PROFIT IS NOT THE FRIEND OF DONALD TRUMP.
The rate of profit for 2018.

On Wednesday the 14th as the Stock Markets were plunging Trump held a conference call with leading bankers, namely J.P. Morgan Chase's CEO Jamie Dimon, Bank of America's Brian Moynihan and Citigroup's Michael Corbat, to get their "read" on the economy. They unanimously opined that the trade war was hurting the economy. Trump of course was more worried about his election chances.

So he should be. His overall rating and handling of the economy has also plunged. The latest FOX news poll shows that Trump will lose to each of the top four Democratic candidates in the next election. He is now viewed unfavourably by 56% of the population and half the voters think he is mishandling the trade dispute. What the poll really brings out is his unpopularity with women voters. https://www.foxnews.com/opinion/mary-anne-marsh-trump-trouble-2020-political-economic-numbers Yet another right-wing populist sparkler who burnt bright and is now going out despite the benefit of the dollar. Ah! these Brexiteers tying themselves to a loser. At least the Chinese had the measure of the man.

Trump was always going to sink into the economic quicksand. This article is the first of two which looks at the profitability of the US economy. The second part will be posted once the profit figures for Quarter 2 are announced at month end. All the indications are for a significant fall for this quarter. This posting has been made possible by the earlier than expected release by the BEA of fixed asset tables covering 2018. As the graphs in this posting show, a crisis of profitability now exists in the USA.

Both Michael Roberts and myself are agreed that the two quarters that spanned the end of 2015 and the beginning of 2016 represented what I call a pseudo recession. We are not alone in this thinking. Analysists on Wall Street now identify a mini cycle between then and now. Henry Song, a portfolio manager at Diamond Hill Capital Management remarked in the Financial Times on the 17th August: *"it feels like we've had a mini cycle since 2016, - we're now back at the level where the 10-year Treasury was three years ago*." (*US Debt Funds Buoyed as Investors Seek Havens* F.T. 17/08/2019)

Actually, we are not back to where we were in 2016. The state of the world economy is far worse. The issue of debt is now also more advanced. "*Twenty years ago, well over half of all bonds yielded over 5%. After 2008 this reduced to 16%. Now it is only 3% the lowest on record. Most of the higher yielding investment grade bonds traded internationally (*and presumably excluding China*) are found in the USA, which accounts for 88% of all the interest paid on these bonds."* Quoted in the Financial Times.(*Negative Yields Force Investors to Snap up Riskier Debt*. F.T. 16/09/2019). Interest rates have collapsed, and equally important, the US with its huge fiscal deficit propping up rates, is paying the Lion's share of the global interest bill.

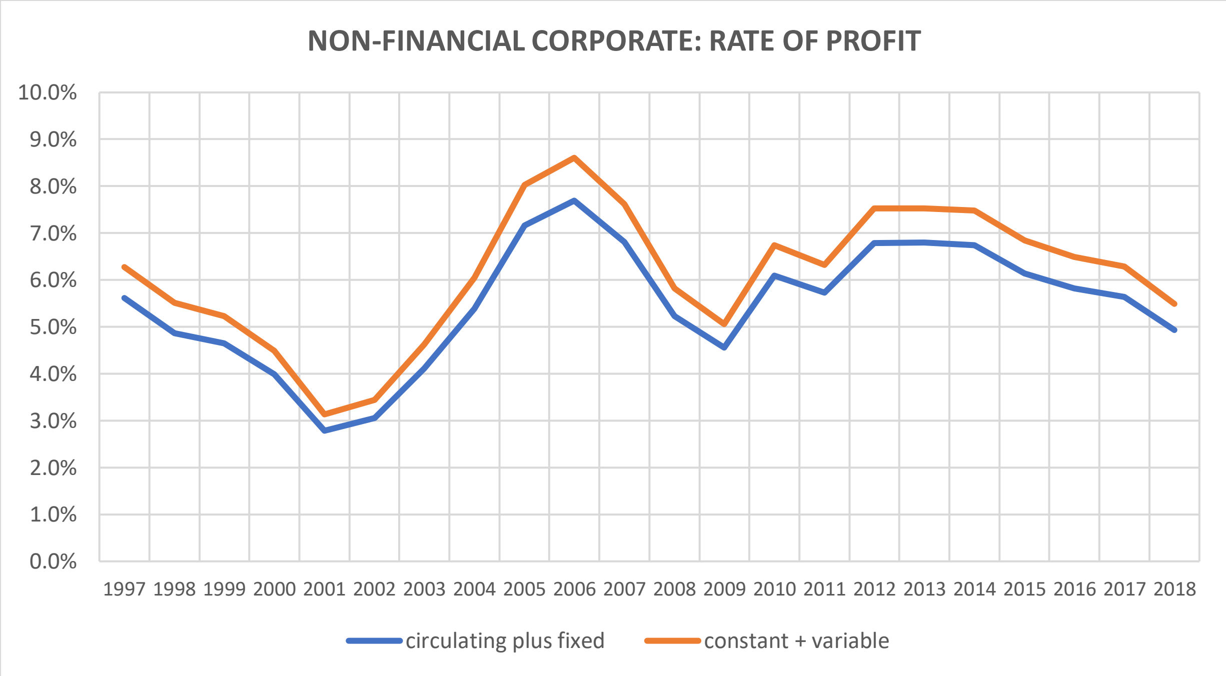
It seems that 2016 can be compared to 2005 and 2019 to 2008. In 2005 the economy was re-stimulated by the explosion and leveraging of mortgage debt. Today the same can be said of corporate debt. Had interest rates been allowed to play their role in purging debt, which would have resulted in a full-blown recession at the end of 2015, the much bigger Crash of 2019 could have been averted.

The rate of profit

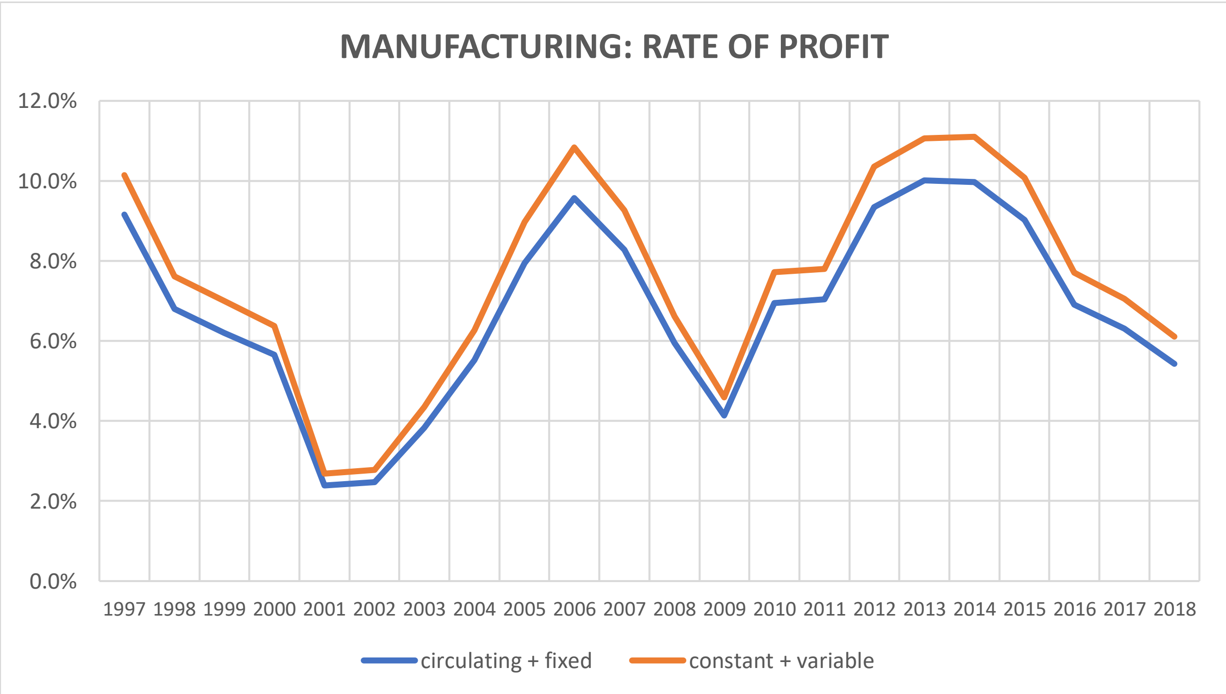
However, it would be an error of method to focus on the rate of interest when it is beholden to the rate of profit. What really distinguishes 2019 from 2016 is that the rate of profit has fallen by between a quarter and a third in both the corporate world and manufacturing. It is likely, as I have suggested earlier, that when the figures come out for the 2nd quarter, the rate of profit will have fallen below the critical 5% mark.

Readers who compare these figures to other Marxian analysts, will note this figure is much lower. This is due to the inclusion of circulating capital. My preferred rate of profit is pre-tax profits divided by fixed and circulating capital. I have also included the regular Marxian rate which uses pre-tax profits divided by constant and variable capital. The reader can find all the sources, data and calculations, plus additional graphs, on the accompanying spreadsheet: "*GRAPHS rate of profit 2018*".

Graph 1.



Graph 2.

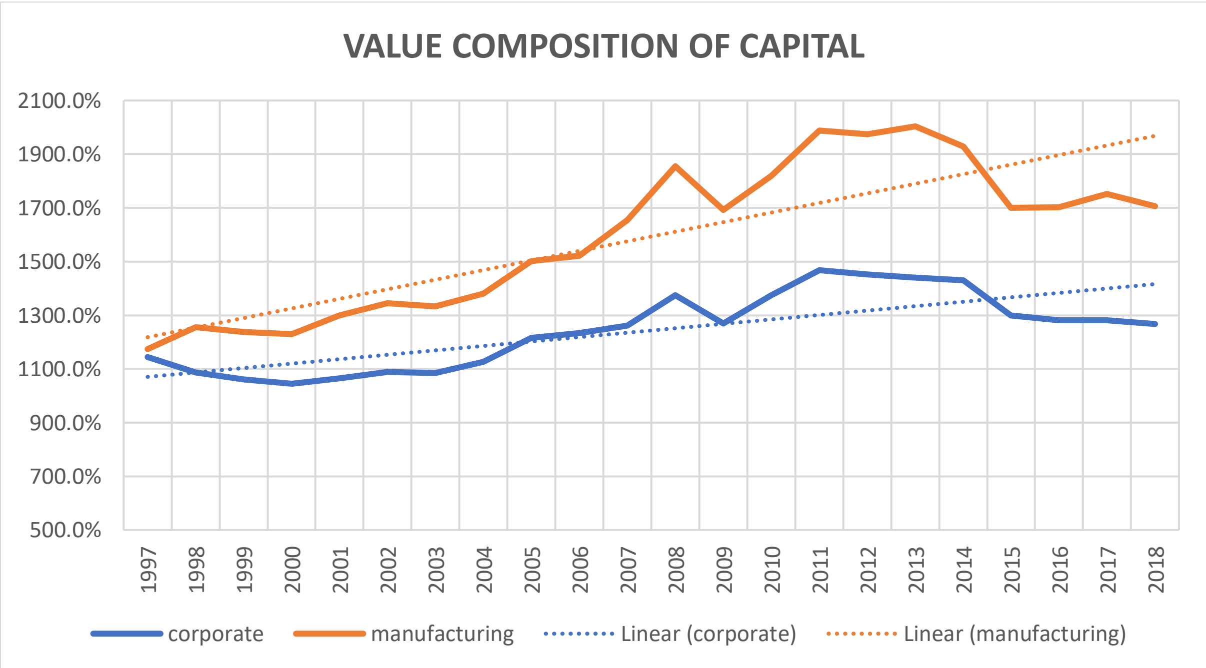


The most important point to note is that the fall in the rate of profit is approaching the nadir last encountered at the bottom of 2009. This applies to both non-financial corporate and manufacturing. The extent of the fall in the rate of profit from recent peak to recent trough approximates the fall after 2006. Manufacturing, which was the main beneficiary of globalisation now ended, has shown a sharper fall than the corporate sector. Once again, it is noteworthy that the fall in the rates of profit are more or less unbroken since the end of 2014, long before Trump even decided to stand for President, and having extended beyond four years, are of exceptional duration.

In this light his tax cuts was a desperate attempt to shore up the after-tax enterprise rate of profit which it did temporarily. In reality this was a one card trick because reducing the tax rate does not affect the underlying rate of profit. All it has done is to boost the budget deficit beyond one trillion Dollars a year earlier than expected.

The reason that the rate of profit has been more volatile in the manufacturing sector is explained by Graph 3. This graph shows that the value composition of capital has increased more rapidly in manufacturing compared to the corporate sector as a whole, particularly this century when it increased by 50% compared to 20% for the corporate sector.

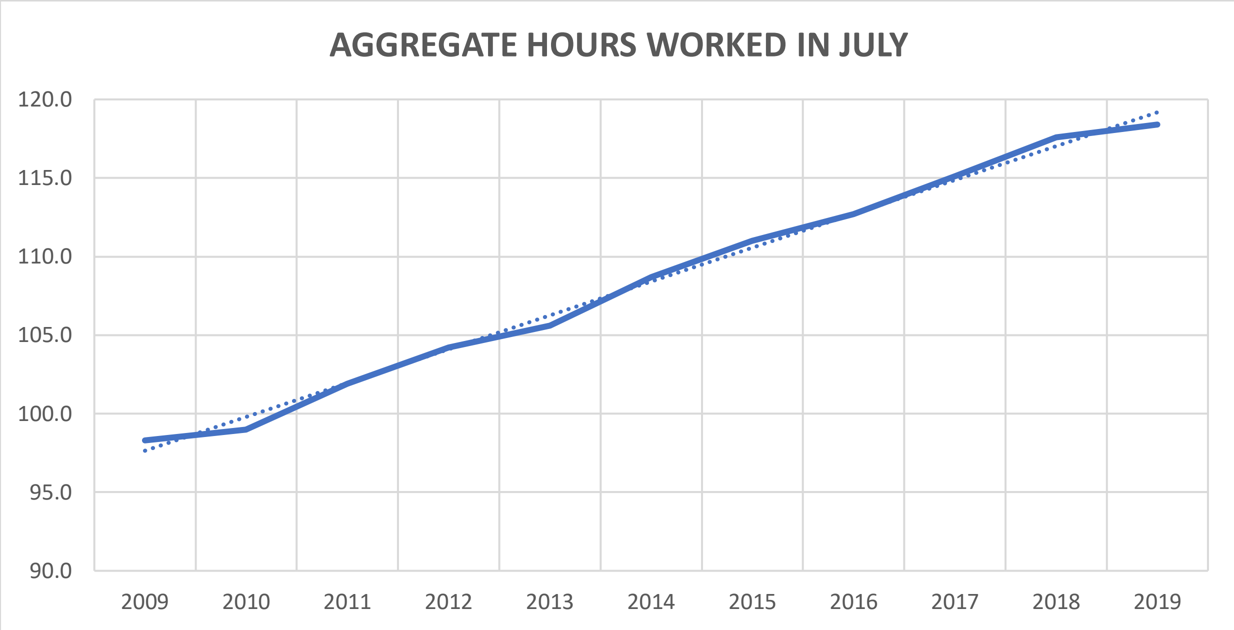
Graph 3.



Our attention is drawn to the fact that since 2014 and the fall in the rate of profit, the growth in the composition of capital has been reversed. This is a function of a fall in the rate of fixed investment combined with the increase in the employment of labour power. The best indicator of employment is not jobs, but the aggregate hours worked as this smooths the data by taking into account not only workers in employment, but the average working week and the division of jobs between full-time and part-time.

Graph 4 plots the increase in hours worked. Coming out of the recession in 2009/10 the uptrend is fairly even until 2018 when it begins to flatten. This plateauing effect is much more pronounced than the slight deceleration found in 2016. The comparison is based on the annual changes to hours for the month of July as this is the latest month the series is based on.

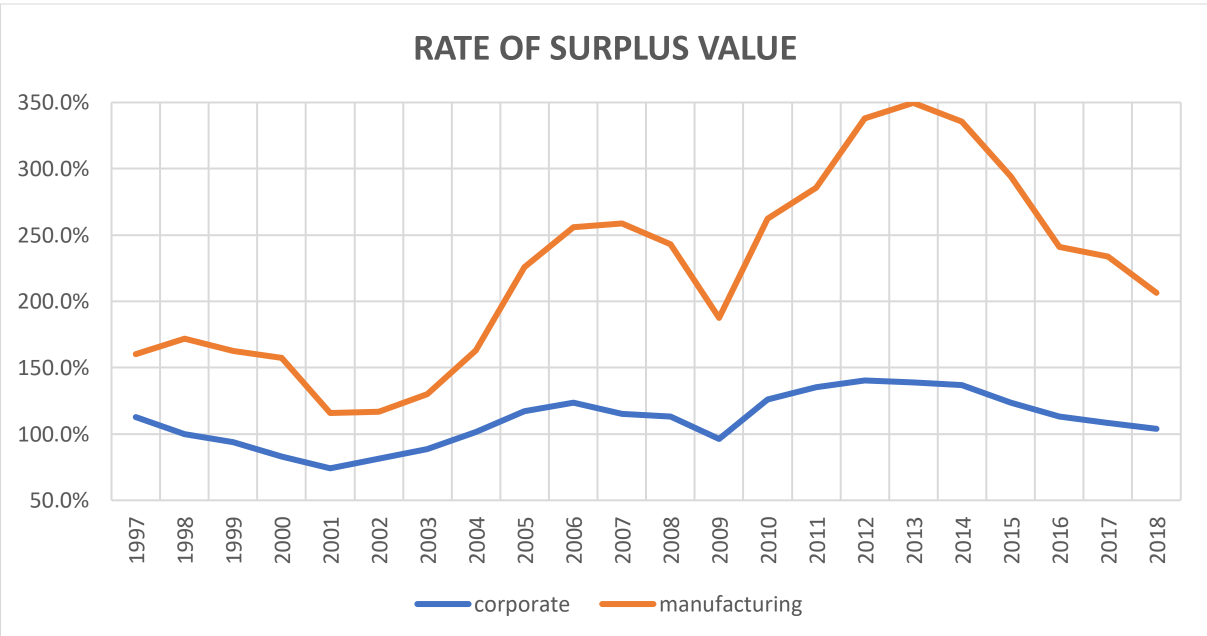
Graph 4.



https://data.bls.gov/pdq/SurveyOutputServlet INDEXES OF AGGREGATE WEEKLY HOURS OF PRODUCTION AND NONSUPERVISORY EMPLOYEES, 2002=100

The final graph in this section is the rate of surplus value. Once again this differs in magnitude and volatility compared to other Marxist analyst's because it uses variable capital rather than the annual compensation of workers. Variable capital as the spreadsheet shows is obtained by dividing annual compensation by turnover. It is the much steeper fall in the rate of surplus value in manufacturing, which together with the rise in the composition of capital, that explains why in Graph 2, there is a much steeper fall in the rate of profit in the manufacturing sector. Preceding this, it also explains why the rate of profit in manufacturing peaked at 10% in 2014 compared to 7% for the corporate sector.

Graph 5.



I find it a redundant argument as to whether or not Marx's assumptions hold true. They do. There is a beautiful symmetry between the rate of turnover, the rate of surplus value, the rate at which the composition of capital rises and the all-important rate of profit. Those academics that dispute this need to leave their ivory towers and count the horses' teeth. This symmetry in all its majesty, cannot be seen unless we include the rate of turnover. In its absence, we cannot distil variable capital, and, unless we obtain variable capital or v, the following formulae remain out of reach, c/v, s/v and s/c+v. I refer of course to the value composition of capital, the rate of surplus value and the Marxian rate of profit.

Conclusion.

The markets recovered gradually from their recent turbulence this week. The key support that kicked in was the buoyant retail sales in July. However, real retail sales are overstated. The BEA's annual RPI is set at 1.8%. But when Walmart cites that its annual inflation is 2.2% and the largest consumer company of them all, Procter and Gamble, cites that it is 3% in both their recent financial returns, then we have to question the BEA's calculations. However, despite being inflated, retail sales remain stable.

Mike Wilson is Chief U.S. Equity Strategist and Chief Investment Officer for Morgan Stanley. He recently stated that over 100% of the recent move in the S&P 500 has not come from a change to fundamentals but from rising valuations based on the expectation of further FED easing. He also believes that earning and economic disappointments will soon assert themselves. He is correct. When falling retail sales are added to the mix of other negative fundamentals, these can no longer be ignored.

It seems paradoxical, that with the US facing a profit crisis, the financial media has become obsessed over the last two days with reports that capitalism is about to abolish its pre-occupation with profits and shareholder value, re-emphasised by Milton Friedman in the 1970s. Milton Friedman's inane assertion was the equivalent of a gynaecologist saying that a new-born baby's first gasp for air signalled the invention of breathing. Tosh.

Of course capitalists have always been obsessed with profit knowing it to be their sole shield against the whip of competition. To now relegate it to one of five considerations, as the US Business Roundtable has done is the equivalent of saying that pupils no longer attend school primarily to study and pass exams, but also to cook for their teachers, to clean the school and generally help the elderly cross the road outside the school. Bunkum. ((*US companies ditch investor-first creed that has driven capitalism since the 1970s.* F.T. 20/08/2019)

Profit is the heart and soul of capitalism. The rate of profit alone informs each and every capitalist whether they should increase or decrease their investments or where best to invest. Excise it and the ship loses its compass. The issue of profit comes to the fore, precisely when the rate of profit is low. A low rate of profit suffocates investment, and when investment falters, the economy always stumbles. So it is foolish for the Roundtable to be having this discussion when capitalism itself is in jeopardy.

To revive the economy, the rate of profit needs to be restored. This leads not to an 'inclusive' capitalism, but an exclusive capitalism, one which purges considerations of "worker wellbeing", or the "environment", to focus on cold sharp cost calculations. Capitalists have no choice. Either they "*personify the needs of capital*" (Marx) or they need to retire to their bunkers.

The 5% level of profit is critical. It can be termed the Japanese level of profitability. (See accompanying spreadsheet: "*Turnover Japan 2015*"). This is the level of profit associated with capitalist stagnation. It is of course unusual for stagnation to precede a crash as it tends to be the consequential phase of such a crash. However, it would be wrong to draw the conclusion that stagnation will prevent a Crash, or that it is the price paid for an averted Crash. Quite the contrary. The more capitalism leans on a crutch, the more heavily it will fall once that crutch breaks. Once the recognition emerges, as it will in the face of deteriorating fundamentals, that central banks cannot prevent crashes, only partially deal with their aftermath, then the Crash will occur. Further discussion will take place once Quarter 2 profit figures are out

Footnote:

I have also added a spreadsheet to show how I calculated the rate of turnover for the corporate sector, which has been problematic because the BEA does not release Gross Output figures for this legal sector. In frustration I have decided to use the turnover figures for the entire goods producing sector as this sector provides more than 50% of the revenue and profits found in the S&P 500. There is a slight under-estimation using this sector of no more than 0.2% in profit rates, but at least it is a consistent under-estimation which leaves the profit trend unaffected. I have attached the file: "*Determining the rate of turnover for corporate*". The rate of turnover here is limited to 1997 to 2018 as pre-1997 data has not had the 2012 GDP revisions added to it. Paradoxically, the pre-2012 data gives a more accurate rate as it excludes the duplications introduced by the 2012 revisions.

Brian Green, August 2018.