The Central Banks' Inflation Is Turning into a Dangerous Deflation

by Paul Gallagher

July 25—American and Chinese trade and economic statistics issued for the first half of 2023 point to a shift underway, from the fierce *inflation* of 2021–2022 to a potentially more dangerous *deflation* and credit shortage. While the repeated escalations of NATO's war with Russia over Ukraine still produce bursts of inflation in food and other commodities, which hurt hundreds of millions of people in the developing countries, the direction of the trans-Atlantic economies is to spread deflation, including exporting deflation to China's economy.

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While NATO's war with Russia produces inflation in the prices of food and other commodities, the trend in the trans-Atlantic economies is deflationary. Here, the Hapag-Lloyd (Germany) container vessel Osaka Express *at the Port of Rotterdam.*

A decade of unprecedented money printing by the central banks of the United States, Europe and Japan, to bail out private banks after the 2008 crash, inflated asset prices only, while fostering economic stagnation. In the late Summer of 2019, central bank panic over the threat of stagnation turning to deflation caused the adoption of a new policy central bankers called "regime change"—the close coordination of central banks and treasuries to accelerate money printing and new government debt, simultaneously and dramatically, in order to create emergency demand. The unprecedented explosion of this money-printing from late 2019 onward unleashed rapid inflation in global commodity prices which badly damaged developing economies. With the COVID-19 pandemic, national treasuries joined the central banks, and consumer- and producer-price inflation raged.

But now NATO's war and sanctions policies, along with U.S. looting of Europe by military demands and trade warfare, have driven the industrial economies of Europe into contraction verging, in some nations, on collapse. This collapse in industrial demand is exporting deflation to Europe's biggest trading partners: to China, and also, like a boomerang coming back at the hurler, to the United States.

In 2022, this now-collapsing Europe (the European Union's 27 countries plus the UK) took more American exports ($425 billion) and sent more U.S. imports ($600 billion) than any other U.S. trading partner or region. In 2022 Europe was still China's largest trading partner as well, but lost that position to the 10 nations of ASEAN in the first half of 2023, as European trade with China fell in May and June both from previous months, and on a year-to-year basis.

Shrinkage of demand in contracting European economies will export deflation to both China and the United States. Deflation will bring falling business investment, employment and wages; credit crunches; and deepening austerity which will be difficult to reverse.

Producer Prices Show Europe's Deindustrialization

From June 2022 to June 2023, the prices of producer goods—sold to companies and agencies which produce consumer goods and services, or to other firms producing other producer goods—have dropped or been flat in the world's largest economies except that of

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Japan. Germany, forced by British-U.S. war policy into an accelerating deindustrialization, is the "leader" in this; German industry's producer goods prices in June were down a very large 14% since September 2022. Producer prices of Italian industry were down 13% in June from December 2022; those of the UK, down 2.7% year-to-year in June; those of French industry are flat for the year through June, but declining every month since October 2022.

U.S. producer prices in June were essentially flat for the year (up 0.24%), as were those of South Korea. Producer prices of Brazilian industry were down 9.5% year-to-year in June; those of India, down 4% for the year to June; and those of China, down a full 10.8% for the year. (The indices are found on Bloomberg, TradingEconomics.com, and Moody's Analytics.)

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Producer prices of Brazilian industry were down 9.5% year-on-year in June. Here, a view of the Campanhia Siderúrgica Nacional (CSN) steel plant in Rio de Janeiro, Brazil.

This producer price deflation reflects a shrinkage of industrial demand around the world, especially in Europe, despite the huge and rapidly increasing U.S. defense budget and the big increases in war spending across Europe. This producer-price deflation will be feeding into consumer goods prices and prices for services in the areas of trade logistics, warehousing, transportation, etc. *EIR Daily Alert* reported on July 22:

> The pace of deindustrialization in Germany is dramatic. The German Chemical Industry Association (VCI) expects sales to drop by 14% [as a whole—ed.] and by 16% in chemicals alone this year. The VCI, which presented its forecast on July 21, had previously expected a 5% decline in production and a 7% drop in sales. "The house is burning," VCI President Markus Steilemann said in a press conference in Frankfurt.
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> The gloomy picture is due to a fall in orders, especially from the automotive, consumer goods and construction sectors. In the first half of the year, production in the chemical and pharmaceutical sectors fell by 10.5% compared to the previous year. Sales fell by 11.5% to €114 billion due to weak demand.

When the monthly S&P Global Purchasing Managers' Indices were published July 24, Cyrus de la Rubia, chief economist at Hamburg Commercial Bank, was quoted in *Hurriyet Daily News*:

> Manufacturing continues to be the Achilles heel of the eurozone. Producers have cut their output again at an accelerated pace in July. The eurozone economy will likely move further into contraction territory in the months ahead.

An EU-wide survey of bank lending officers conducted by the European Central Bank (ECB) and released July 24, showed that business loan demand across Europe is as low as in Spring 2009, in the depths of the physical-economic collapse which followed the 2008 global financial crash. At no other point in the 21st Century has business loan demand in Europe been this low.

Nonetheless, both Federal Reserve and ECB plan to raise key rates further.

U.S. and Chinese Trade Prices Fall

Prices are also in deflation across the board in the *trade* of both the United States and China. Over the past 12 months, the prices of goods and services in U.S. trade have steadily fallen, such that overall, prices of imports to the United States were down 7% from mid-2022 to mid-2023; and overall, prices of exports from the United States were down by 12% over that period.

This deflation is in end-user prices for all commodities and services in international trade. The biggest factor (other than the Federal Reserve's own "strong dollar" rate policy) has been U.S. energy exports to European nations, which grew very dramatically in volume in 2022 after Europe was robbed of Russian energy, and are still causing inflation in some European economies. But those prices have fallen in 2023, equally dramatically, while demand for them has also shrunk. The factor in second place: Motor vehicle and vehicle systems demand in the EU has plunged.

European total demand for liquid fuels (oil and natural gas, primarily) dropped by 10% in the first half of 2023, from a year earlier, according to the International Energy Agency. Lack of demand is spreading in other goods in the trans-Atlantic countries as well, primarily in the European Union—computers and cell phones, for example, as well as motor vehicles, sales of which in Europe have fallen to historic lows.

Overall industrial production in Europe (including UK) is down by 2.7% thus far in 2023, from the 2022 level.

Now, economic activity is measurably contracting in the United States as well. Industrial production has been declining month to month, and that became a year-to-year contraction in May and June. Within U.S. industrial production, manufacturing activity has fallen every month this year, and prices of machinery and materials inputs to manufacturing are falling according to a July 3 *Bloomberg News* report.

In the case of China, trade statistics for the first half of 2023 were reported by the Customs division of the Commerce Ministry on July 12. China's total trade volume for the first half of 2023 was about 2% higher than in 2022, with a slight decline in imports and 3% growth in exports. But in May and June, both imports and exports fell—in dollar terms. Imports, in fact, fell by about 9% from a year earlier, generating headlines. China's consumer price index for the first half of 2023 showed zero inflation from a year earlier.

And between the United States and China, American demand for Chinese goods has dropped and also been blocked by government actions. China's imports in 86 of the U.S. Census Bureau's 98 categories have declined in the first five months of 2023; the drop in the top five categories of imports, from electrical machinery to furniture, is 22% compared to those months in 2022. China's share in total goods imports to the United States was 21.6% in 2017, and is just 13% thus far in 2023, as reported July 12 by *Politico* from Census data.

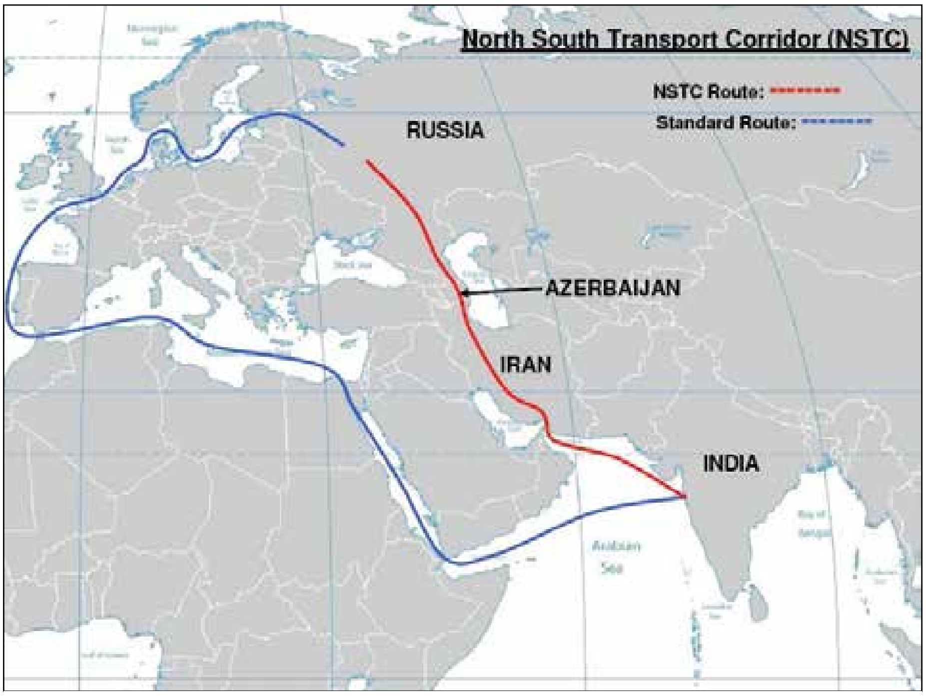
kremlin/ru

Russian President Vladimir Putin, speaking at the plenary session of the Russia-Africa Economic and Humanitarian Forum, St. Petersburg, July 27, 2023, told African leaders he would donate tens of thousands of tons of grain within months, despite Western sanctions.

Between trade with the United States and with Europe, there is no question how deflation is being "imported" into China's economy.

China-India trade, by contrast, rose strongly in 2021 and 2022 and has dropped only very slightly, and only in money terms, in the first half of 2023 (by –0.9% for China exports, –0.6% for China imports); total trade *volume* has risen again, according to a report in *The Hindu* July 14. The trade is very unbalanced, with India running a 2022 trade deficit equivalent to $101.02 billion, a much larger deficit than in 2021.

The Exception: Russia



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The 7,200 km International North-South Transport Corridor (INSTC), a multi-modal network (in red) of ship, rail, and road transportation via India, Iran, Azerbaijan, and Russia, is compared to the standard route (in blue). The INSTC is shorter than the traditional Suez Canal route by 40%, and is expected to reduce freight costs by 30% when fully operational.

The Russian economy, not one of the world's largest by conventional measures but extremely important as a top producer and exporter of food grains, energy, and strategic metals commodities, nuclear power plants and nuclear fuel systems, armaments, scientists, artists—and a maritime and space-faring power—is the exception to this shift to deflation; inflation there is rising throughout 2023. Taking, again, producer prices as a measure: They fell in Russia by 7% from July 2022 to January 2023; but they have risen by 10% since then, as of June.

The Russian economy's return in 2023 to economic growth, industrial and manufacturing growth, rising real wages, and its ongoing substitution of important areas of imports suddenly cut off by global NATO sanctions 18 months ago, when $300 billion of its foreign exchange reserves were also seized, has been extraordinary and completely unexpected by Wall Street, Washington and NATO attackers.

Moreover, were it not for the coordination of Russia, Saudi Arabia and the United Arab Emirates in managing a series of substantial quota reductions and voluntary production cuts by the nations of OPEC-plus, to maintain oil prices, in the face of falling global oil demand and investment and NATO's attempted imposition of "price caps," fossil fuel prices may very well have collapsed during the past two years, leading to more rapid and serious deflation.

A very detailed report on the Russian economy was mobilized based on the July 3–5 seminar of the Center for the Study of Modes of Industrialization, School of Economic Warfare (Paris); and the Institute of Economic Forecasting of the Russian Academy of Sciences. This was a seminar of French, Russian, Armenian and Belarusian economists, held under Chatham House Rules so that participants cannot publicly be identified with their statements; but the cited report, by a well-informed participating economist, is extensive.

With all their positive findings on the Russian economy—including strong growth in consumer and business demand—they report that business investment in *new* plant and equipment is low; labor force productivity growth has been low, and is now negative. They agree the Russian government must take on more debt, and issue more credit; the government must develop new infrastructures, especially to the East and to the South (Central Asia and the Sub-Continent), including housing and health infrastructure—the North-South International Trade Corridor must be developed to meet the Belt and Road Initiative—in Iran.

In doing this, Russia will need credit support from multinational development banks—the New Development Bank of the BRICS, and the Asian Infrastructure Investment Bank.

The economists' positive findings on Russia's economic recovery bring to mind the American economy in the 1860s: Plunged into war, cut off completely from credit markets and import-dependent, the Union government of the U.S. Republic issued its first paper currencies, through the Treasury and a re-created banking system; the "Greenback" currency inflated/devalued by close to 25% during the Civil War, and the Treasury, holding the inflation down, raised business and income taxes and paid between 6% and 9% on the U.S. bonds which funded the war.

Russia's authorities face the same predicaments. The United States, prevailing in the Civil War, developed rapidly thereafter to the world's leading industrial economy.

A major difference, though, is that President Abraham Lincoln's administration also invested strongly in new infrastructure, particularly railroads; built new industries including steel; developed an essentially new higher education branch and linked it directly to crucial technical improvements in American agriculture. While labor force productivity was not formally measured by agencies of the late 19th Century, economic historians like Robert R. Gordon and Anton Chaitkin believe that U.S. productivity grew strongly after the defeat of the "Rebellion," and under the impact of the infrastructures and industries created in Lincoln's time.

Defeating Deflation and Collapse

Fortunately, this is the antidote to the deflationary impulse and its depressionary consequences and austerity economics.

Infrastructure investments using new technologies, and the resulting, rapidly growing labor and factor productivity, overcame the Great Depression for the United States under President Franklin Roosevelt in the 1930s. That decade of the Tennessee Valley Authority and the "Four Corners" great hydropower projects—as well as efforts to export infrastructure capital goods to Latin America—launched what is called "the golden age of American productivity" from the 1930s to the 1970s.

Since threats of a bank crash in the United States and Europe six months ago constricted credit and likely gave a deflationary push to those economies, it's urgent to separate the bank credit channel from the speculations of the big banks, by enacting Glass-Steagall laws in every country. But more important are the interventions to raise the technological level of production, above all through new infrastructure.

This is a great opportunity, and also a great responsibility for the multinational development banks linked to the Global South—particularly the New Development Bank of the BRICS, and the Asian Infrastructure Investment Bank. The World Bank and other "development banks" which have long been under Wall Street and London control, are obsessed with loans and investments which *reduce nations' physical-economic capacities* supposedly to "save the planet."

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For South African President Cyril Ramaphosa and other African leaders, the physical-economic demands of developing nations are clear: power and water management, modern industry, healthcare, and food production, not war.

Therefore the developing nations' multilateral development banks have the initiative to build the physical economy up in technological quality and quantity—and for this reason, they have recently come under both "insider" sabotage attempts and "outside" media attacks led by the *Wall Street Journal* and the London *Economist*.

Read the polemical statements of South African President Cyril Ramaphosa and other African leaders in late June, in an *EIR* feature in the July 14 issue. The physical-economic *demand* from developing nations is clear; it is power and water management; modern healthcare systems against pandemics; river valleys developed as the Tennessee Valley Authority was developed for America; and first and foremost, expansion of fertilizer availability and food production.

The credit for this high-productivity, physical-economic growth depends now on increasing the capital and thus the long-term project lending capacity of the multinational development banks of the "global South"; and the spotlight is above all on the New Development Bank linked to the BRICS nations.