuring much asset inflation (albeit punctured briefly in 1966 and 1969). By autumn, there were indications of a looming recession and then all the scares of the massive supply shock unleashed by the Yom Kippur War and the quadrupling of the oil price. Stock markets priced to continue economic miracles in Europe and Japan amidst continuing US-led monetary inflation suddenly came down to earth. There were grounds for fearing that the approaching recession would indeed be one of the most severe on record.

2007

Finally, the crash and great recession of 2007-9 (extended into 11/12 in Europe). There was a long antecedent in virulent monetary inflation from the mid-1990s, showing up mainly as asset inflation, but with a spike of goods and services inflation briefly in 2000 and then in 2005-6. The central banks led by the Fed had briefly tightened policy in 1999/2000, but the recession had been very shallow. A more extensive and meaningful tightening occurred in the mid-2000s, playing a pivotal role in precipitating the Crash and Great Recession, given the amassed economic and financial weaknesses during the long monetary inflation.

A monetary diagnosis in Summer 2021

So now we come to the present juncture.

A long and virulent monetary inflation ran since 2012. There was a brief pull-back in 2014/15; there was an even weaker pull-back in 2018 related to the brief Fed tightening through the second half of 2017 and the uncertainties of the US-China tariff war. The monetary inflation intensified through the economic spasm of the onset of the pandemic in 2020.

There have been many speculative narratives, some ferocious; the biggest of all is related to the wonders of digitalisation. Unlike in most of the run-ups to past Crashes, there has been no actual or threatened pull-back of monetary inflation except for those Fed tweaks about whether the first rate hike will be in early or late 2022 and whether QE operations will taper from late this year or into next year. Like most run-ups to previous crashes, there is much talk of bubbles, not just in the area of cryptocurrencies but much more broadly.

There is not much talk of actual or imminent economic pull-back/recession, perhaps after an immediate late pandemic bounce-back. Still, there could be already some waning of optimism so rampant in the consensus market storytelling of early 2021. Evidence comes from the remarkable fall in recent weeks of long-term US interest rates. The emerging-market story has essentially turned sour for Latin America and ASEAN, and there are warnings of impending slowdown even concerning China.

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Much popular economic writing, including the latest BIS Annual Economic Report, treat the pandemic spasm of economic activity through 2020 as a recession that merited the deployment of government and central bank anti-depression tools, which will now have their largely predictable effects. All this could be pie-in-the-sky.

Economic spasm (due to pandemic) unaccompanied by any subsiding of monetary and credit inflation hardly meets the economic definition of a decisive cyclical turning point. The excess leverage driven by a monetarily induced boom in financial engineering built up during 2012-19 has gone into further overdrive during the pandemic's even more virulent monetary inflation.

The search for malinvestment – digitalisation vs green

We should now add to the already existing amount of malinvestment on the eve of the pandemic huge new layers added during the pandemic, most likely and ostensibly in the area of digitalisation. We should also watch out for, in assessing malinvestment, anything green. The involvement to a considerable degree of the state in subsidising green should undoubtedly make us cautious about economically inefficient outcomes driven by much cronyism. There is also the possibility of corrupted monetary signals and cronyism subsidies setting the "environmental revolution" on a seriously flawed course. For example, it is still possible that electric vehicles will be seen as a state-driven detour on a journey that should have proceeded more directly to vehicles powered by hydrogen cells. This would have a much weightier consequence than what it means for Tesla or Volkswagen.

Malinvestment lies camouflaged below the vivid accounts of wealth during the asset inflation. The national income statisticians play their role in the camouflage. When the subsequent Great Recession arrives, camouflage failure could mean a shocking decrease in economic well-being reflected ultimately in the economic statistics.

For example, the war against cyber insecurity (including viruses, more comprehensive cyber attacks) adds to recorded GDP. Yet this is undoubtedly a toll on economic prosperity. According to some estimates, the stock market valuation of companies selling cybersecurity may be as much as 2 trillion dollars. The lack of choice that individuals have in cyberspace and the manipulations by the big tech monopolists do not directly subtract from statistical measures of economic welfare. Ultimately, however, loss of dynamism in the economy would be reflected in lower living standards – including such measures as median real incomes.

A counterfactual assessment of economic damage from big tech monopolies

The advance of monopoly capitalism adds visibly to stock market values – as we have seen in the fantastic valuation of the five most giant monopolies quoted at the beginning of this essay. Yet when we consider prosperity, we should subtract economic dynamism and its benefits smothered by the monopolists. It is always speculative how much more prosperous we would be if digitalisation had occurred more slowly and brought less monopoly power in its wake and how much more wealth in different forms could have been created. Still, we should not ignore it in consequence.

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This is not a new problem. Professor Robert Fogel earned fame by researching the significant railroad expansion in the US during the mid-late nineteenth century and asking how much prosperity this brought. Towards this end, he considered how the canal system might have expanded if the railroad investment had been slower over time and less driven by repeated manic speculation as caused by monetary and banking instability. He did not approach this counterfactual exercise comprehensively from the viewpoint of identifying mal-investment, which would have involved taking account of how investment might have grown further outside the transport area if railroad investment had been less.

There are similar calculations to be made in the counterfactual route to examining the benefits of digitalisation. Suppose this had occurred more slowly and without the acceleration of the pandemic period (during which the pandemic stock bubble led the way). How much more prosperous would the US and global economy have been during the years 2015-25?

A vital issue in this mal-investment question, not so relevant to the historical case of the railroads, is monopolisation.

Let's consider these monopolisation costs, albeit they may lie outside the vision of some judges. For example, a US government judge last week provisionally ruled that Facebook should not face monopoly charges. Illustrations include the concentration of online advertising and its corruption – which may incidentally end up with society spending more on the negative-sum game of advertising and distributing the spoils in a way that curtails the commercial possibility of an independent media essential to freedom.

Monopoly positions as gatekeepers, whether Google concerning the internet or other big tech for their platforms, may end up with a spread of knowledge which is inferior fundamentally to what might have been - Wikipedia instead of a range of renowned encyclopedias online and self-funded by adverts. The competition and search process for retail goods and services may be inferior to what could have been despite outward simplicity. We consider how the gatekeepers prioritise their products and services in any search process, whilst independent brokers or agents have been snuffed out commercially, not gaining visibility.

Could the next crash start in the monopoly sector?

All these causes of dissatisfaction about the pace and direction of digitalisation and its essential role in the advancement of monopoly capitalism, all intimately tied in with monetary inflation, does not amount to a diagnosis of Crash any time soon. There could be a connection if they provide grounds for a growing view the stock in the Big Monopolists now enjoy bubble valuations which could snap at a point when the speculative narratives about them become tired. Yet there is no visible path for this to happen – except in so far as public discontent and dissatisfaction about their abuse of power open a way to new forms of technological competition, and where political/judicial action would prevent the Big Monopolists squashing these by pre-emptive take-over.

In assessing whether Big Monopolist stock market valuations are excessive, a key question must be whether and how far into the future there will be a severe reversion to the mean in profits as competition becomes a live force. With current sky-high P/E ratios for the big monopolies, one could say there is not

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only such possibility priced in, rather the converse, that being, years of further monopoly advance.

The monopoly stocks are understandably not priced based on yielding monopoly rents on the present scale with absolute certainty. Instead, these rents will rise and fall with the business cycle, even though they continued rising through the pandemic economic spasm. If there were a great recession, for example, in 2022-4, we could imagine some sharp revenue falls – for example, how much discretionary spending would there be on Apple phones and how much advertising spending online or anywhere else. And yes, there could be some sharp falls on online retail spending. That is why in a rationally priced marketplace, we should expect substantial risk premiums on the monopoly stocks even without considering the possible eventual breaking down of their monopoly power.

Could we expect a sudden sharp fall in monopoly stocks on account of markets suddenly taking note of all the risk factors mentioned and concluding that these are insufficiently discounted at present? Unlikely, that could occur in a more general asset deflation that smothers narratives across the board, including the monopoly narrative.

The key dynamic of the business cycle in timing Crash danger

Most of us might agree that present high stock market valuations based on a big monopoly story, most of all in the FAAMGs, together with a general flight of investors out of assets subject to high monetary taxation, but not accompanied by any long-run boom in prosperity including living standards, is inherently fragile. But no imminent reining back of monetary inflation is on the agenda, which could expose this fragility in its historical role as a critical factor in market crashes. Instead, the key triggering factor to a market crash is likely to be disenchantment with the narrative of high earnings and economic growth over several years to come, all in the context of a general march forward in prosperity.

Disenchantment and flat or soft market performance can, in turn, enter the dynamics of financial strategies. So many investors who have built their financial structures on the assumption that high returns from stocks and real estate are a "right", well demonstrated by all financial and econometric research in recent decades, could lose their confidence in those assertions.

Could the progress of business and earnings already disappoint by late this year and into 2022? Of course, that is possible. All the talk of stimulus and how it will buoy spending may turn to be about a dud – Keynesian fine-tuning might finally meet its day of reckoning. In the big picture, we should undoubtedly note how the emerging market narrative has faded. As recently as ten years ago, the catching up of emerging markets (convergence) with the advanced economies was a lead theme in financial markets. But this does not apply today, and colossal indebtedness at corporate and government levels is the result. In short, despair and hate might form towards the present economic and market reality of high monetary taxation, huge increasing burdens of all taxation in the future, ugly and corrupting monopoly power, and weak long-run growth in economic prosperity at best.

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Washington's appeasement policies increase economic risks

Ironically, an immediate challenge to the unbroken continuation of asset inflation comes from monopoly power outside the US, the OPEC cartel. The Biden Administration, given its pursuance of appeasement with Iran and its well-known coolness towards the US-Saudi special relationship, has not been able to convince Riyadh to boldly step up production and break with the present cartel arrangements with Russia and Iran. Understandably the Saudi rulers consider their relationships with the Moscow-Teheran-Beijing axis in a context where they no longer have the US back. Abu Dhabi may indeed be the "wild card", though the outcome here will certainly involve reaching an agreement on strategy with Riyadh.

And meanwhile, the Administration's Green agenda frightens potential rapid re-expansion of shale oil and gas production in the US. Higher energy bills, together with high prices across a range of goods and services related to present supply disruptions, could add to the dampeners on consumer spending through coming months which could go together with a fallback of business spending in the areas which thrived during the pandemic, especially anything cloud-related.

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