PROFIT REPORT: USA & CHINA SECOND QUARTER 2019.

This posting and a following one examine the movement of the mass of profits in the USA and China which accounts for about 60% of corporate profits worldwide. It includes a proxy for the rate of profit in the USA enabling real time quarterly calculations of the rate of profit in the USA. Chinese data provides monthly "complex rates of return". Finally it sequences the movement of profits with that of investment, showing that changes in the movement of profit precedes changes in the movement of investment by between two and three quarters. All data and calculations can be found in the accompanying spreadsheets. (Part B covering China will be posted within the next two weeks.)

While Chinese industrial profits reversed their decline, US corporate profits continued to decline. The first part of this posting deals with the USA. In Table 1 below the annual change in total corporate profits (which includes financial) and non-financial profits only, are detailed. In all cases profits declined, particularly when adjusted for inflation. Attention should focus on the fall in post-tax profits, showing that the "Trump Bump" is well and truly over, with its only legacy being a bloated fiscal deficit.

Table 1.

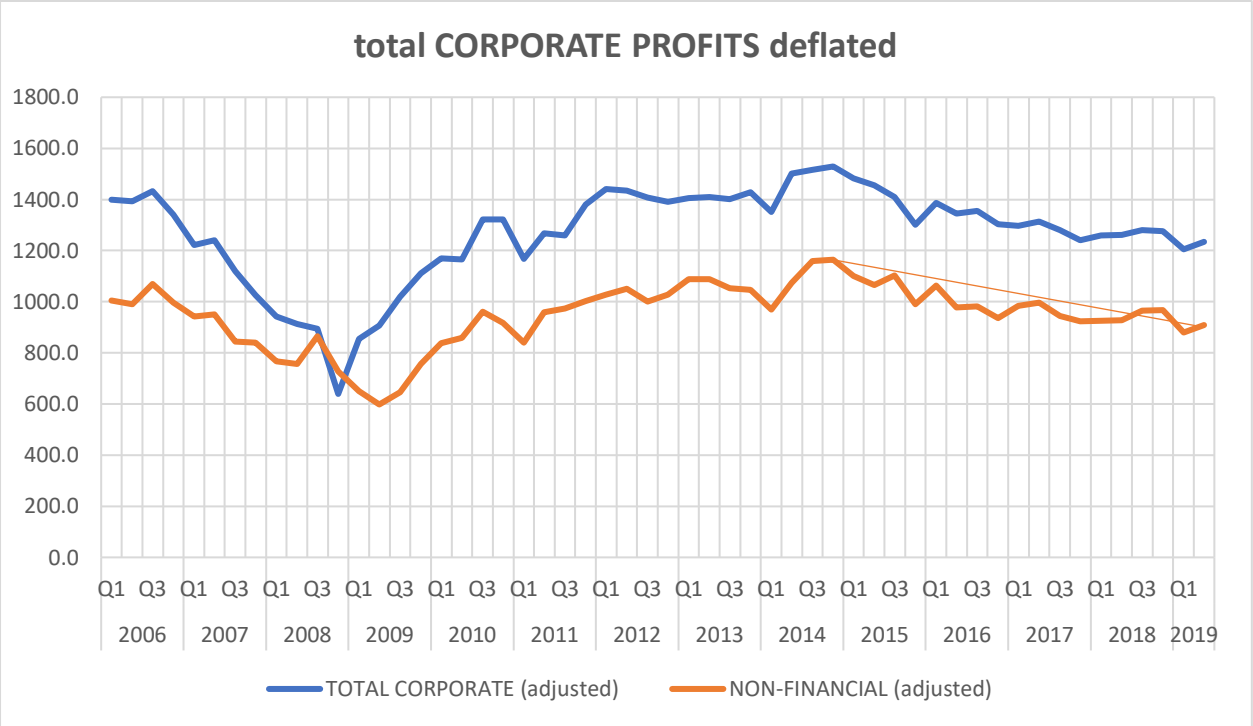
	Nominal	inflation adjusted
Total corporate **with** adjustments pre-tax	-0.4%	-1.8%
Total corporate **without** adjustments pre-tax	-1.5%	-2.9%
Total corporate **with** adjustments post-tax	-1.0%	-2.4%
Total corporate **without** adjustments post-tax	-2.3%	-3.7%
Non-financial **with** adjustments pre-tax	-0.4%	-1.8%
Non-financial **without** adjustments pre-tax	-2.5%	-3.9%
Non-financial **with** adjustments post-tax	-2.0%	-3.4%
Non-financial **without** adjustments post-tax	-4.5%	-5.9%

(Source: Table 1.14 Gross Value Added of Corporate Business)

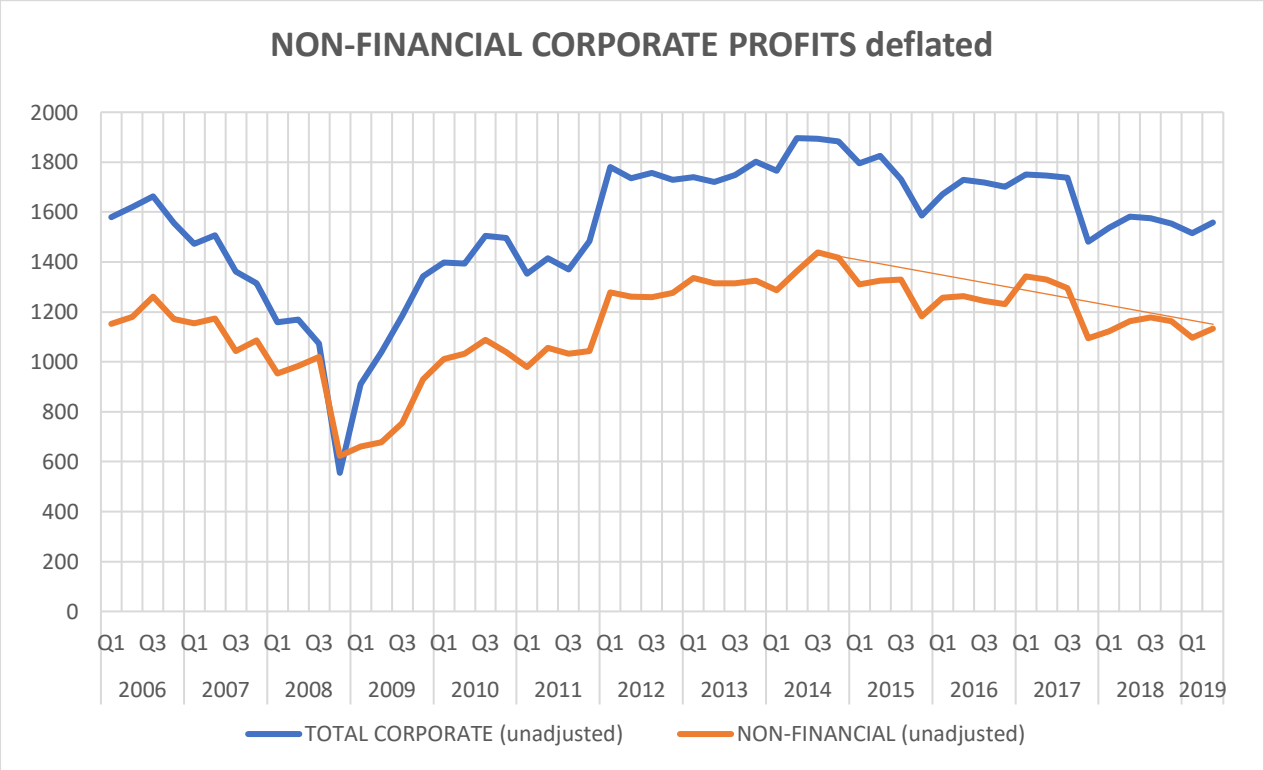
I expect profit figures for Q2 to be revised down in due course. There is a particular problem regarding revenue in this release. Turning to FRED Table TOTBUSSMSA which stands for Total Business Sales, the combined annual revenue growth for Manufacturing, Wholesale and Retail amounts to only 1.9% between the second quarter of 2019 and the second quarter 2018. This is in line with FactSet's revenue per share for the S&P 500. And yet when corporate gross value added is examined in Table 1.14 (spreadsheet attached) we obtain a growth figure of 4.6%. Though not strictly comparable, if the gross value added is overstated as it appears, then so too will the profit figures.

In the above-mentioned spreadsheet: "TABLE 1.14 QUARTERLY UP TO Q2 2019", graphs detailing the nominal mass of profits can be found. The two graphs below however have been selected because they are adjusted for inflation because this gives a clearer picture regarding the movement in the mass of profits over time. In all cases there is an insignificant improvement this quarter. This is primarily due to the rise in the rate of exploitation seen in Graph 4. In line with reports emanating from Wall Street, corporations are now embarking on cost cutting and trimming their workforces, following 6 months of falling profits and expectations for more falls.

Graph 1.



Graph 2.



With regard to Graph 2, profits for non-financial corporations (pre-tax and unadjusted) are down 21% from their peak in 2014. The effect of this fall in the absolute mass of profits has an enhanced effect on the rate of profit which is dealt with further down.

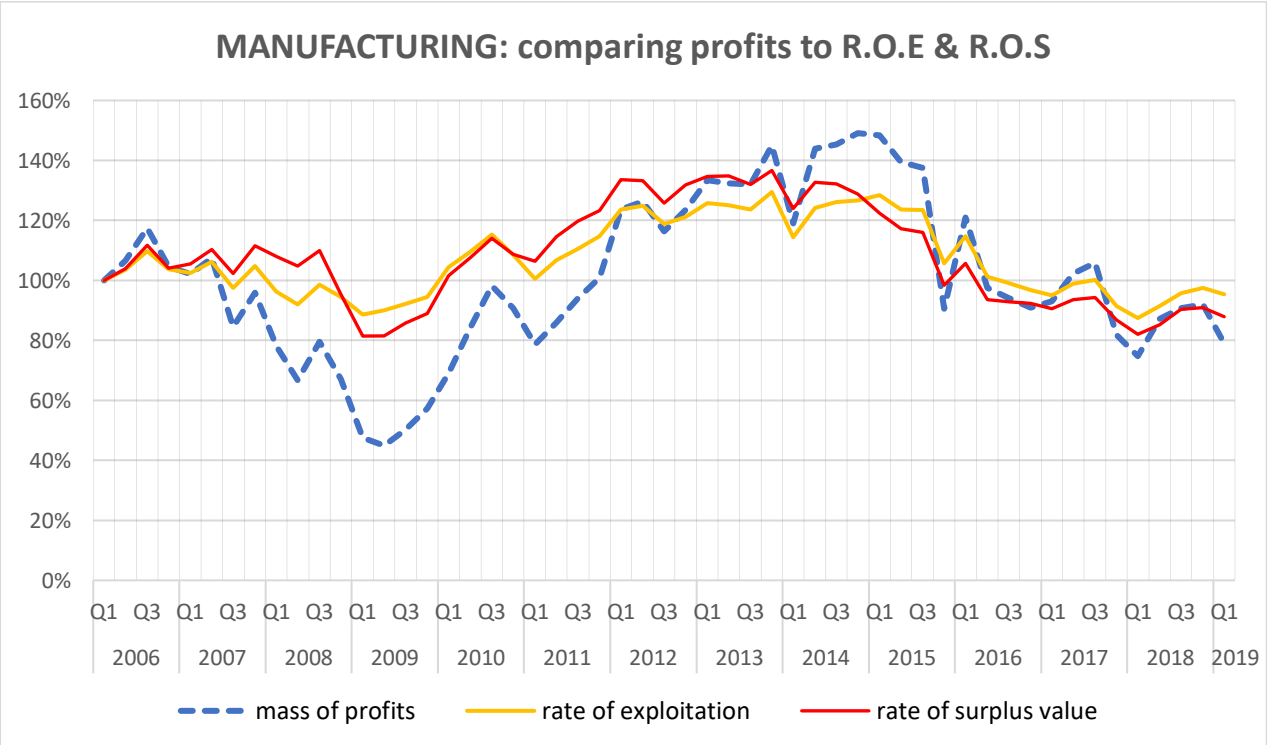
A correction.

In previous postings where I have dealt with the inter-relationship between the rate of exploitation and the rate of surplus value I used the following formulation: the rate of turnover acts as a multiplier to the rate of exploitation. In other words when they move in the same direction, the rate of surplus value is either driven down or up faster, and when they more in opposing directions, the effect on the rate of surplus value is moderated.

This formulation is not correct. While it is true that the rate of exploitation has no bearing on the rate of turnover, the opposite is not true. The rate of turnover does affect the rate of exploitation as measured in the National Accounts. A fall in the rate of turnover, everything else being equal, will automatically lead to a fall in the rate of exploitation for two reasons. Firstly, a fall in the rate of turnover will lead to an elongation in the period of turnover, say from 50 to 60 days. Thus wages which covered 50 days will no longer cover 60 days and so must be increased reducing the rate of exploitation. Secondly, as these are annualised figures, fewer periods of turnover per annum means fewer circuits in which to convert unpaid labour into profits. Thus it has a depressive effect on the realised surplus which also depresses the rate of exploitation.

This provides a fuller explanation as to why it is, that when the rate of surplus value resides below the rate of exploitation, it tends to depress the mass of profits, and when it sits above the rate of exploitation it tends to elevate profits. Only when the rate of turnover increases can the rate of exploitation rise to the point where it has the power to propel the mass of profits upwards. All of this can be seen in the reproduced Graph below from an earlier posting. *"FIRST QUARTER 2019 REPORT ON THE RATES OF TURNOVER, EXPLOITATION AND SURPLUS FOR THE US ECONOMY."*

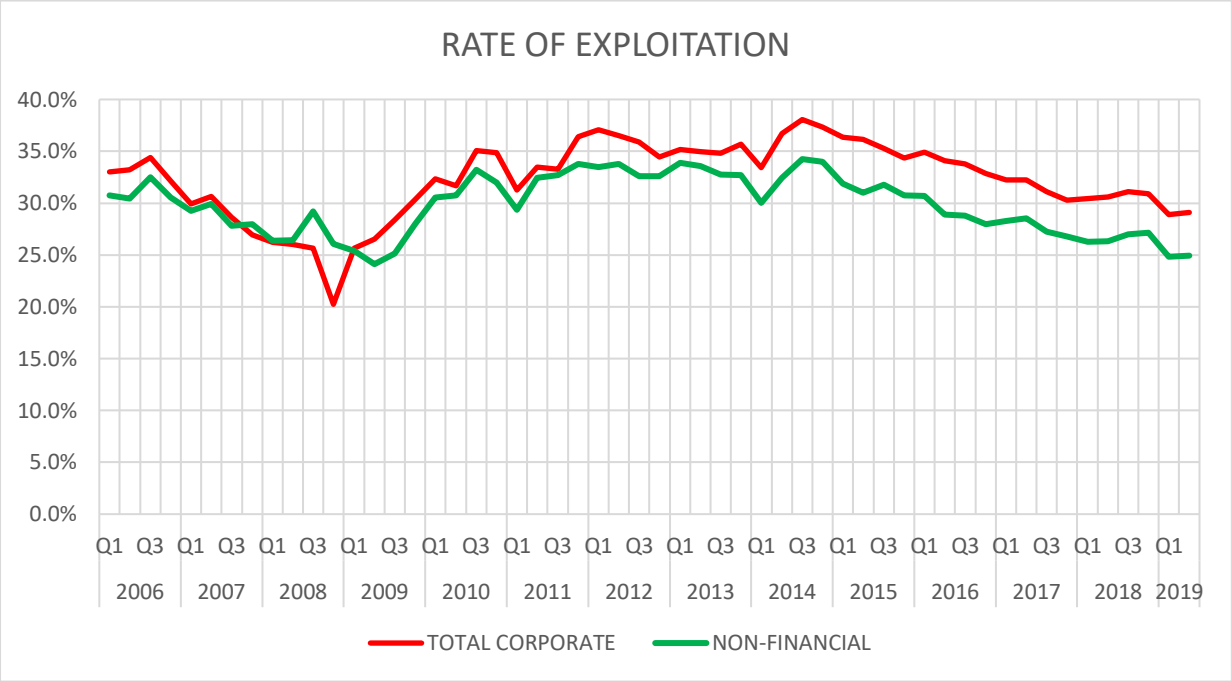
Graph 3.



Note a rising mass of profit (broken blue line) is associated with the red graph residing above the yellow graph and a falling mass of profits is associated with the red graph below the yellow graph. Ever since 2014, when turnover began to decelerate, the rate of exploitation has subsided dragging down the mass of profits.

Returning to the present period, Graph 4 shows the marginal uptick in the rate of exploitation which yielded a quarterly improvement in the mass of profits. Whether or not this is associated with an improvement in turnover cannot be determined until October 29th, when the BEA releases second quarter gross output and gross value added data, enabling calculation of the rate of turnover for that quarter.

Graph 4.



A proxy for the rate of profit.

The movement in the mass of profits can be seen in real time. Generally with a lag of about 6 weeks. Not so with changes to the value of fixed (produced assets). Generally they appear 6 months later and then only for the preceding year. It therefore seems impossible to calculate movements in the rate of profit in real time as the element of capital is missing.

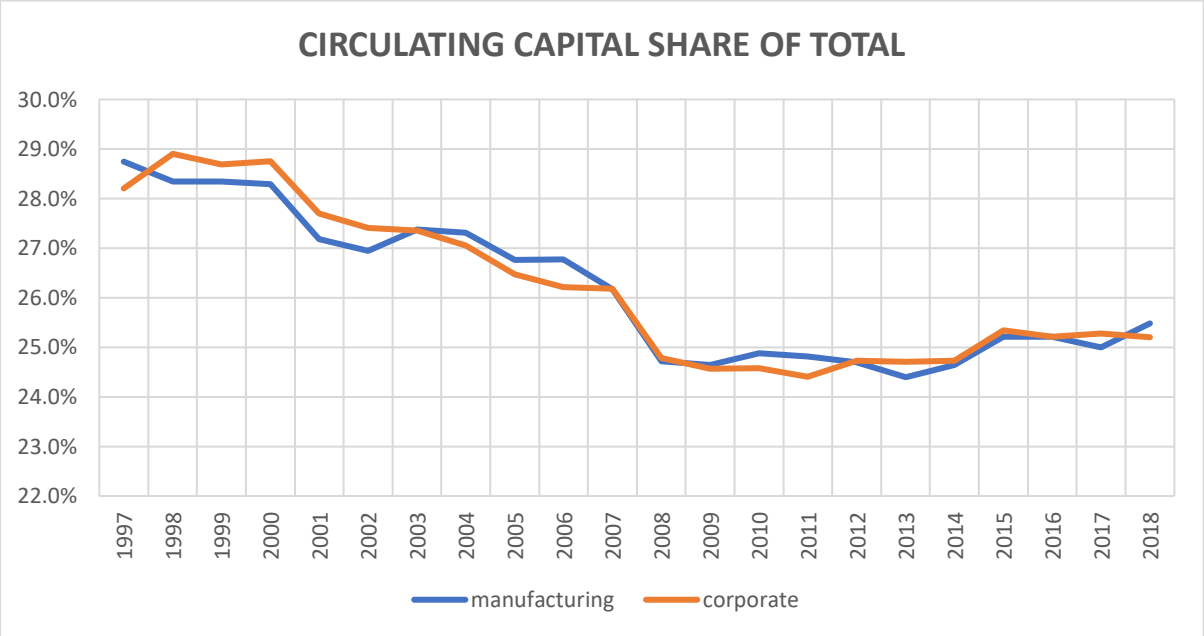
However, it is possible to calculate a proxy for this rate. The Statistical Bureaus around the world use a system called the "*Perpetual Inventory Method*" (PIM) to estimate the stock of fixed assets comprising equipment, structures and Intellectual Property. It is a lazy but cost-effective way of estimating fixed capital, short of a doing a national census each year. Its two main legs are gross fixed investment and depreciation. Deduct the latter from the former, the latter which reduces value and the former which increases it, and theoretically with a Hail Mary, a rough estimate of changes to fixed capital can be arrived at.

This method can be adapted to allow for a real time proxy for the rate of profit through providing an estimate for fixed capital. If we assume the mass of depreciation is a function of the mass of fixed capital over the short term, say under five years, then changes to the mass of depreciation must be associated with changes to the mass of capital. Fortunately, Table 1.14 provides quarterly as well as annual figures for depreciation or as it is called: "Consumption of fixed capital" (most probably a Leontief expression as it sits alongside Marx's use of the expression "productive consumption").

In the attached spreadsheet on this site titled: "working paper Q2 corporate profits" I have used depreciation to prepare a moving rate of profit which includes Q2. In testing for the proof of concept

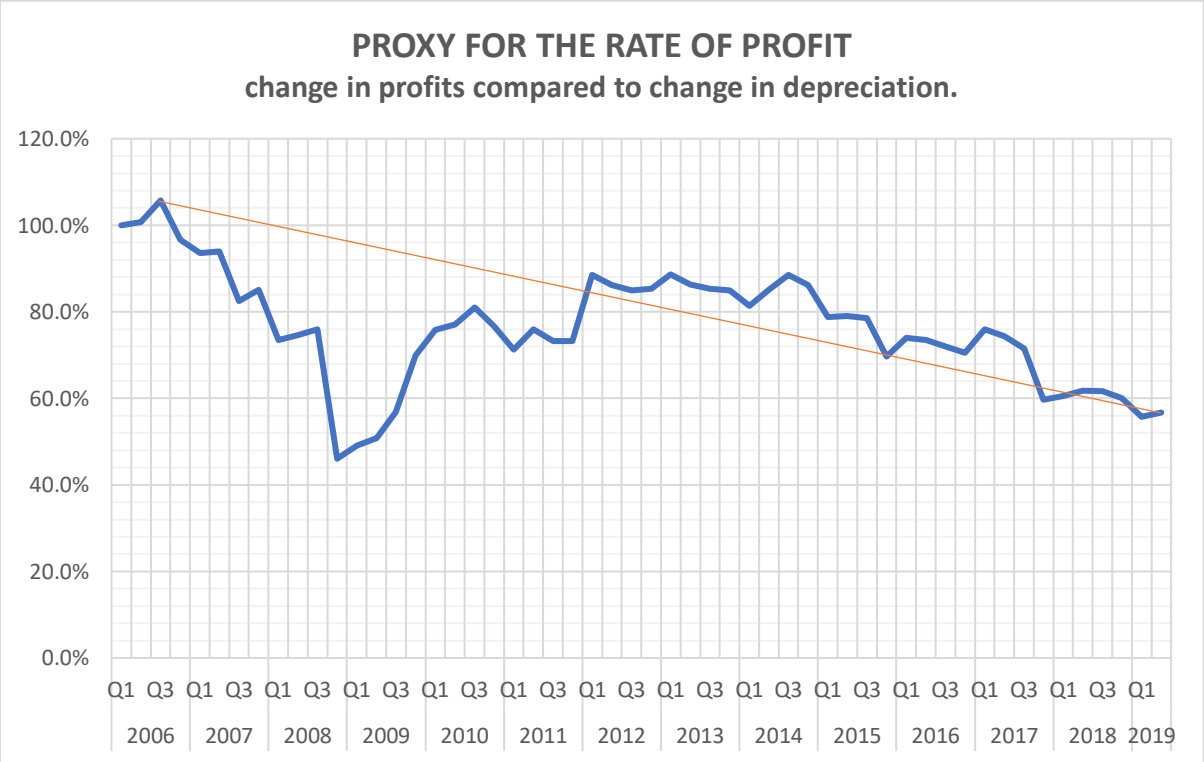
it turns out this proxy is 98% accurate when compared to the actual rate of profit (2014 versus 2018) based on pre-tax unadjusted profits divided by fixed plus circulating capital. One of the reasons for this degree of accuracy is that the shares of total capital between fixed and circulating over this period have been stable. Following the fall up to 2008, there shares have move by less than 1%. Where it not for the stable relation between the two the proxy would be less accurate.

Graph 5.



The proxy for the rate of profit appears below and relates to non-financial corporate.

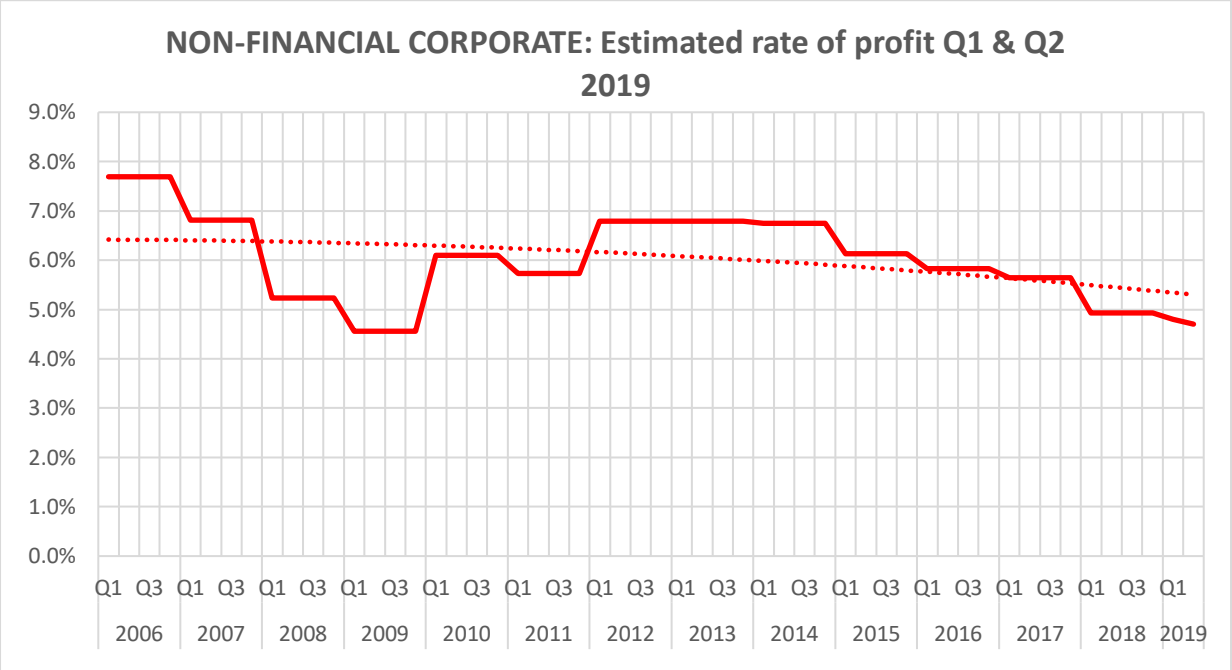
Graph 6.



I will use this proxy quarterly. The next step is to convert this proxy into the rate of profit which is done in the spreadsheet. This results in Graph 7. The step effect is formed because average annual rates are extended over the four quarters that make up each year. Only Q1 & Q2 2019 are not annualised but based on quarterly rates derived from the proxy above. This allows us to track its movement quarter by quarter during 2019 and to avoid waiting for July 2020 when the tables for the stock of produced assets for 2019 will be published.

We note that the rate of profit is now estimated to be 4.7% in quarter two down from 5% in 2018.

Graph 7.



Profits are now expected to contract on an annualised basis for Q3 as well. This being the case, it means that corporate profits will have contracted for five years. This is unprecedented. Clearly this length of time passes from the cyclical to the structural. This story not only includes the chapter on the rising organic composition of capital, but in addition, the US's loss of its monopoly of the global value chain. It represents a restructuring of the world economy since 2014. Thus the trade war is not the cause of the underlying loss in profitability, but rather the accelerating loss in profitability is the cause of the trade war. Trump is the mere inept figurehead trying to deal with this development.

Sequencing profits with investment.

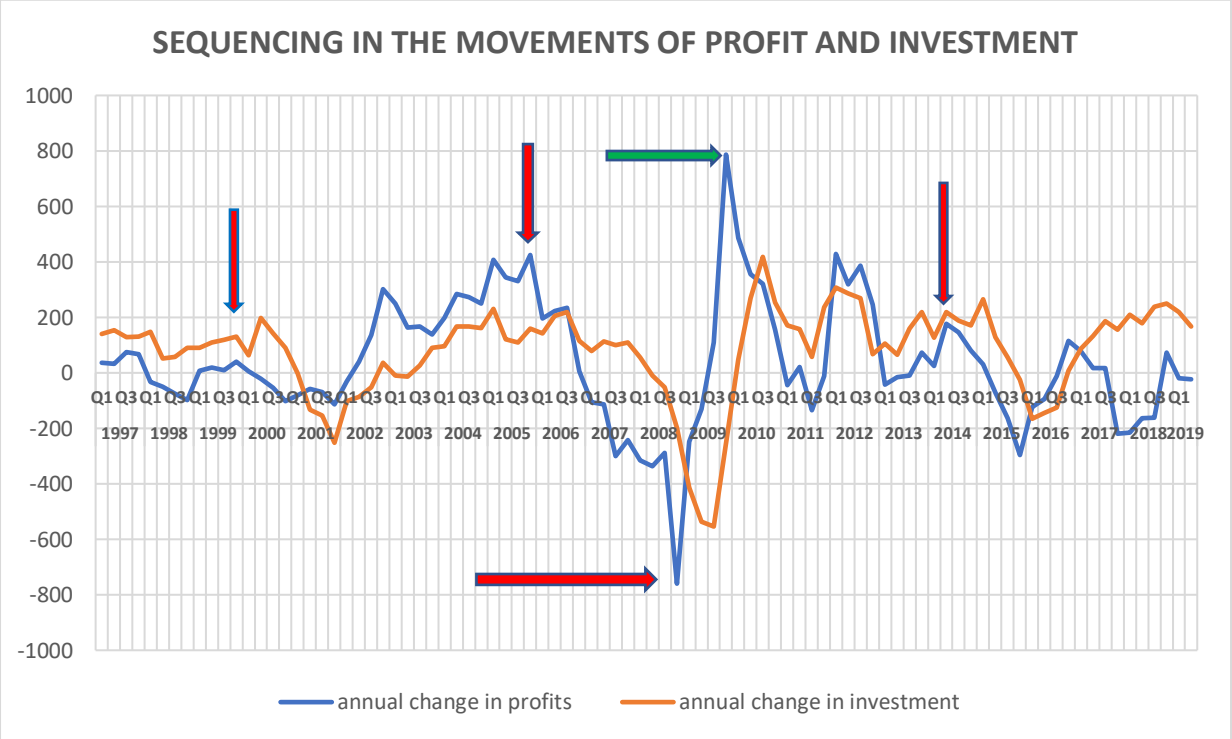
In Michael Robert's recent posting "It is all going pear shaped" there is once again a vigorous debate concerning the sequencing of profits and investment, or which leads which. https://wordpress.com/read/feeds/313842/posts/2389310568 In concert with Michael Roberts I am firmly of the view that profits are the horse and investment the cart. Whatever direction the horse goes the cart follows and not vice versa. This is in opposition to analysts such as Jack Erasmus, who oppose this view.

Michael has provided numerous graphs to show the sequencing of profits and investment. I would like to add another graph. Once again I have sought to obtain real time information. Table 5.1. *Saving and Investment by Sector* is released with a month of the conclusion of the previous quarter, in this case

quarter 2. I have used the release dated 26th July rather than the most recent release dated the 29th, because I have worked on the earlier release.

Table 5.1 provides quarterly investment data for domestic industry, and to the best of my knowledge this table provides the only quarterly investment figures for industry. Corporate business is more than three quarters of domestic industry when measured in terms of fixed assets. This high weighting makes domestic industry a reliable indicator for corporate investment which is unavailable in real time. In common with the graphs used by Mr Roberts, it shows that profits reverse their direction between two and three quarters prior to investment responding. The arrows in Graph 8 highlight inflection points to demonstrate these trends. The green arrow signifies that this inflection point was not associated with a recession.

Graph 8.



(Source: see attached spreadsheet "US SAVINGS AND INVESTMENT".)

What is notable is the role of investment during the last two years. With the exception of the period leading up to the dotcom crash at the beginning of this century, this is the only time that investment has outpaced profits while on the ascendancy. This state of affairs generally leads to over-investment relative to profits, and, results in a sharp correction as happened in 2001.

It is of course disappointing to witness so called Marxian scholars inverting the relationship between profits and investment or downgrading the importance of their inter-relationship. Certainly this confusion does not take place around Wall Street. Currently banks like J P Morgan are discussing whether the profit drought, as defined by falling margins, will lead to accelerating declines in Capex and hiring. The only area of dispute is how deep this will go, and whether it will leach into consumer spending.

For the first time evidence of falling spending by the top 1% on themselves, is emerging. Whether it is the car auctions at Scottsdale 2019, the double digit fall in revenues at Christies and Sotheby's, or

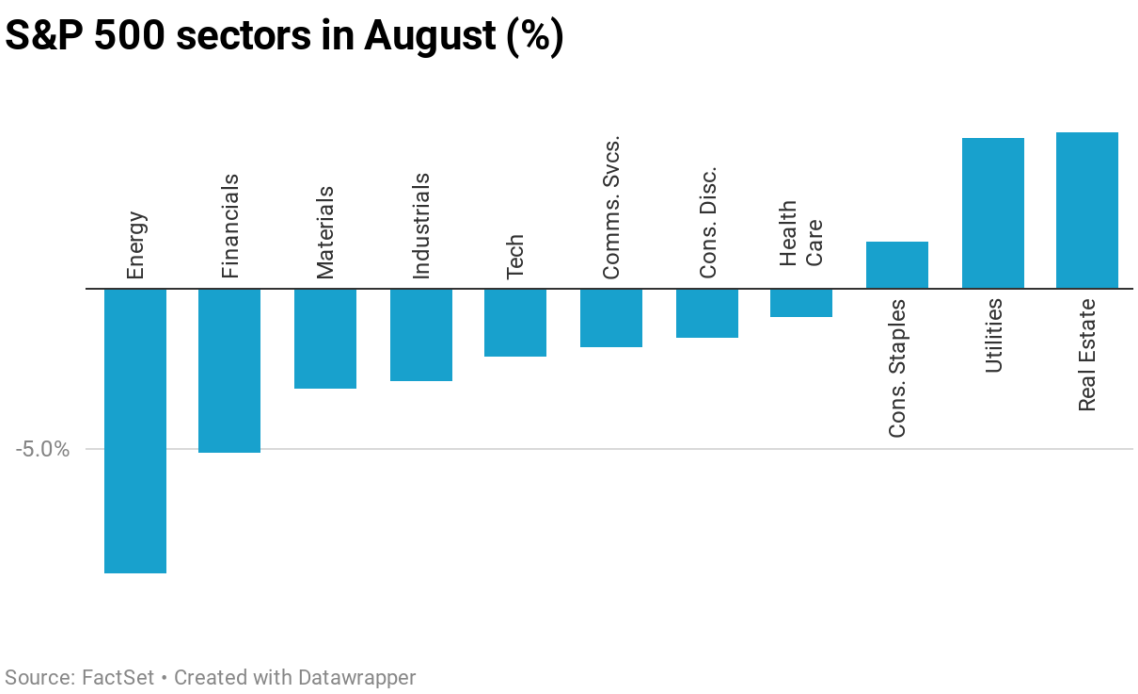
revenues turning out to be softer than diamonds at De Beers which saw a 44% fall in its latest sight together with Signet's 66% fall in share price (revealing that diamonds are not the investors *best friend*), spending in the luxury sector is falling fast. Add in the fall in higher end property prices in places like New York, and it is clear the long expected cracks in consumer spending are appearing.

The rot so to speak is spreading from the head. The popular Michigan University Consumer Sentiment Index for July fell sharply to its lowest point in the Trump Presidency. It fell sharply from 98.2 in June to 89.8 in July. As the *Street* wrote, a combination of trade wars, recession warnings and market turbulence may be taking its toll. If it is and consumer spending tanks, the remaining prop holding up the economy will have been kicked away.

Interest rates.

Every time I write, the share of negative yielding bonds globally goes up by a few percentage points. Currently, the share of negative yielding bonds has passed the 30% threshold. Longer dated bonds are falling faster and inversions are deepening. The bond market is indicating that the global recession is deepening. One of the primary reasons that bond yields are falling is that investors are abandoning shares (equities) in order to invest in "safer" fictitious havens such as bonds, particularly investment grade bonds. And this lack of confidence in shares is occurring at a time when dividend yields exceed most bond yields. The exiting of shares, not yet a stampede, accelerated after what has been called "Wild August". "*The S&P 500 posted 11 moves of more than 1% in 22 trading sessions for August. Those moves included three declines of at least 2.6% as well as the index's worst day of the year on Aug. 5."* (Quoted in CNBC with the link below Graph 9 taken from the article.) The only unexpected increase was that of real estate where the fundamentals all deteriorated over the course of the month.

GRAPH 9.



https://www.cnbc.com/2019/08/31/august-was-a-wild-month-for-wall-street-heres-what-happened.html

August was an abnormal month because of its volatility which was accentuated by thin markets due to the holidays. On an annualised basis share prices are unchanged from this time last year. The share market is being abandoned, not only because of the fear of fragility, but because even a best case scenario does not envisage any appreciable capital gains for shares in the near future. This contrasts with the bond market which is resplendent with capital gains. However, capital gains, not associated with growing future income streams, is a ticking time-bomb. Not only are the number of time-bombs increasing, but they are being found in areas normally free from them.

A rapid fall in interest rates world-wide is normally associated with a global collapse in investment and production. The latest world trade monitor released by the CPB Netherlands Bureau for Economic Policy Analysis shows World trade momentum was -0.7% and World industrial production momentum was -0.1%. When looking at quarterly momentum rather than monthly, world trade momentum decelerated to -0.7% in Q2 compared to -0.3% in Q1. https://www.cpb.nl/en/worldtrademonitor

While a few regional surveys have ticked up in the USA, they provide false positives. Overall the fundamentals in the economy continue to deteriorate. Another false positive is the view that falling interest rates are supportive. The test for this obviously lies in that most rate sensitive sector, housing. And yet, despite plunging mortgage rates, provisional new house sales for July fell to 635,000 units, below the moving average for 2019 of 661,000.

One of the best bell weathers of the economy is of course Trump. It is well known that Trump's personality condition is untweetable, but this has the advantage of him thinking with his internet mouth open. Over the course of the last two weeks his growing desperation has been manifest in vicious tweets aimed at the Federal Reserve, whose chairman he called a bigger traitor than Chairman Xi from China. Very strong language for a president. Trump, who lives on entitlement, clearly believes the mandate of the FED should include his re-election.

A growing theme on Wall Street is the "Japanification" of the world economy. The collapse of interest rates is being compared to Japan 30 years ago when its property and other bubbles burst. This is in fact the better scenario, because it assumes a steady subsiding of the world economy and the avoidance of a crash because of pre-emptive central government measures as well as a truce being declared in the trade war.

Whatever the outcome, it is the collapse in the international rate of profit that is the main determinant. Its fall means the pulse of capitalism has slowed down, and with the resulting fall in blood pressure, the probability of the patient keeling over grows. These are the conditions in which that "toadstool feeding on the rot of empire", Boris Johnson, pushes for a no-deal Brexit by proroguing Parliament. In the person of Boris Johnson, it shows that capitalism is no longer fit to govern.

Brian Green, August 2019.