

THE RATE OF TURNOVER, FIRST QUARTER 2017.

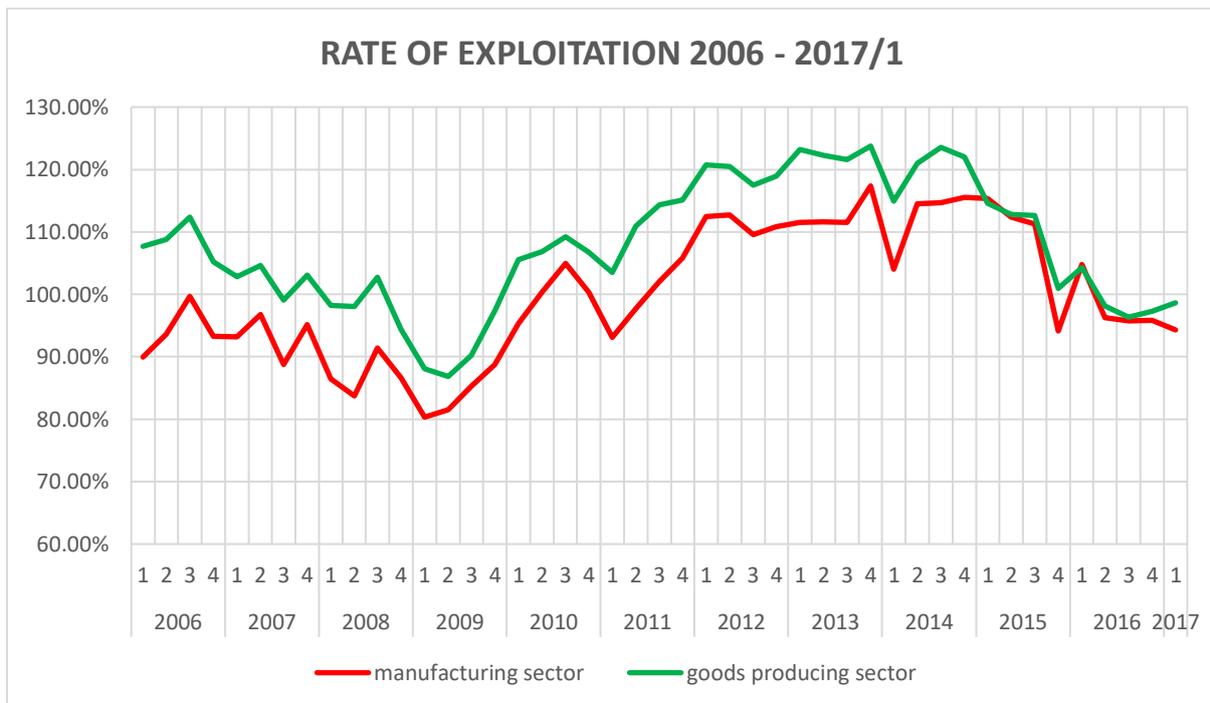
The turnover formula used is: $\frac{G.O. + (G.O. - G.V.A)}{G.V.A. \quad G.V.A.}$

where G.O. is Gross Output and G.V.A. is Gross Value Added. The data for G.O. and G.V.A. can be found on the BEA website under interactive data, GDP-by-industry, in the sections Value Added and Gross Output.

The first quarter of 2017 represented the quarter when the power of the Trump smelling salts was at its strongest. The illusion that the business-friendly Trump would deliver had yet to implode. Industry, believing that the economy would be reflat with lower taxes and an infrastructure boost, raised the tempo of production. While this was not reflected in the GDP figures which ran at a lacklustre 1.2% barely above the figure that merely reflects GDP noise, the industrial indicators were stronger. In part, this was due to an improving world economy which peaked around April.

In the first graph, the increase in labour costs resulted in a diverging (crude) rate of exploitation. As always, the caveat is that the formula used here is based on wages and salaries not the bigger compensation figure which is not yet available. Wages/salaries are then deducted from net value to obtain the undivided surplus. In turn, the rate of exploitation is calculated by dividing this undivided surplus by wages and salaries. As wages and salaries produce a smaller denominator than does compensation, both the (crude) rate of exploitation and surplus value are overstated.

Graph 1.

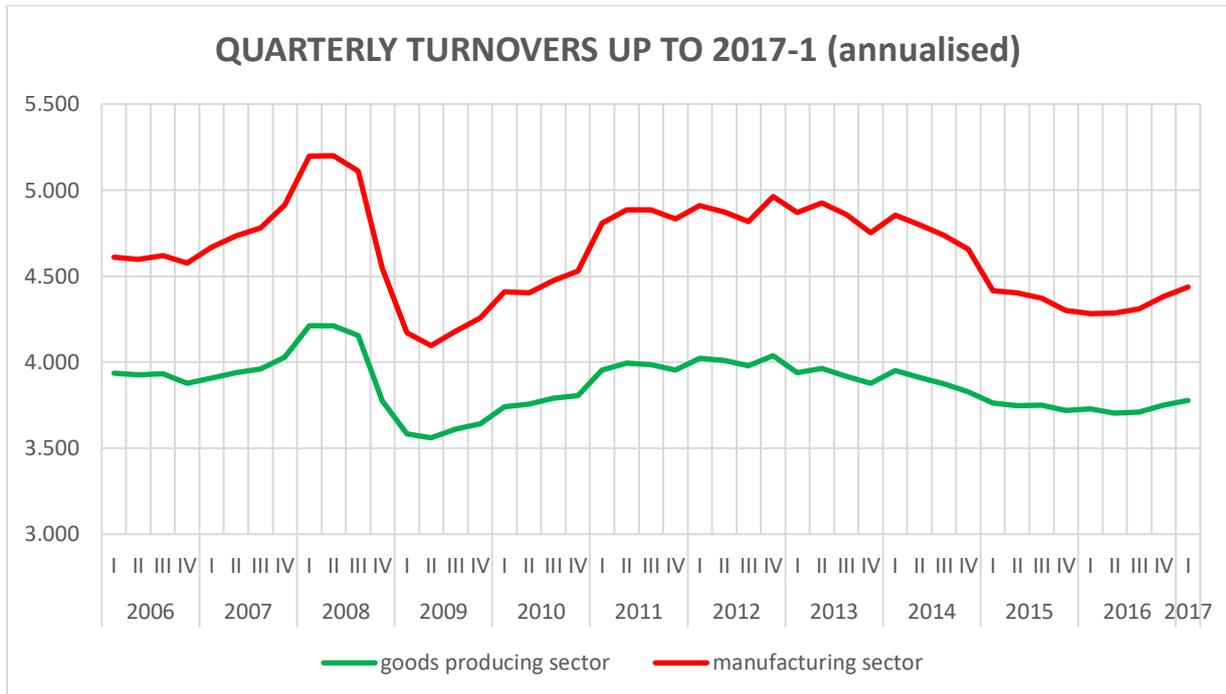


(Sources: BEA Interactive Tables: National Income and Product Accounts Tables 2.2D for wages and salaries and Table 6.1D for national income.)

Unlike previous quarterly reports, the series here is extended back to 2006. The reason is that some of the rates have started to reverse their recent falls, hence extending the series puts this reversal into perspective. We note that while the rate of exploitation has increased in the goods producing sector it has continued to fall in manufacturing.

The same is not true for turnover. As Graph 2 reveals, the rate of turnover has accelerated for three quarters in both sectors due to revisions to the data (see previous report). However, this improvement has made up only 30% of the fall since 2014.

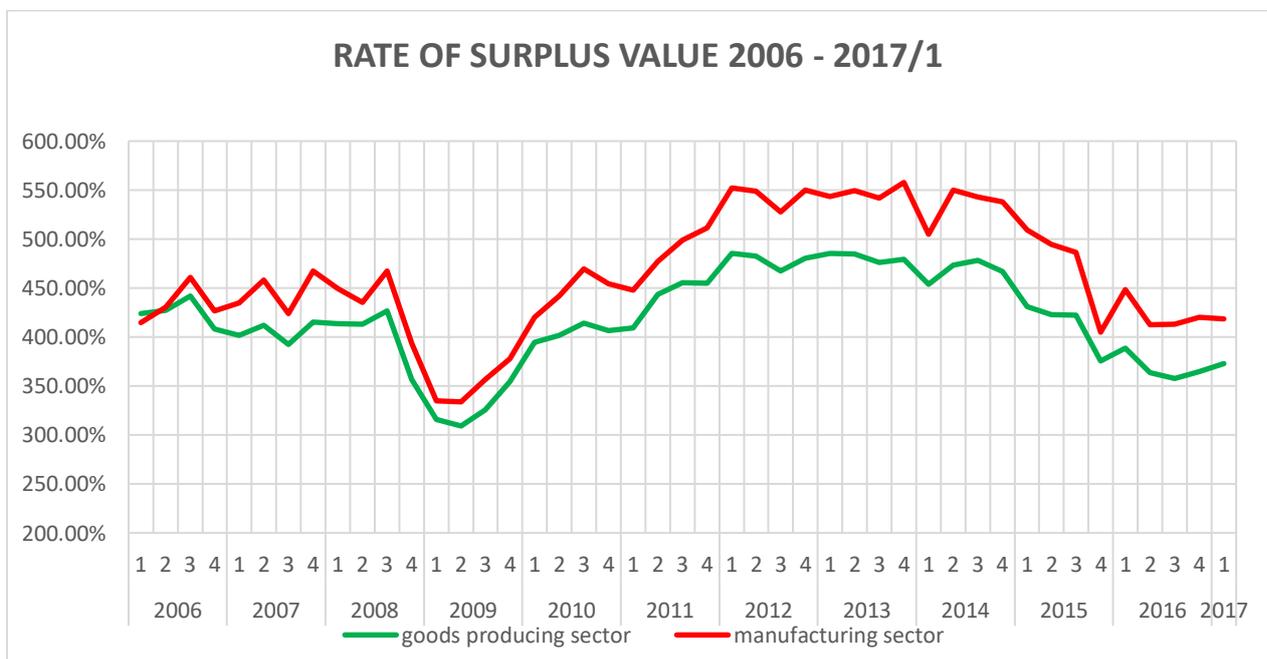
Graph 2.



(Source: BEA Interactive Tables, GDP-by-industry, Value Added and Gross Output tables.)

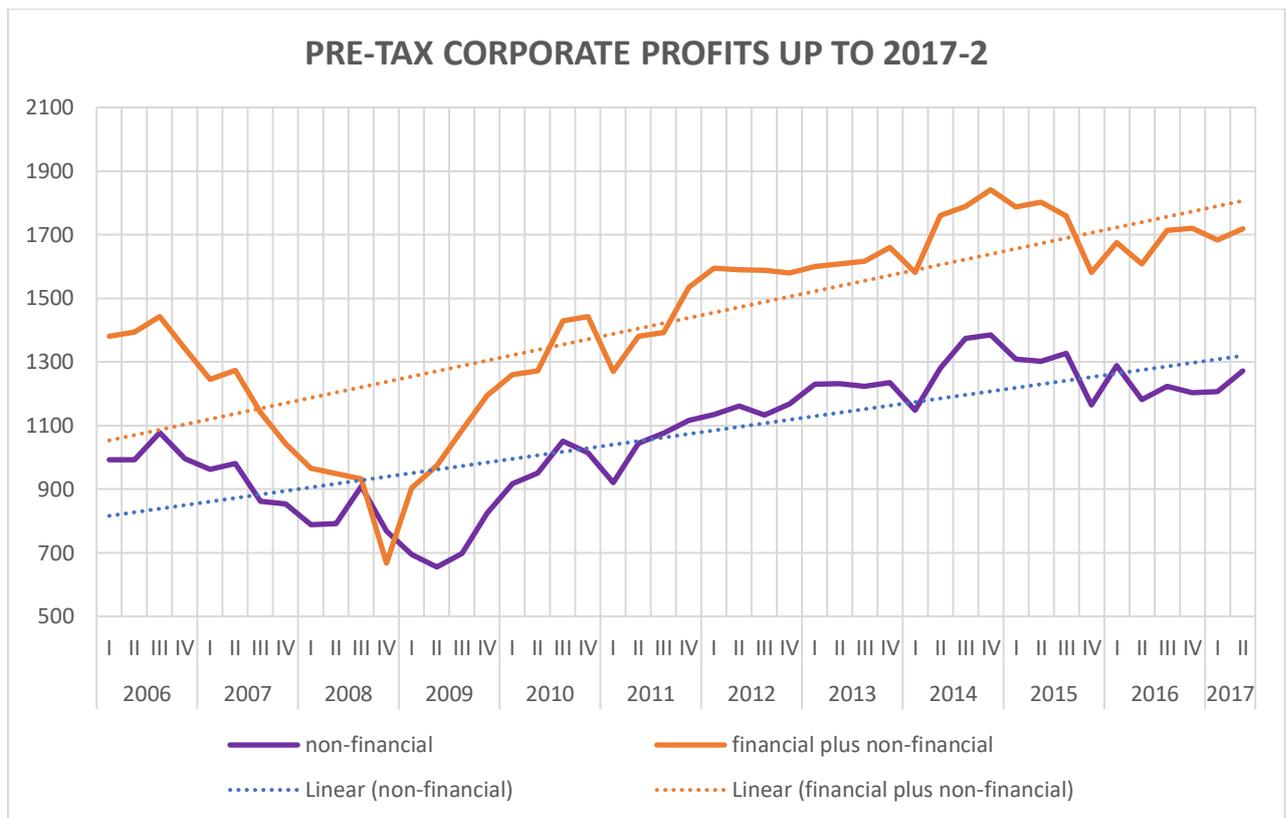
The question is this: has the improvement in the rate of turnover been sufficient to add to or reverse any fall in the rate of exploitation? This interaction is presented in Graph 3 below which is calculated by multiplying the rate of exploitation by the number of annual turnovers measured by quarter.

Graph 3.



In the case of the goods producing sector the acceleration in turnover has added to an increase in exploitation resulting in a marked improvement in the rate of surplus value. In the case of manufacturing, the more rapid acceleration in turnover was sufficient to offset the fall in exploitation yielding a slight improvement in the all-important rate of surplus value. The next step is to determine whether or not it is the rate of exploitation rather than the rate of surplus value that determines enterprise profit. To determine this, graph 4 below examines the movement of corporate pre-tax profits. Graph 5 examines this relationship in much greater detail. The goods producing sector, which includes manufacturing, but is much larger, is a good guide to corporate profits as the companies found in the goods sector provide over half of all non-financial corporate profits.

Graph 4.



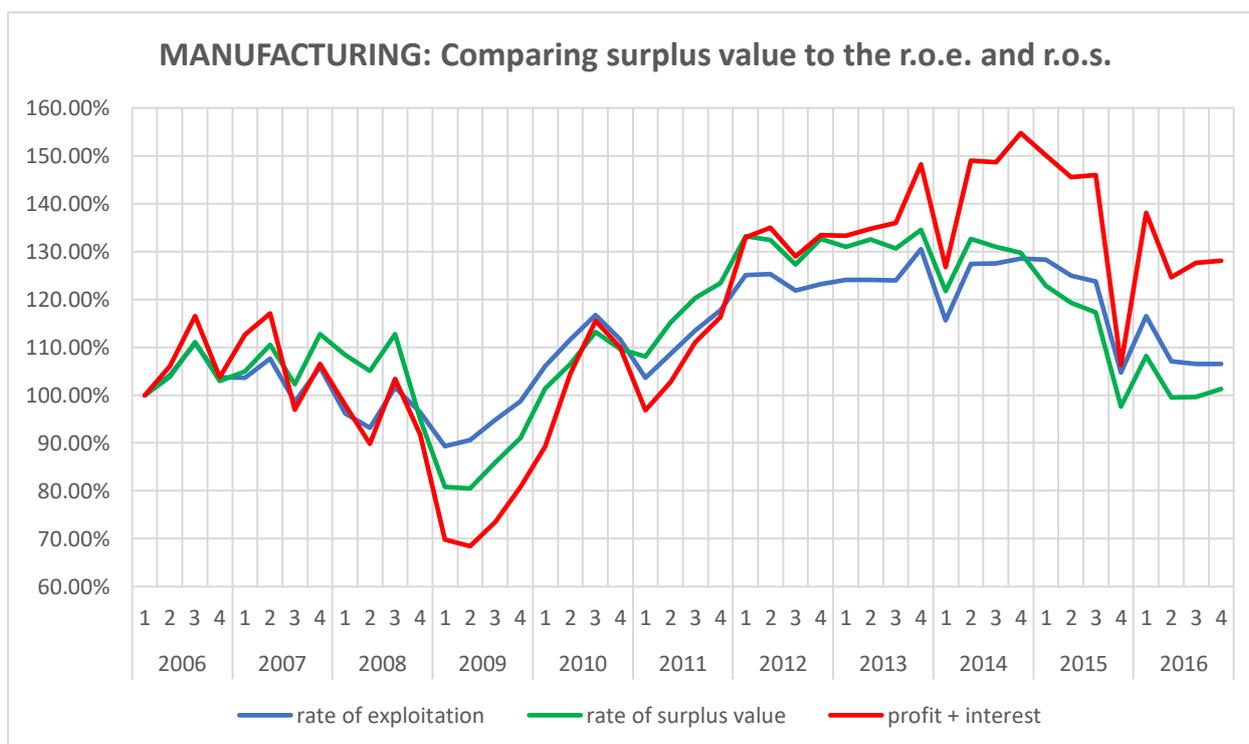
(Source: BEA Interactive Tables: National Income and Product Accounts, Table 1.14)

The trends reveal the curse of financialisation, leverage and the consequent rise in fictitious capital yielding a faster upward trend in financial corporate profit than non-financial. But that is by and by. What is more pertinent, is that the trend in corporate profits more closely mirrors the movement in the rate of surplus value than it does the rate of exploitation.

While the correlation here is difficult to see, Graph 5 brings it out. To ensure direct comparison, only one sector is used – manufacturing. To better approximate the mass of surplus value, net interest paid by manufacturers is added back to their enterprise profits (pre-tax profits). Depending on the phase of the business cycle (and this graph covers two) interest payments differ sharply and this can affect enterprise profits by different magnitudes. By adding back interest payments there is thus a smoothing effect allowing a tighter correlation with the rates of surplus value and exploitation.

A final note, as net interest is available only on an annual basis while profits are available on a quarterly basis, net interest is added quarterly as the average for the year.

Graph 5.



(Sources: BEA Interactive Tables: National Income and Product Accounts, Table 6.16D for profits and 6.15D for net interest.)

To reveal the relative movement between the three graphs, all data has been indexed to 100 in the first quarter of 2006.

The first movements to note are the absolute rises and falls. The fall of profits+interest in 2008 was replicated by the fall in the rate of surplus value, but not by the rate of exploitation which fell by a much smaller amount. The same applied to the rise in profits between 2010-13. There was an eight percent higher movement in the rate of surplus value than exploitation. The same applies to the subsequent rise to the third quarter of 2013.

The absolute movements constitute our first observation. The second is the more complex interaction between the rate of exploitation and that of surplus value. Where the rate of surplus value rises above the rate of exploitation, profits increase significantly and where the rate of surplus value falls below the rate of exploitation, profits fall significantly. In 2009 and 2015 the rates crossed over and profits fell substantially. Conversely, from 2011 when the rate of surplus value crossed back over, profits rose substantially. Furthermore, the sustained downward trend in the rate of surplus value from the second half of 2014, despite a stable rate of exploitation, resulted in a sharp fall in profits after quarter 3 of 2015. In this sense the movement in the rate of surplus value is a forward looking indicator because any sustained fall in the rate of surplus value, after a short lag will result in a fall in profitability.

Currently, the rate of surplus value stands below that of exploitation. The gap is closing but it will take another three quarters for the rate of surplus value to overtake that of exploitation, should these trends continue. Until it does there will be no impetus to profits and the growth in profits will not exceed the 2014 peak. Comparing non-financial corporate profits at \$1239.6 million for the first six months this year against the first six months of 2016 at \$1226.5 million, the improvement in profits is only 1%, or when measured against inflation, a fall of nearly 1% in real terms. Were it not for the boost to profits in mining by the recovery in oil and gas prices, even this marginal nominal improvement

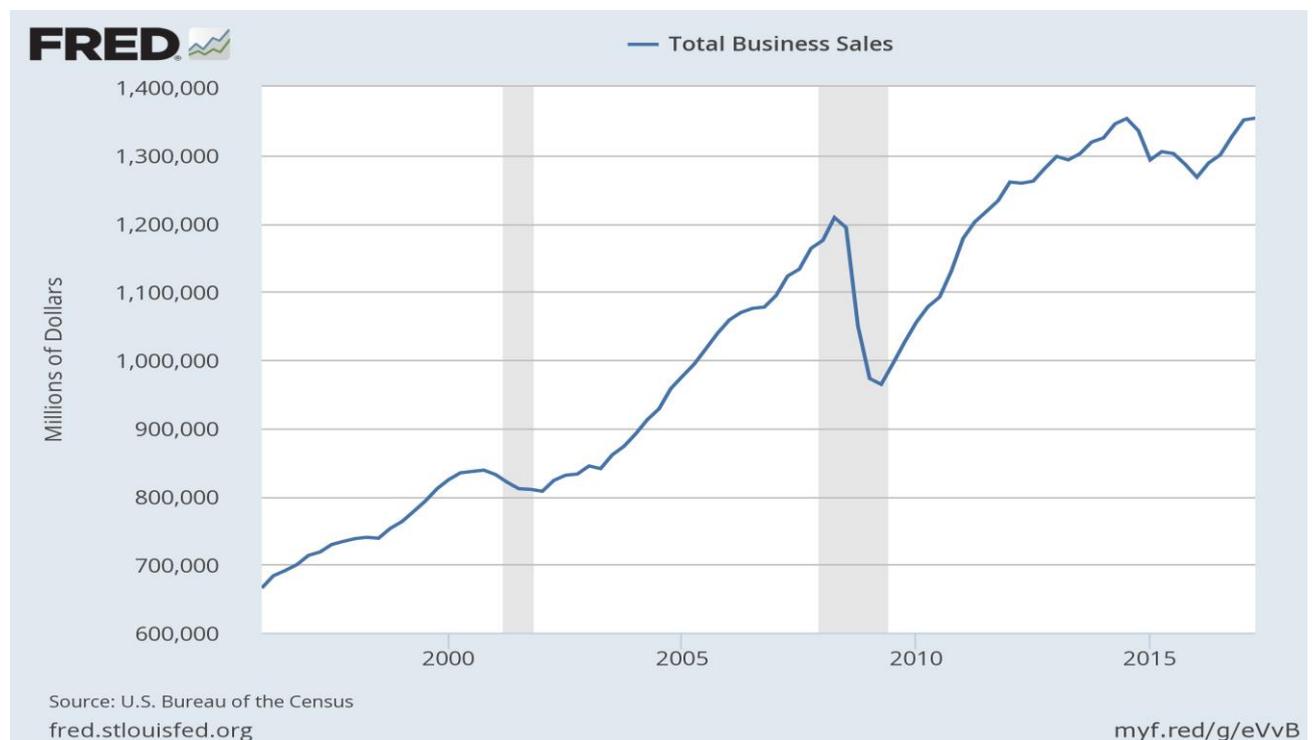
would not have occurred. (To make the comparison between these periods more accurate, a six-month period was chosen as this was needed to even out the gyrations in the dollar in 2017 and therefore its influence on profits.)

The business cycle.

The best underlying indicator for the business cycle is the Table “Total Business Sales”. It is the sum of all the sales for manufacturing, wholesale and retail. (The wholesale sector is important to tally imports and their effect on total sales.) Together these three sectors are responsible for over 50% of gross output in the economy. That is to say, they are responsible for over 50% of all the actual exchanges that take place in the economy.

The business cycle is presented in Graph 6 below. The vertical shaded areas represent periods of recession. However, one is omitted. That is the period made up of q4 2015 and q1 2016. The reason is that GDP growth did not contract at this time though it has now been revised down to just 0.4%, which is well inside what is called “GDP noise” made up of imputations, duplications and an expanding government deficit.

Graph 6. (Quarterly values)



(Based on quarterly values up to q2 2017.)

However, the above graph is less ambiguous. In 2001 from peak to trough total sales in nominal values fell 3.9%, in 2009 they fell by 20.2% and in 2015 they fell by 6.8%. While total sales did not fall by as much as 2009 the fall was much higher than after the dotcom crash. After 2001 and 2009, it took three years for total sales to eclipse their previous high in each case. Currently sales have increased for 33 months, but have yet to eclipse their 2014 peak, and more significantly the trend is flattening.

If, however, total sales sit on the plateau formed by the last 6 months, it brings into question whether or not this will be a full recovery and whether or not the economy passes from the period of “growing animation” to “prosperity” (Marx’s six phases of the business cycle). It is argued that the US economy

remains within the confines of animation. Other measures support this assumption. Turnovers are well below their 2014 level, resulting inter-alia, in profits standing 13% below their 2014 peak in the second quarter of 2017 (adjusted for inflation). Investment, profit's child, is stagnating. Total private gross fixed investment excluding Intellectual Property was \$1,561 billion in 2014, \$1,590 billion in 2015 and only \$1,542 billion in 2016. It recovered to an average of \$1,625 billion in the first half of 2017 equal in real terms to both 2014 and 2015 (Table 1.1.5.).

Additionally, the CASS Freight Index for July shows the sharpest May to July fall in the volume of deliveries since 2014 leaving the Index less than 1.5% above last year - despite the growth in internet related sales. Auto sales which comprise at least 20% of retail sales, in volume terms were down 2.9% in July and 4.2% in August. House sales of new and existing properties have weakened significantly. July sales of new homes has fallen below the level of July 2016, while existing home sales have fallen to their lowest level this year. Non-residential construction is down 5% year on year.

Other than the health sector whose financialisation is sucking the life out of consumers and the economy nothing else is expanding. The 3% second quarter GDP growth owed more to the GDP deflator than to the rise in nominal growth. The biggest factor contributing to the prosperity phase in the US economy since 1996, globalisation in general and particularly its monopolisation of the commanding heights of the international value chain, is fading because of the ascent of China. In this light, the skyrocketing of Apple's share price looks particularly ill-judged as sales are falling in China. This fall contributed to the reduction in its operating income over the last nine months compared to the prior nine months (*CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS* Unaudited.)

It is not only Apple that is flying on fumes, so too its fellow FAANG corporations, particularly Google and Amazon. These two giant corporations are thriving on their monopolisation of internet advertising. However, this fad has little endurance. Not only do users not pay attention to the adverts, they resent their intrusion and having to trip over them every time they log on or switch on their phones. When advertisers finally twig that they are throwing good money into cyberspace there will be a reckoning, and it is likely that these tech giants which have senselessly driven up the market will also be the catalyst for its fall.

The final factor that needs to be taken into consideration is whether the issuance of credit is consistent with the tail end of the credit cycle. There was a marked slow-down in the growth of consumer credit to 4.5% in the second quarter down from 7.1% in 2015 and 6.5% in 2016 (FED Table G.19). In contrast total bank credit increased in the second quarter to 3.5% from a desultory 1.3% in the second quarter. The FED considers the risk environment to be benign as it has not registered any significant increase in bad debts. All the FRED graphs on delinquencies are consistent with the period of growing though tepid animation and not with overproduction and credit stress (end of the credit cycle phenomena).

The environment is more nuanced when examining forward looking indicators. The New York FED's Quarterly Report on Household Debt and Credit released in August and covering the second quarter shows that delinquencies measured at the 60 day and 90 day level have stopped falling and are beginning to rise. (page 11) The point at which they stopped falling is well short of the levels found in 2004/5, the phase of prosperity. Instead they have fallen back only to the levels found in mid-2007 when the USA was one year away from imploding and when forced lending (more risky lending) was keeping the financial bubble inflated.

Particularly worrying are student loans, car loans and credit cards. Total Household debt has now exceeded its previous peak in 2008 not because the share of mortgages has risen, but because less secured debt has risen, particularly car loans and student loans, which now comprise 20% of the total

or \$2.6 trillion. The car and student loan sector is now one third the size of the residential mortgage market.

However anecdotally, nervousness is increasing. While bankers are soothing the market with reports of low delinquencies, ample provisions and reserves, the Financial Times reported that “executives and board members have dumped a net 9.32 million shares since January”. (*Wells Fargo’s woes come at a troubling time for banks*. 02//09/2017) The desperation with which Chryslers’ CEO is trying to flog the company, ‘if only the Chinese were allowed to buy it’ is testimony to the stresses in the sub-prime auto market to which Chrysler is the most exposed. It is also likely that Hurricane Harvey will have forced many junk bonds in the fracking industry underwater. Total losses are currently estimated at \$180 billion and the hurricane season still has three months to run.

To use FED jargon, it is likely that on balance the negatives outweigh the positives. Political barriers thrown up by the first leg of globalisation are blocking the second leg, the emergence of the single markets necessary to stimulate investment. Once again history repeats itself, as the rising and more competitive economy, China, champions free trade, while the declining and less competitive economy, the USA, resists it. The difficulty Britain is experiencing disentangling itself from the EU, equivalent to reversing out of a single market, graphically demonstrates the extent and depth of national peculiarities in what is essentially a globalised economy. And it is these peculiarities that act as a barrier to the global corporations needing to resolve the impediments to renewed investment.

The main positive for the USA is the state of the world economy and the weakening dollar. But even here questions hang over the world economy. Commodity prices are an important indicator of the tempo of the economy as they tend to rise when demand starts outstripping supply. Commodity prices may have reversed some of their fall since March, but the recovery in the prices of commodities may simply be a put on the 19th CCP Congress which is opening on 18th October in Beijing. Traders recognised that the smooth running of the CCP Congress requires the smooth running of the economy prior to the Congress and that this would be supportive of commodity prices.

The proof of this speculative put lies in the divergence between the price of oil compared to hard commodities (copper, iron ore, zinc, aluminium). While China’s consumption of hard commodities is over 40% of the global total, it only consumes 13% of global oil output. (2015 - US Energy Information Service). In 2015 the daily value of the 96.74 million barrels of oil produced was 20 times the value of the 52,300 tons of copper produced. Put another way, oil and related products comprised 12.7% of world merchandise exports while all the ores and metals exports only 4.4%. (World Bank 2015 Trade Data) Whereas hard prices have recovered, oil prices remain soft despite the OPEC cuts. It may be the case that it is the weak oil price rather than the price of copper that reflects the state of the world economy.

The strength of the world economy is supported on three legs not four. Quantitative Easing in Japan, Quantitative Easing in Europe and infrastructural spending in China. The fourth, international fixed asset investment, though improving, has not reached the levels last seen in 2008. Although there have been recent improvements of 20% in the amount being invested in the EU and Japan, this is being cancelled out by the relative fall in investment in China. China’s growth rate of 25% as late as 2010, fell to 7% at the beginning of this year with a further fall of 1% since April. Growing investment in Japan and the EU has been a function of the rise in profits, but this rise in profits is contingent on currency wars, on the depreciation of the Yen and Euro against the dollar, which has now reversed.

In sum, the high point of the year remains April, when measured by the rate of growth in world production and world trade. As the confounding factor of the Congress falls away, the underlying trajectory of the world economy will soon become clearer.