

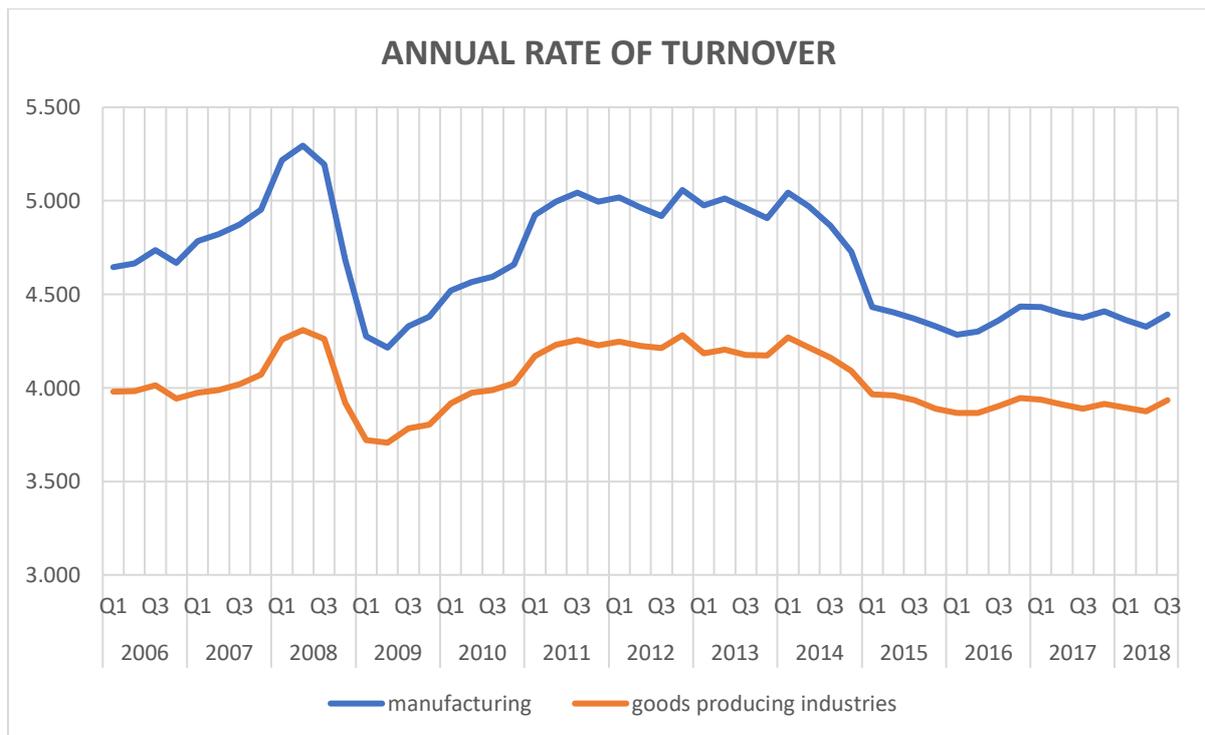
## THIRD QUARTER REVIEW OF THE US ECONOMY. THE PINNACLE OF THE TRUMP BUMP.

This is the review of the US economy, published every quarter immediately after the release by the BEA of its most recent GDP-by-industry tables (21<sup>st</sup> February). The publication of the Gross Output figures as well as the Gross Value Added figures for the third quarter of 2018 enables the calculation of the rate of turnover. This data is translated into Graph 1 and is based on the formula:

$$GO/GVA + (GO - GVA)/GVA$$

where GO stands for Gross Output and GVA stands for Gross Value Added.

**Graph 1.**

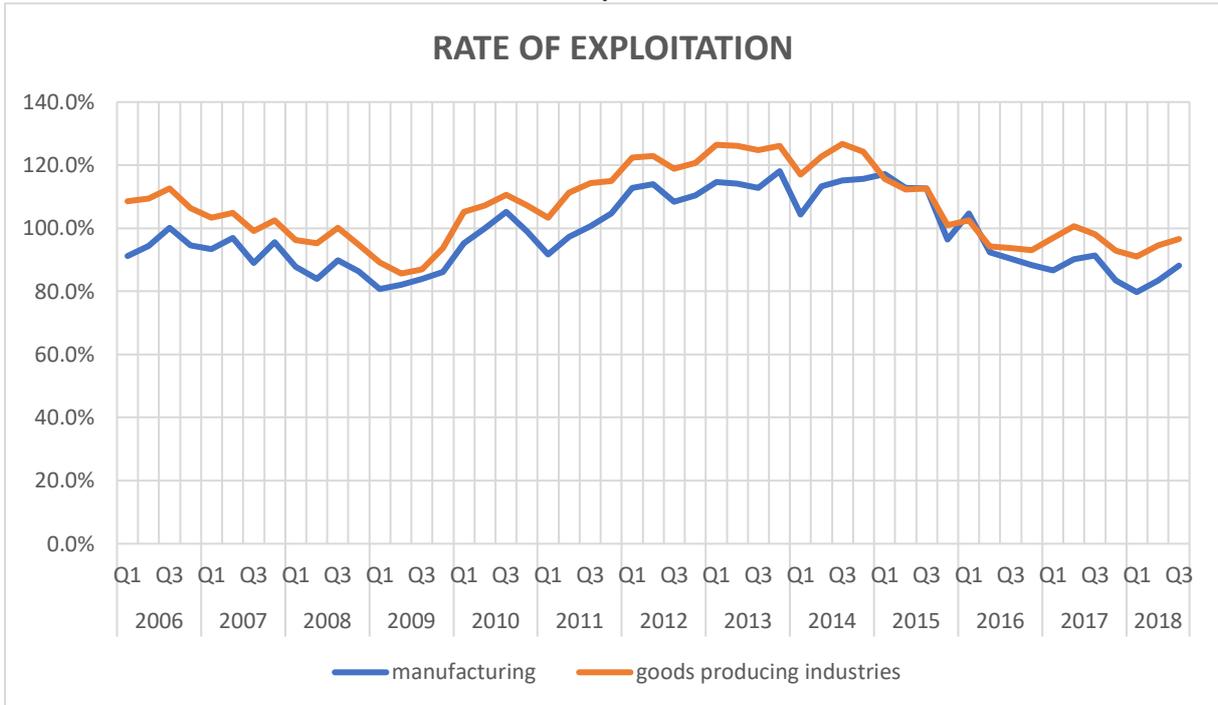


(Source: attached "Spreadsheet turnover Q3 2018")

The rate of turnover reverses the dip in the second quarter. However, this only lifts turnover by 2% compared to its lowest point post-2008 (goods producing) and by 3% for manufacturing. However, this is still 15% below the peak in 2014 which equal to the addition of 11 days to every individual period of turnover (manufacturing). Clearly this deceleration in turnover, meaning more days are needed to realise profits, has a deleterious effect on the rate of surplus value and through it on the production of profits.

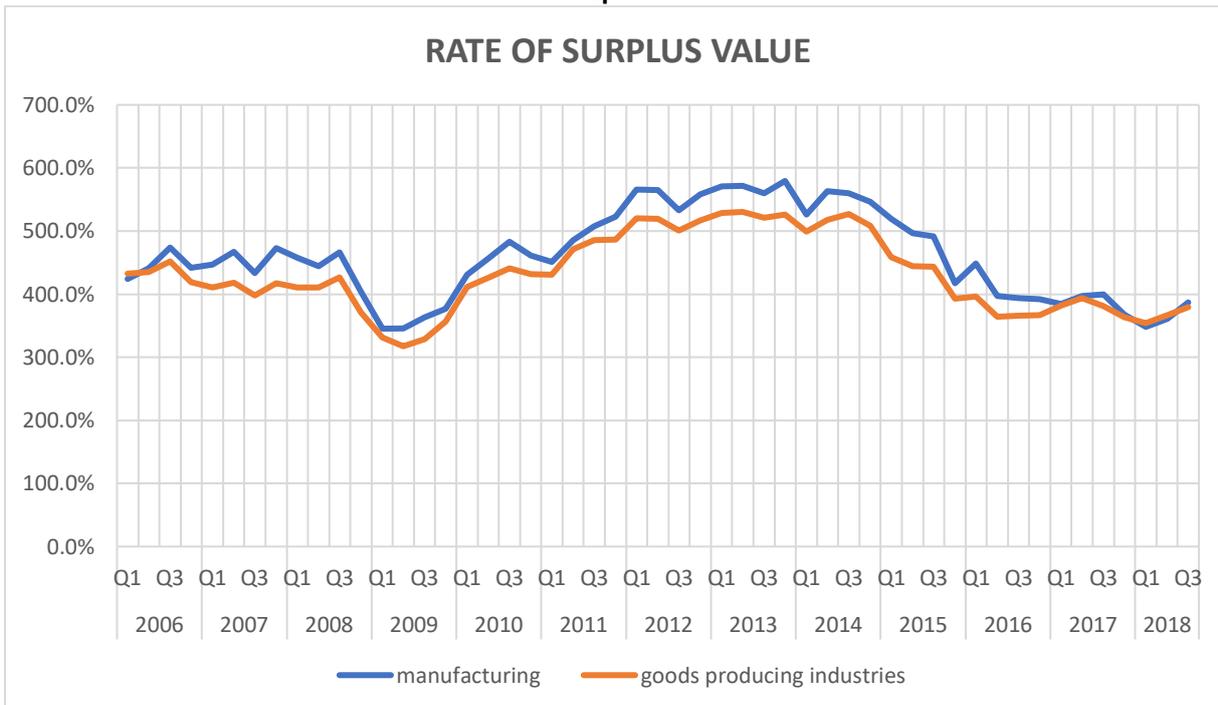
In determining the rate of surplus value, both the rate of turnover and the rate of exploitation needs to be estimated. The calculation of the rate of exploitation found on the attached worksheet is simply the annual surplus divided by annual wages and salaries. This surplus is obtained by subtracting wages and salaries from net value added (national income). Wages and salaries mustn't be confused with annual compensation which includes benefits paid by employers making it a larger figure. When this larger figure is deducted from net value added, it diminishes the surplus thus yielding a lower rate of exploitation. (Unfortunately, compensation figures for Q3 2018 have not yet been released.)

**Graph 2.**



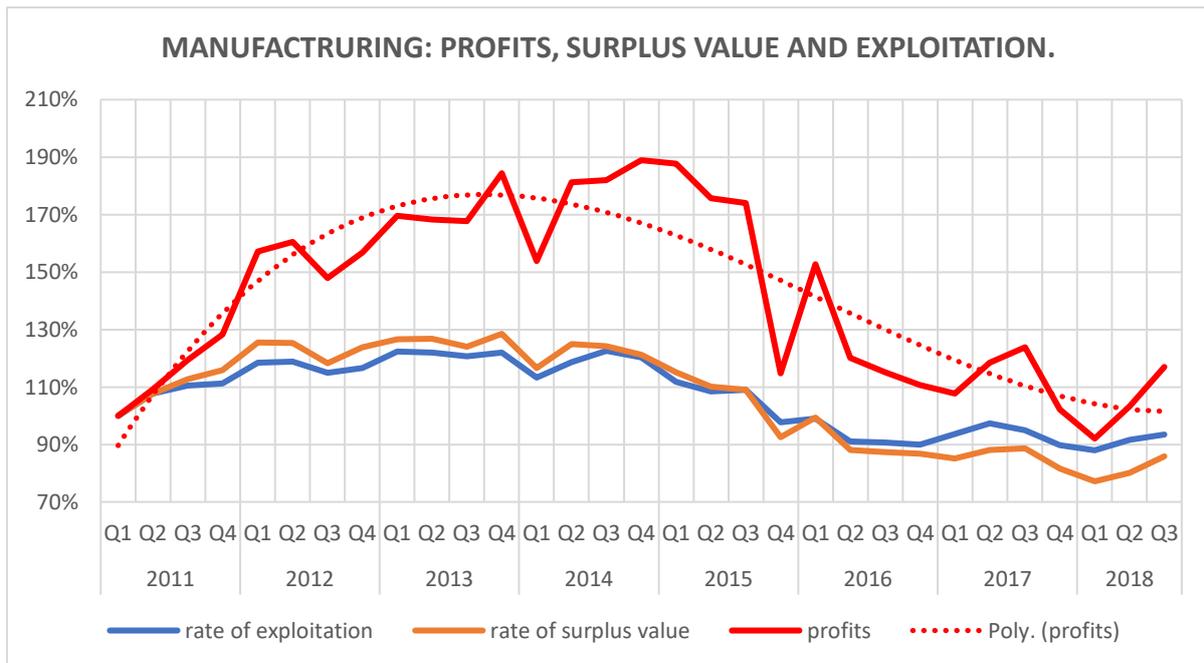
As with the rate of turnover, the third quarter witnessed a concurrent reversal of the recent fall in the rate of exploitation. Both these reversals ensured an improvement in the rate of surplus value which rose by 7% because turnover acts as a multiplier of the rate of exploitation. Notwithstanding this improvement, the rate of surplus value is still down 35% compared to 2014.

**Graph 3.**



The rate of surplus value had a direct bearing on the mass of profits, and its fall has taken its toll on the mass of manufacturing profits (Graph 4 below). Graph 4 is based on indexed numbers in order to track the relative movement of profits, the rate of surplus value and the rate of exploitation.

Graph 4.



There has been a 27% improvement in profits this year driven by the 7% improvement in the rate of surplus value and revenue growth of 5.5%. However, despite this 27% improvement profits are still down 38% since 2014 (before adjusting for inflation).

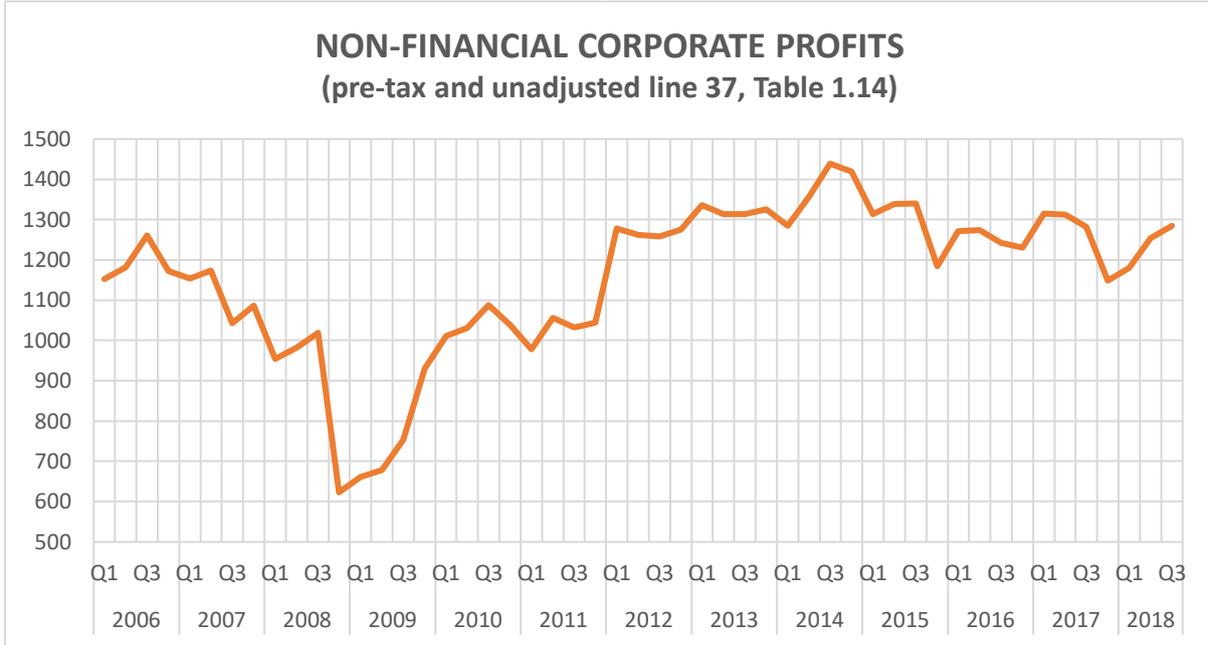
The real importance of the above graph is the interrelation between profits and the rate of surplus value compared to exploitation. As profits rise up to 2014 the rate of surplus value rises faster to stand above the rate of exploitation. This is a function of accelerating turnover. When profits start falling the opposite is the case; the rate of surplus value falls faster than does the rate of exploitation because turnover is now decelerating. The rate of surplus value falls below the rate of exploitation in the second half of 2015 and remains below the rate of exploitation up to the present quarter.

I have shown this effect in previous graphs. The following law applies: a rising mass of profits is associated with a rate of surplus value increasing faster than the rate of exploitation due to the effect of turnover, and a falling mass of profits is associated with the rate of surplus value falling faster than the rate of exploitation. The three peaklets in profit post-2014, Q1 2016, Q3 2017 and Q3 2018, are all associated with a more rapid rise in the rate of surplus value and therefore a narrowing in the gap between the two.

Currently the rate of surplus value has risen faster than the rate of exploitation. This has halved the gap this year. Had the trend continued into quarter 4 and quarter 1 of 2019, which it won't, the gap could have been eliminated and the mass of profits could have risen to 2016 levels. Unfortunately for investors, the trend will have reversed by the fourth quarter. It is already clear that the third quarter of 2018 was as good as it got for the Tramp Bump.

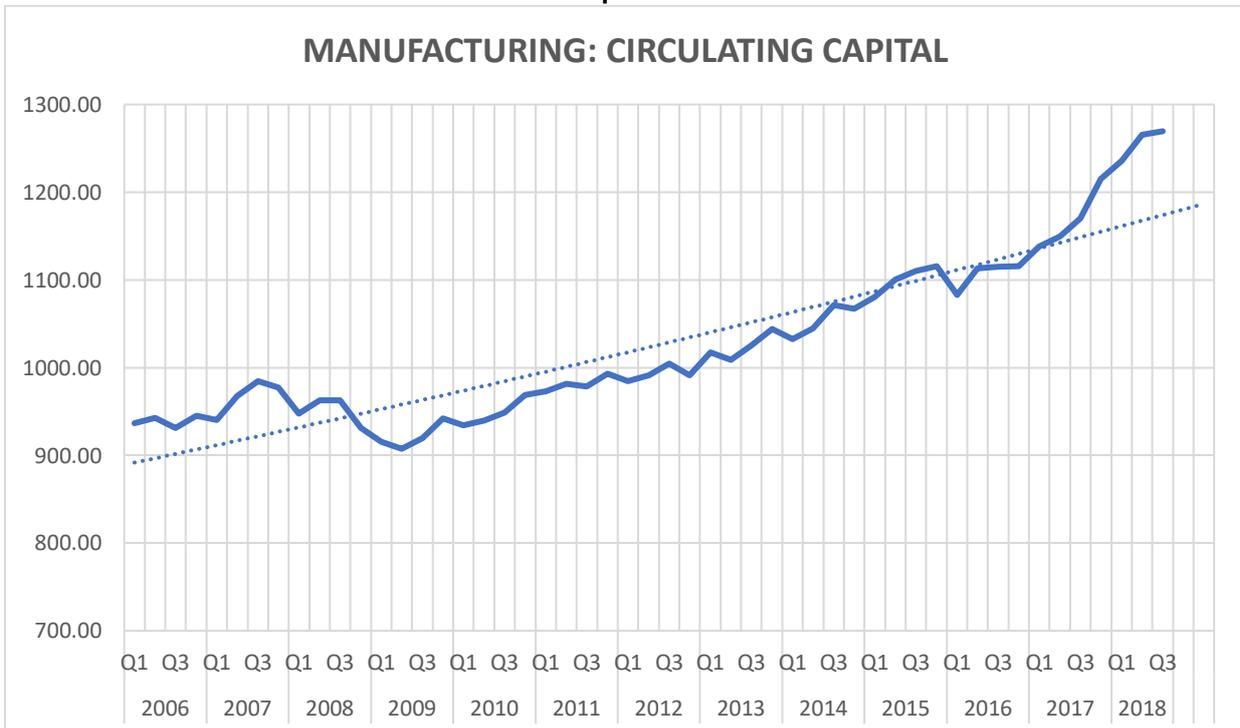
A similar trend, though less volatile is found for the larger non-financial corporate sector in Graph 5 below. Here the fall in the mass of profits since 2014 is more muted at 11%. When taking the corporate sector as a whole, there are industries represented which do not share the same level of international competition as found in manufacturing. There are also more fictitious profits present than is found in manufacturing. (Pre-tax unadjusted corporate profits are 3 times larger than manufacturing when excluding manufacturing profits from the total.)

Graph 5.



I have also decided to include a graph plotting changes to working or circulating capital for manufacturing. The effect of the fall in the rate of turnover is responsible for the rise in circulating capital above trend over the last three years. This clearly shows the two-sided effect turnover has on the rate of profit, firstly by delaying the realisation of profits, and secondly, raising the amount of capital. In the case of profits, a slower turnover, everything else held equal results in a fall in the mass of annual realised profits. (Thus, Marxists who fail to include circulating capital and obsess only with fixed capital, are only able to gain a partial insight into the rate of profit and its movement.)

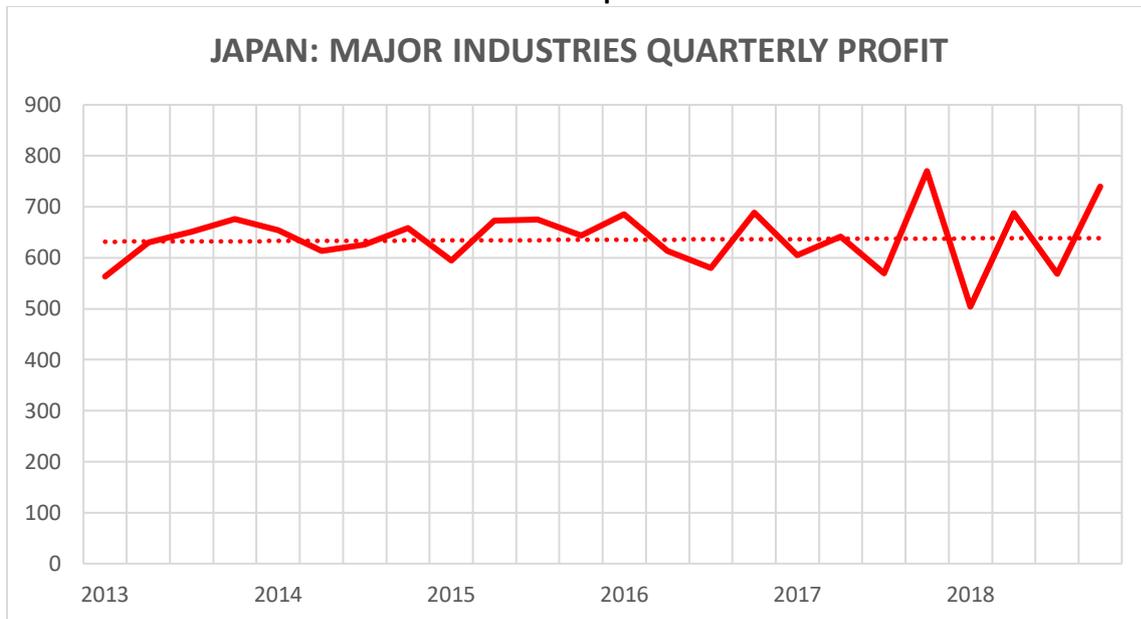
Graph 6.



**Conclusion.**

The squeeze on profits is found in other major economies as well. In a previous posting on China, I reported that profits there were contracting at a 2% annual rate. The same applies to Japan. Recently released figures show that Japan’s annual contraction to be 4% in the fourth quarter.

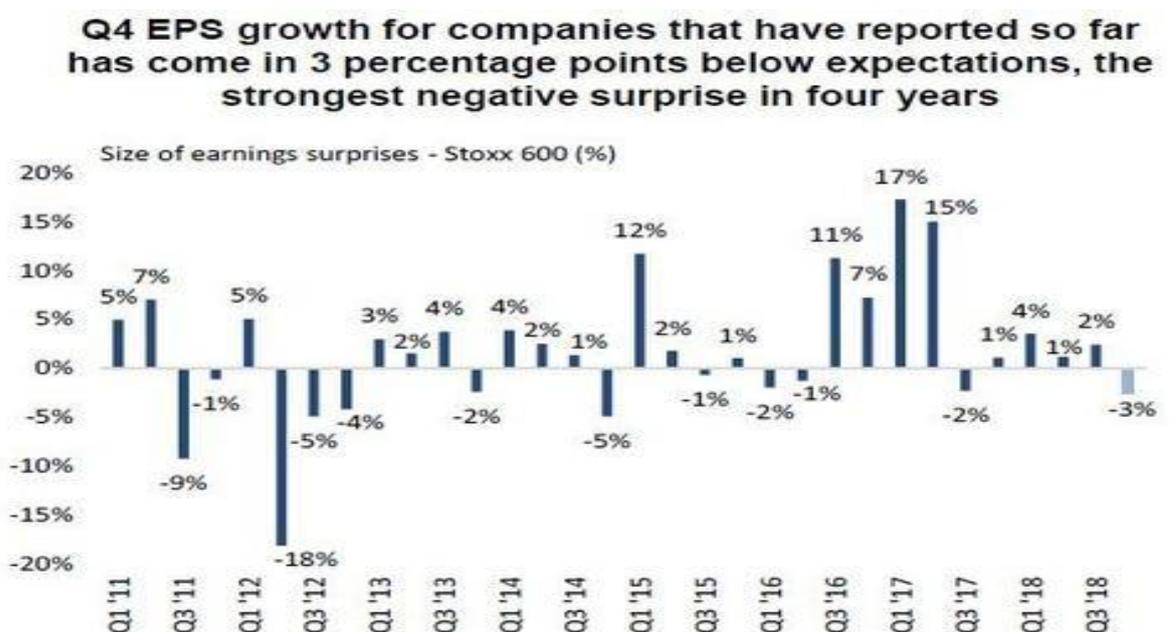
**Graph 7.**



(Source: Statistics Japan, Operational series release date 22 February 2019. <https://www.e-stat.go.jp/en/stat-search/files?page=1&layout=datalist&toukei=00200541&tstat=000000210001&cycle=2&year=20180&month=24101200&tclass1=000000210001>)

The same contraction is found in Germany. Here provisional profits fell by 1% in 2018 (Source: [https://www.destatis.de/EN/FactsFigures/NationalEconomyEnvironment/NationalAccounts/DomesticProduct/Tables/DisposableIncomeSavingNetLending\\_NetBorrowingTotalEconomy.html](https://www.destatis.de/EN/FactsFigures/NationalEconomyEnvironment/NationalAccounts/DomesticProduct/Tables/DisposableIncomeSavingNetLending_NetBorrowingTotalEconomy.html))

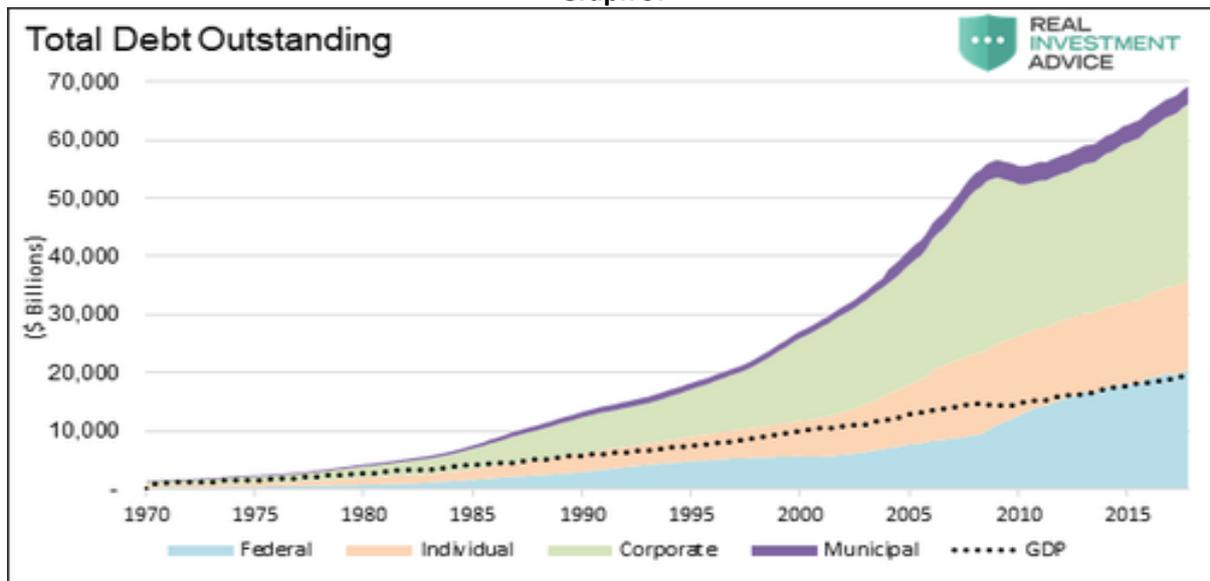
**Graph 8.**



(Source: Deutsche Bank)

Of course, this worldwide compression of profits has to be set against the rise in debt. This interesting graph plots total US debt as well as its composition. What is notable is the growth in corporate debt.

Graph 9.



(Source: *St. Louis Federal Reserve and Bloomberg*)

Finally, I have been emphasising how inequality interacts with asset bubbles and consumer spending. With inequality levels the same as 1929, the top 10% of earners spend as much as the bottom 80%. The top earners spending habits are highly correlated to asset bubbles particularly the share market. The plunge in share prices in the last quarter had an immediate and dramatic effect on retail sales.

Graph 10.



The same applies to the fall in wholesale sales. They too were down 1% month on month, but more importantly, compared to December 2017, they were only up 1% or well below the rate of inflation. In both retail and wholesale, inventory ratios rose as inventories built, which is why it is highly likely that the rate of turnover fell in the fourth quarter of 2018 because inventory ratios are influential. <https://www.census.gov/wholesale/pdf/mwts/currentwhl.pdf>

In addition, the fall in consumption has impacted production with the Chicago Fed's National Activity Index falling in December. Mirroring this, the Cass Freight Index in December fell below the level obtained in December 2017 despite being nearly 10% higher in mid-year. However, the hard data has not impacted share prices. Stock markets are intoxicated by the negotiations between China and the USA. They are ignorant of the fact that whatever deal is struck, conditions will not be reset to what they were, but will in global terms, be less beneficial to the world economy.

The re-floating of the world economy since 2008 through quantitative easing by all the major central banks has been one giant Ponzi scheme. If we are to identify Ponzi schemes as those schemes which endure only as long as more money is pumped into them, then certainly central banks have fed this phenomenon. By inflating asset bubbles, and therefore making investors feel richer, it has boosted spending by the top 10% at the expense of the bottom 80%.

This has made the economy highly dependent on asset bubbles which explains the Federal Reserve sudden U-turn on interest rates and monetary accommodation. Clearly the wise members of the FED underestimated the effect tightening would have on the real economy through its effect on share prices. What the final graph above shows is that what goes up can come down. Deflating asset bubbles by curtailing consumer spending, in an environment of weak investment, threatens to upend the economy in what I call the phase 2 effect.

The initial estimate for 4<sup>th</sup> quarter US GDP will be released on the 28<sup>th</sup> February and initial profit data only on March 28<sup>th</sup>, due to the delays caused by the government shut down around the turn of the year. It is likely that with wholesale sales now accounted for, GDP will trend closer to 1% than to 2% when it is released later this week. Only after these releases will it be possible to gain a detailed insight into the US economy for the whole of 2018 and appreciate the rapid slowdown that occurred in the final quarter of 2018, a slowdown which lagged the global slowdown by one quarter.

Brian Green, February 2019.

# Chicago Fed National Act Index (CFNAI)

