FROM GRANDSTANDING TO "PRESENTING ARMS".

In April the BEA released Gross Output and Gross Value-Added data for both the whole of 2018 which included the final quarter of 2018. This has provided the data needed to prepare both the quarterly and annual rate of turnover. Assessing the strength of the US economy at a time the tariff war is boiling over and when both China and the USA are grandstanding, is prescient.

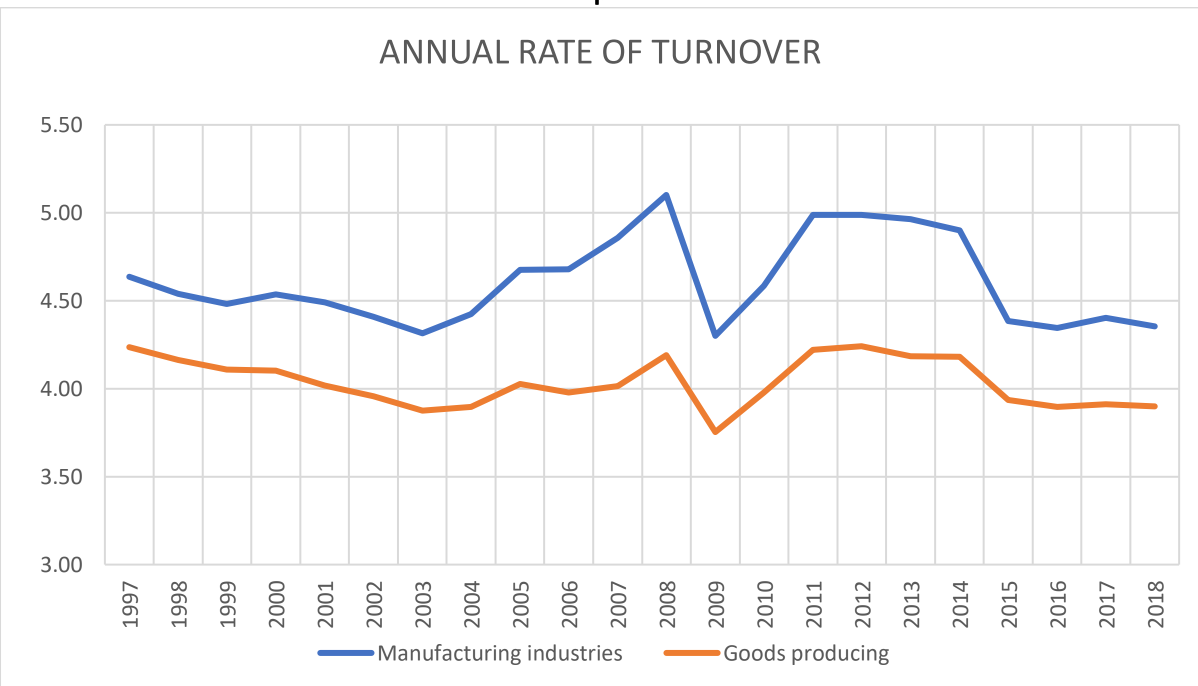
In nature as much as society, adversaries fluff their wings or flex their muscles when facing off. The same is true of Trump and Xi. Both plumped up their GDP figures to show that the the trade war left their economies unscathed. Of course, if one side does not back down then the plumping of feathers gives way to fangs and beaks. This week the trade war negotiations have boiled over and it is clear that the Chinese have not backed down. It is also clear that the US has been negotiating in bad faith by flying their warplanes and sailing their warships into disputed areas around China.

The US GDP figure for the first quarter of 2019 at 3.2% is onjectionable. It was driven by grandstanding, the fluffing of feathers, an attempt to show that the ship was not only afloat but gathering speed. GDP was primarily distorted by seasonal adjustments, namely the use of a GDP deflator belonging to the final quarter of 2018 and not to the first quarter of 2019. This alone inflated US GDP by around 1%. Add in the fillip given by the increase in house prices, the soaring budget deficit and the build in inventories and real growth was much weaker. This is confirmed by looking at final sales. This data is found in Table 1.17.6 line 11 "final sales to private customers" where the real increase is 2.8%. When adjusting for the deflator it is around 1.8% which is more or less where real growth is, because now the distortions resulting from a growing budget deficit and a build in inventories is absent. https://apps.bea.gov/iTable/iTable.cfm?reqid=19&step=2#reqid=19&step=2&isuri=1&1921=survey

The rate of turnover.

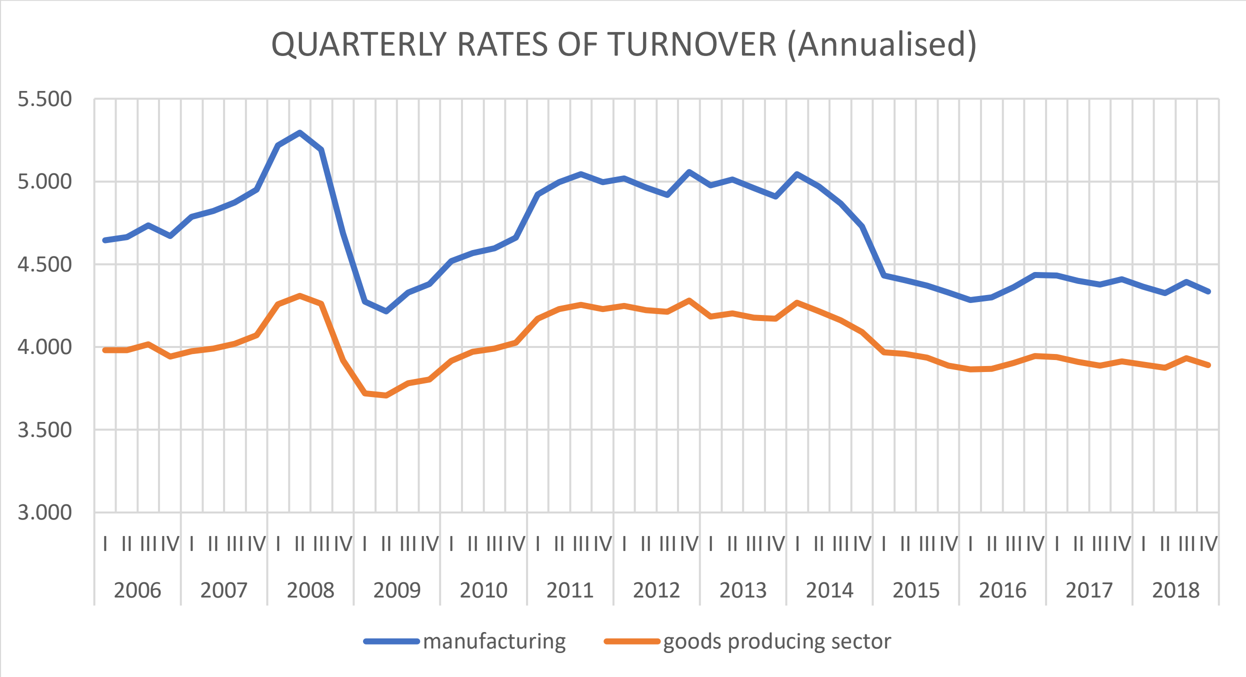
The rate of turnover is presented on an annual basis as well as a quarterly basis in Graph 1 (annual rate) and Graph 2 (quarterly rate) which is more contemporary.

Graph 1.



(Sources: See accompanying spreadsheets.)

Graph 2.



In Graph 1, the annual rate of turnover in manufacturing fell in 2018 compared to 2017. It has fallen from 4.9 in 2014 to 4.35 in 2018 or when measured as a period, increased from 74.5 days in 2014 to 84.0 days currently. Thus, the average period is nearly ten days longer than the period found between 2011 and 2014. This has had a profound impact on the profitability of US capital.

When turning to Graph 2, and the quarterly rate annualised, we note the mini-peak in the third quarter of 2018. In every way the most profitable quarter for the US economy and the Trump tax bump was the third quarter since when profitability has subsided. The same trends appear when examining the larger goods producing sector which includes the manufacturing industries. It too shows a mini-peak in the third quarter.

The goods producing sector is important because it provides more than half the revenue and profits found in the S&P 500. This will be discussed in greater detail under the section on profits.

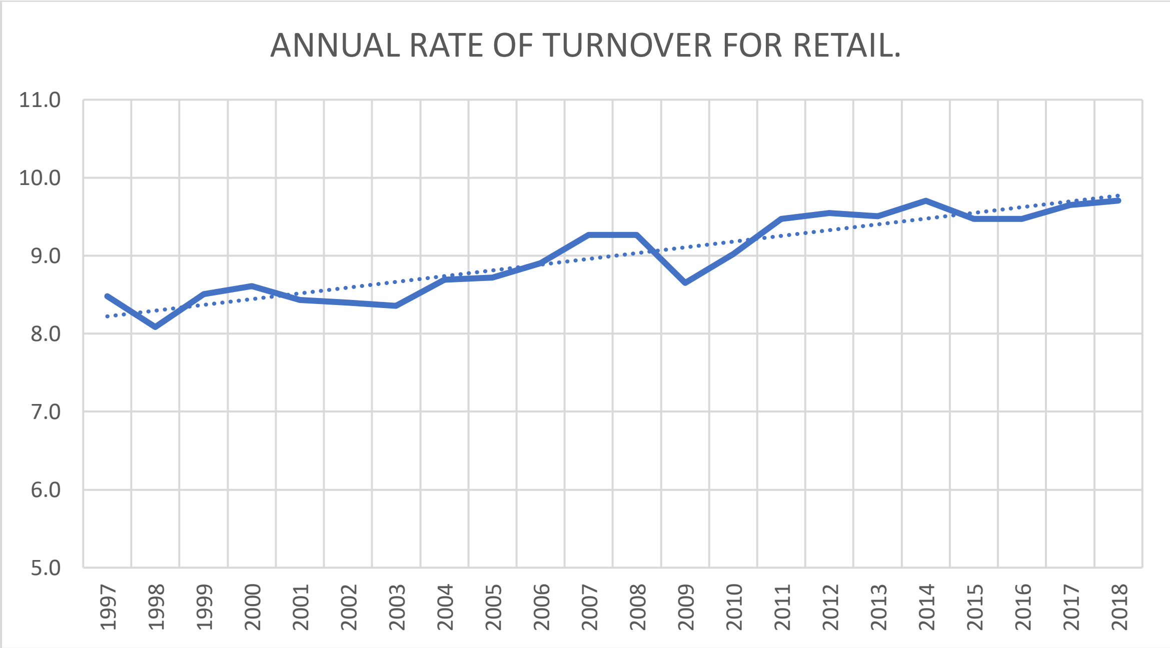
In previous postings I stated my intention to review turnover for the retail sector as it is representative of the economy as a whole. Because the US is the dominant global economy blessed with the ability to issue the global universal equivalent, the dollar, it consumes more than it produces. It imports more goods than it exports. This growing imbalance reflects the structural changes that have occurred as the manufacturing sector contracted while the wholesale sector expanded because manufacturers turned into wholesalers (importers) by closing their US factories and outsourcing production to countries like China. Thus retail, which encompasses parts of manufacturing as well as wholesaling, represents the spending taking place in the economy, spending which helps drive GDP.

(Methodology note. The formula for turnover in retail is distinct because the BEA correctly does not include merchandise for resale in retail gross output because these sales are taken elsewhere, e.g. in manufacturing and wholesale. To correct for this, the retail turnover has this unique formula.)

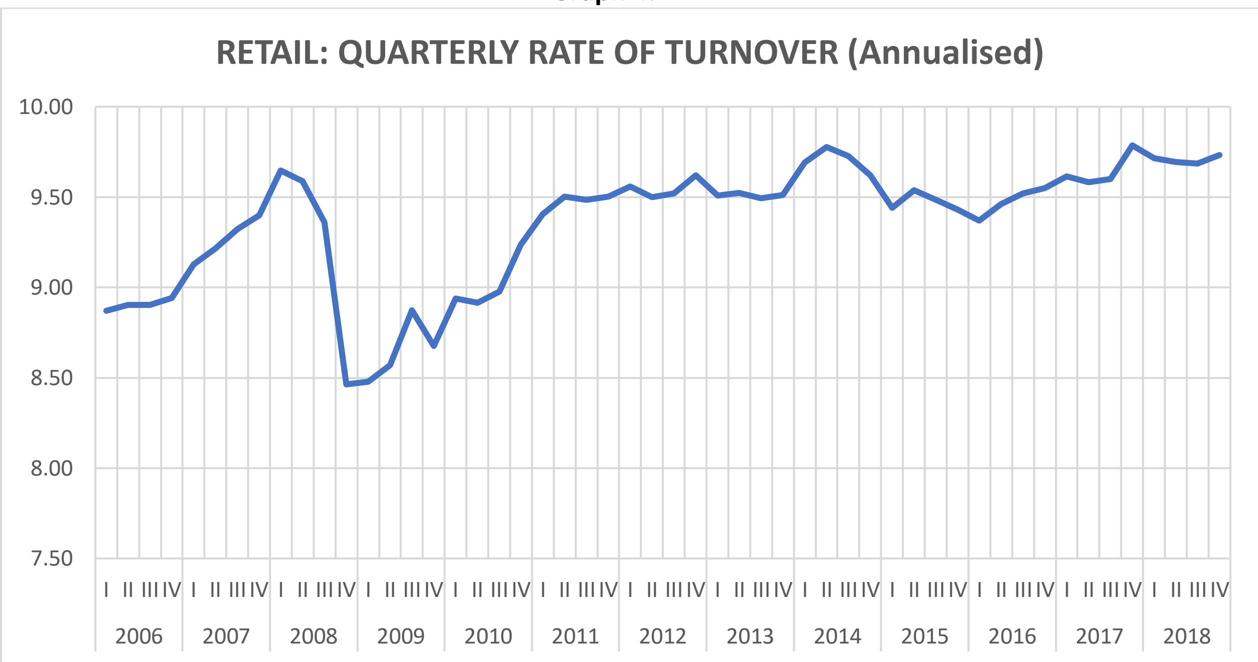
$$\frac{RS + IS}{GVA} + \frac{([RS + IS) - GVA)}{GVA}$$

where RS stands for Retail Sales, IS for intermediate sales within the Retail sector and GVA for Gross Value Added by the retail sector.

Graph 3.

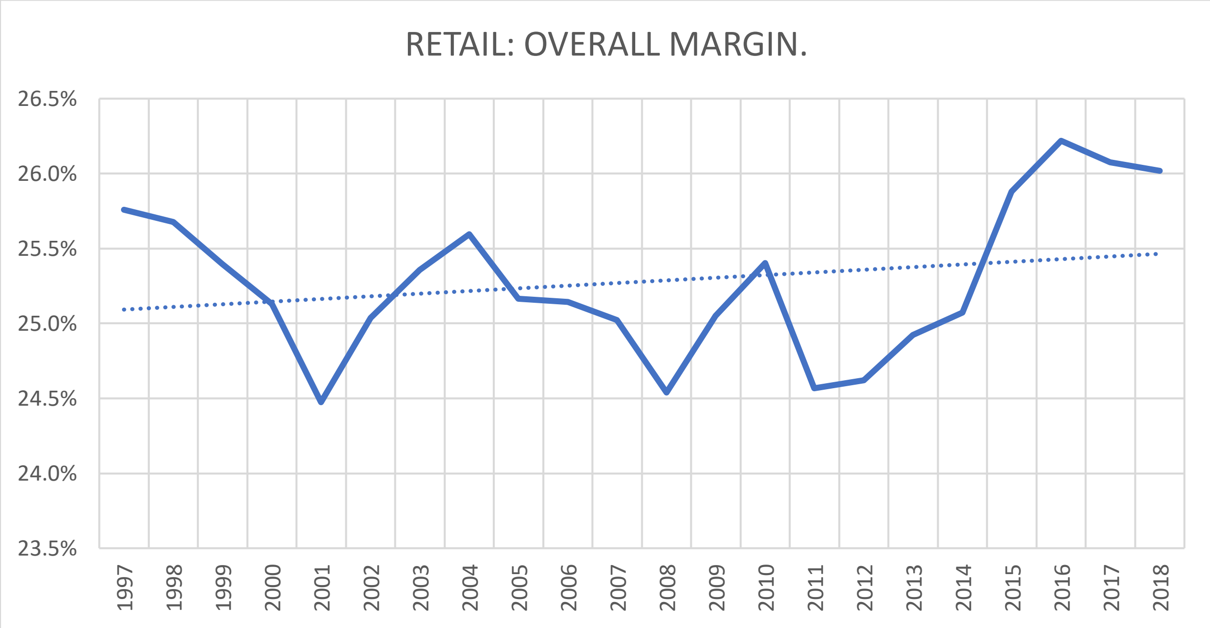


Graph 4.



Here we see a difference. Retail turnover has gone up whereas the turnover in the sphere of production has fallen. The annual rate of turnover in 2018 approximates that of 2014 at 34.5 days when measured as a period. Consequently, there has not been the fall in retail profitability found in production, as the data in Graph 5 reveals. The Gross Margin (EBIDTA) actually peaked in 2016 at a level higher than in 2014. This margin is confirmed by the empirical data for retail supplied by the New York University Stern Business School. It shows margins of between 25 - 28% other than digital sales. http://people.stern.nyu.edu/adamodar/New_Home_Page/datafile/margin.html It also shows the improvement in margins is likely due to the growth of digital sales which enjoys a higher gross margin, but mark, a lower net margin. Digital sales also explains the increase in the rate of turnover.

Graph 5.



The final point to make is that the October (2018) mini peak for *total business sales* (combined manufacturing, wholesale and retail – the metric favoured by Leontief) equalled the previous peak in August (2014) adjusted for inflation. Since then it has fallen back.

The stock market and profitability.

This section begins by looking at the tech industry and smartphones in particular. Apple, decreed by Wall Street, issued results which marginally topped expectations resulting in a bounce in its share price at the time. This is surprising because its results were down sharply as the table below shows. Net income was down 16% on an alleged revenue fall of 5%. Despite this fall in net income, and after adjustments for buy backs, its share price was up 14%. Thus, relative to its income, its current share price is up 30% compared to Q1 2018 when it was riding high on newly released pricy X phones.

	q1 2019	q1 2018	
Net Sales	58.0	61.1	-5%
Cost of Sales	36.2	37.7	-4%
Gross Margin	21.8	23.4	-7%
Net Income	11.6	13.8	-16%
Share price	210	169 (adjusted for 7% buy back inflation) +14%	

https://d18rn0p25nwr6d.cloudfront.net/CIK-0000320193/301d11ab-0075-44dd-a9e2-f96e5d47d664.pdf

In fact, it is difficult to reconcile Apples figures with industry figures. According to IDC, the authoritative research group, Apple's iPhone volume sales fell by 30%. However, Apple only recorded a fall in iPhone revenue of 17%. This means that Apple's iPhone prices must have risen by an average of 13% which goes against the widespread accounts of Apple discounting its smartphone prices to boost sales. The argument sustaining the rise in Apple's share price is that Apple is repositioning itself as a service company rather than a hardware company. This is Wall Street stupidity. Apple's success as a service company depends on its user base and its user base is defined as those replacing their iPhones with other iPhones and not defecting to Android style phones. This does not seem to be the case because according to IDC data, Apple's fall in volume sales is five times greater than the average

6.6% fall for all the major suppliers. https://www.idc.com/getdoc.jsp?containerId=prUS45042319 This is especially true when looking at Huawei's growth of 50.3%.

Apple's share price is another example of the exuberant stock market which has had one of the sharpest new year rises for 50 years, and this at a time of tectonic trade talks. Amongst the original FAANG shares which drove the feeding frenzy on Wall Street, Google has now joined Apple in losing its lustre. It is likely that Facebook's figures are not credible, and Amazon depends on retail sales being propped up by booming stock markets which is what occurred in March when retail sales spiked due to the gains on Wall Street. As I have discussed, the effect of capital appreciation on retail sales is now well establish and conclusive as the fall in December sales versus the rise in March sales shows.

A recent report in CNBC showed the growth rate in digital advertising in slowing significantly. https://www.cnbc.com/2019/05/07/digital-ad-revenue-in-the-us-topped-100-billion-for-the-first-time.html According to this study, the combined advertising revenue currently enjoyed by Alphabet and Facebook is roughly 63 billion dollars, (based on their market shares of 37% and 22% respectively). In the case of Alphabet, 84% of its revenue derives from advertising and virtually 100% for Facebook. Against this revenue the market capitalisation of the two corporations is $1.38 trillion. In short the markets are propping up a share price that is 22 times higher than their advertising revenue, which is more than most Price to Earnings ratios.

It is not only smartphones but the entire tech industry that is in the doldrums. Add in the global car industry together with other key industries and little wonder global industrial production ground to a around the end of last year. In the USA the CASS Freight index for March fell once again. This was the fourth consecutive fall prompting the authors of the index to declare "*With March down -1.0% — the fourth YoY negative month in a row — we are preparing to 'change tack' in our economic outlook."* In other words, they believe the economy is going into reverse. This confirmed by yet another 57% collapse during April of the all-important Class 8 heavy duty trucks which carry that nation's freight. For the first 4 months of this year, orders for this class of trucks has fallen an unprecedented 66%.

Turning to reported profits for the first quarter of 2019. FactSet has examined the 90% of S&P 500 companies that have reported their earnings. Year on year the figure is down 0.5%. This figure is earnings per share. Thus, for the purpose of comparisons this data has to be adjusted for the orgy of share buy backs which peaked in the first quarter.

Yardeni puts the net retirement of shares at 1.5% of the outstanding float of shares on the S&P 500 (quarter 1 2019 compared to quarter 1 2018). http://www.yardeni.com/pub/sharesos.pdf This is an understatement. In the table below Yahoo finance has calculated the market value, dividends and share buy backs for 2018. The important points to note is that the total return of 6% (column 8) exceeds the earnings total yielding of 5.3% (column 3 divided by column 1) and that the ratio of share buy backs to dividends is roughly 2:1.

	MARKET VALUE $ BILLIONS (1)	OPERATING EARNINGS $ BILLIONS (2)	AS REPORTED EARNINGS $ BILLIONS (3)	DIVIDENDS $BILLIONS (4)	BUYBACKS $ BILLIONS (5)	DIVIDEND YIELD (6)	BUYBACK YIELD (7)	BUYBACK YIELD (8)
2018 Prelim.	$21,033.30	**$1,281.83**	**$1,116.83**	$456.31	**$806.41**	2.17%	**3.83%**	**6.00%**

https://finance.yahoo.com/news/p-500-q4-2018-buybacks-145300869.html

This is confirmed by a recent article which appeared in the Financial Times on the 4th May written by Robin Wigglesworth who provides additional data. For now we concentrate on the 3.8%. This figure is far removed from the 1.5% figure provided by Yardeni and would be even further removed were we to consider the running total which accelerated into the first quarter of 2019. Indeed, much of the rise in share prices in this quarter was not due to new money flowing into the markets but to the volume of buy backs. How therefore do we reconcile the volume with the value difference? The dominant reason is that not all shares are priced the same. They are not equal. Many of the buy backs were concentrated in high value shares like Apple which alone was responsible for over 10% of the value of buybacks. Thus, the retirement of above average value shares explains the difference.

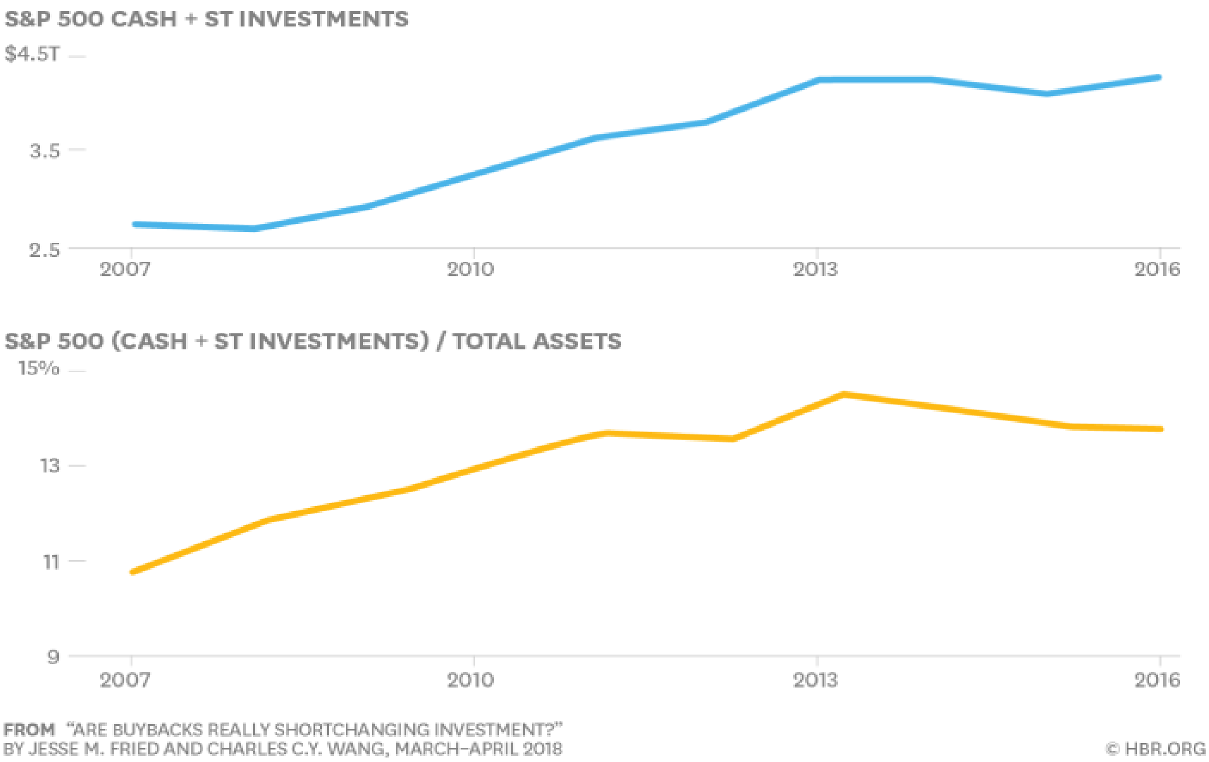
It is likely that adjusted for price, the retirement figure is double that of Yardeni's volume data or 3% of the approximate 4%. It is difficult to obtain the value of new shares but a few studies including the one cited here suggests a figure amounting to 1% of total market capitalisation. https://www.researchaffiliates.com/en_us/publications/articles/385_are_buybacks_an_oasis_or_a_mirage.html By deducting this figure of 1% for shares newly issued, from around the 4% in buy backs, the current figure of 3% is found.

If we use this figure of 3% and add in annual inflation of at least 1.5% then earnings in real terms must increase by at least an annual 4.5% to break even. Currently FactSet is registering a 0.5% fall which means if this figure is finalised, then annual profits will have fallen by at least 5%. Compared to the third quarter peak profits will have fallen by over 10%.

The USA IS a quarter of a year behind the rest of the world due to the Trump Bump.. The rest of the world entered a profit recession in the final quarter of 2018 and is now joined by the USA. This earnings recession is the second one within the space of three years. The short duration between these two events shows the capitalist malaise is deepening.

The record buy backs in the USA needs to be put in context. As the graph below prepared by the Harvard Business School shows, total cash held by US corporations rose to $4.3 trillion by 2016 and to $4.9 trillion in 2017 before the recent surge in share-buy backs took place.

Graph 6.



https://hbr.org/2018/03/are-buybacks-really-shortchanging-investment Harvard Business Review.

Since 1996 the multinationals particularly in the US and Japan have amassed huge hoards as they monopolised globalisation. Much of this hoard is being given away in the USA and now increasingly in Japan. Over the last ten years a total of $8 trillion has been returned to shareholders in the USA alone, a sum exceeding that of quantitative easing. If we take the total valuation of the S&P 500 and Nasdaq which amounts to $32 trillion, that amounts to 25% of their market capitalisation. (It must be mentioned however, that this hoard is spread unevenly over the S&P 500, being concentrated in a minority of Tech, Information and Pharmaceutical Corporations.)

Conversely, the bottom graph shows that investment faltered after 2014, falling by 2% relative to cash and total assets. This was due, as I have shown many times, to the significant fall in the rate of profit after 2014, though to be sure, the renowned Harvard Business School is flummoxed as to the reason for this fall in investment.

This brings me to the structural change underlying the reduction in the rate of turnover within production. It is the fall in the rate of fixed investment. Since the reduction in the rate of profit post 2014, investment in machinery and equipment has wilted. But this is the investment needed to speed up the production process as well as the circulation process. A similar pattern has emerged in China were fixed investment has fallen by two thirds.

Thus, the tempo of turnover, other than that provided by market conditions, depends on investment. In turn, as the rate of turnover of fluid capital is held back by the paucity of fixed investment, it compounds the problems faced by capitalists. On the one hand they conserve their capital in terms of fixed investment, on the other they have to lay our more capital to compensate for the extension in the period of turnover. (It must be added, discussed previously, that it is the effect on the rate of turnover by changes in market conditions, which converts the relative fall in the rate of profit into an absolute fall. Which ever way the problem of profitability is examined, the rate of turnover is key to developing a comprehensive understanding.)

In addition, turnover provides a key explanation for the fall in productivity. One of the key drivers for rising productivity is an acceleration of turnover, and one of the brakes on rising productivity is the reduction in the tempo of turnover. In retail, where turnover has accelerated, productivity improvements have averaged around 2% p.a. between 2007 and 2017. https://www.bls.gov/news.release/pdf/prin1.pdf The missing link is turnover. Michael Roberts in a recent article discusses the interaction between investment and productivity, and he like me, attributes the fall in investment to the movement in the rate of profit. However, because he ignores turnover his analysis is crude and clumsy despite it pointing in the right direction. https://wordpress.com/read/feeds/313842/posts/2273308763

Conclusion.

The riches provided by globalisation is petering out. The additional haul of surplus value since the early 1990s, which ended up in the pockets of the multi-nationals, was mainly derived from the exploitation of workers in China and the former USSR. To maintain this level of expropriation, China in particular had to be kept in a state of technical dependency, imprisoned at the bottom the value chain.

China has escaped this dependency, which means that as it rises up the value chain, it has to share less and less of the surplus value its workers produce with these multi-nationals, particularly those owned by the USA. Apple is a striking example. Once upon a time it appropriated over 90% of all profits in the smartphone industry globally. Then along came Huawei and other Chinese smartphone providers. Huawei is making deep inroads into Apple's territory, not only grabbing sales but forcing

Apple to discount its prices and Samsung to fumble the launch of its foldable phone. As a result, the gross income (net sales less cost of sales) for Apple's hardware sales has fallen from 85% of its total gross income in the first quarter of 2018 to only 66% in the current quarter. At this rate it will earn less than half its income from hardware sales by this time next year, and, its share of global smartphone profits will have fallen by three quarters.

Here then is the reason why the US wants to crack open the Chinese economy. Now that they can no longer indirectly exploit Chinese workers through sub-contracted production, US capital wants to directly exploit China through outright ownership. As long as Chinese exports were primarily executed by manufacturers contracted to the multi-nationals, trade deficits were tolerated. Now that the composition of these deficits is beginning to change, from favouring US companies to favouring Chinese ones, they are not. In addition, should the enforcement of tariffs provoke a recession and thus the devaluation of Chinese capital, then all the better.

The US is determined to not only prevent "technology theft", forced "technology transfers" and respect of Intellectual Property rights, but to see the Chinese economy liberalised. The last issue would be made easier if the liberalisation of the US economy, where planes fall out of the sky and patients are turned into legal addicts, was a shining example and a model to adopt. In short the US wants to be able to cherry pick the best bits of Chinese industry and financialise the rest. This is a direct challenge to Chinese sovereignty.

This is where the tariff war comes in. It is not about protecting US jobs. It is about enforcing compliance through a mechanism of punitive tariffs. Little wonder that the Chinese cannot accept the proposals put forward by the Trump regime as they represent a neo-liberal Trojan Horse, a means of imposing US interests on the Chinese

Both economies have glass jaws. Trump's tweets which moves markets, and, which is a gift to anyone forewarned, shows his concerns. If he begs the FED to bring forward interest rate cuts, it is because he knows the trade war threatens to bring down the markets, markets on which the US economy is critically dependent. On the other side, Xi uses the "National Team" to achieve the same result, that is rescuing the markets every time they swoon.

The raising of tariffs will make it more difficult to achieve a negotiated deal. China is not Japan in the 1980s. To be sure the CCP must be aware of the lost decade in Japan triggered by the forced appreciation of the Yen by the USA in the second half of the 1980s. China is the world's largest industrial economy by a significant margin, it is also the world's largest retail market and it is the pre-eminent exporter. Thus, it is in a position to play off the EU and Japan against the USA in a manner not available to Japan thirty years ago.

In the end economic competition can easily spill over into military confrontation, particularly as the US has been on a permanent war footing since 1945, with offensive weapons pre-positioned in forward-bases ringing the planet and surrounding China. Of particular concern is the US's current repurposing of its strategic nuclear weapons by reducing the yield of its warheads. Even if the current trade dispute is settled and China makes some concessions on the movement of capital into and within its economy, this is but one skirmish in a broader war, the fight for hegemonic control of the world economy. Unless the international proletariat intervenes, it is likely we are seeing the beginning of the end to the two-century old dominance of the world economy by Anglo-Saxon capital.

Brian Green, May 2019