

## **Zoomibar. Global prospects at the end of lockdown.**

*Here is the introduction I presented to the joint Zoom discussion with Michael Roberts this week. Michael is currently editing the discussion and will publish the interview shortly. When he does, I will provide the details you need to view it on Zoom. The projection by the Bank of England today, for a 14% contraction in UK GDP, is in the ballpark of the projections discussed on Zoom. This is the most important economic discussion since the war, and, one in which we all should engage with.*

I would like to begin by thanking Michael for arranging this Zoom event. There can be no more important discussion than the one we are embarking on: perspectives for the world economy on exiting the lockdown.

We all recall the vivid pictures of temperature testing at airports and other public areas once the pandemic broke, in a desperate attempt to capture those contagious. Similarly, with capitalism, its temperature is the rate of profit, because it alone can determine whether the economy is sick or not. The only requirement for assessing the future is to first comprehend the past. Thus, our starting point has to be the rate of profit as it presented immediately before the pandemic or plague.

Both Michael and I are adamant that profit determines investment and not the other way round. The cart does not lead the horse. The operative rate of profit, that is the one that informs investment decisions, is the enterprise rate of profit. I use pre-tax and unadjusted non-financial corporate profits as the biggest body of uncontaminated profits in the economy. It is then divided by fixed and circulating capital. I believe this rate of profit to be the operative rate and not the rate of return which excludes circulating capital.

I do not wish to dwell too much on the subject of circulating capital having suggested to Michael that we organise a future panel to debate the method which provides the most accurate estimate of the rate of profit but I would like to draw attention to the strange phenomenon that has emerged post the financial crisis which helps explain the sharp fall in the rate of profit found in Graph 2.

### **Graph 1. (all graphs to be found at the end of article)**

Michael, you have provided numerous examples of how fixed investment has fallen below trend post the 2008 crash. I believe it is one of your supports for the view we are in a depression. What is seldom observed is how this fall in fixed investment has both slowed the rate of turnover and is associated with a growth in circulating capital. Graph 1 shows how the share of circulating capital in US manufacturing has stopped falling after the 2008 crash. In the ten years prior to the crash it fell quite rapidly in manufacturing by around one fifth, from 38% to below 31%. In the ten years following the crash no decrease, even a slight increase. This flatlining expresses the structural changes that took place in US industry with a growing reliance on employing labour rather than additional means of production. This flatlining is consistent with US manufacturing capital sweating its assets, by means of extra shifts, longer shifts, and, up to and including substituting cheap labour for machinery and equipment. And it answers the question as to why productivity growth has decelerated.

In sum, this means there is little scope after the pandemic for further rises in the absolute rate of exploitation. Those gains are behind the economy not in front of the economy which is a negative for the future prospects in the economy.

I will now present the rate of profit for the USA.

### **Graph 2.**

There are two important points in the graph to note. Firstly, that the rate of profit last peaked in 2014 and has fallen for 5 years in a row since then. This is unprecedented without precipitating a recession. Secondly, that at around 4.5% pre-tax, it is much lower than expected compared to other measures. In fact, considering this is an average, which masks unevenness, and taking into account the cost of capital at over 3.5%, it means a significant portion of US corporates are in fact unprofitable.

I would like to make a quick point about China acknowledging that you will be dealing later with the larger picture of profitability globally. It is not the case that the fall in profitability in the US is due to the rise in profitability in China. China's complex rate of return peaked in 2013 and the decline in its rate of return and turnover has mirrored that of the USA.

Now this fall in profitability should have led to a fall in production. When examining the global economy in 2019 this is confirmed. Whether it was investment, or industrial production or the trade in goods, we find at best stagnation or at worst actual contraction. And yet the global economy apparently continued to expand. This expansion was driven by personal consumption expenditures which was derived mainly from capital gains in the stock and bond markets.

To co-opt a medical term in this time of plague, Central Banks were treating economic symptoms with ever cheaper money while the underlying health of the global economy deteriorated. An economy driven by falling interest rates rather than a rising rate of profit, by personal consumption paid out of speculation rather than productive investment is a profoundly unhealthy economy. That was the case with the global economy prior to the outbreak of the plague. The neo-liberal claims that economies were robust had more to do with admiring bubbles than looking below the surface.

One way of examining the extent of the bubble economy is to compare the real multiple versus the fictitious multiple when looking at stock prices. The real multiple is the inverted rate of profit, that is total capital divided by profit. (Graph 2 inverted.) The fictitious multiple is the regular Price to Earnings ratio found in the financial press which is the market cap of shares divided by their trailing earnings per share. As a result of the discussions I have had with Michael, I have also included the inverted rate of return (fixed capital divided by profit) for reference purposes only.

However, I would like the viewer to concentrate only on the green and red graphs. We note that up to 1997, the real multiple was higher than the fictitious multiple. This is the healthy period, because the fictitious multiple should reside below the real multiple implying that share prices do not exceed the intrinsic value of the corporations on which they are based. We can return to why this should be the case in the discussion later. The gap narrowed in the nineteen sixties during which time there was a share price rally, but it was only with the dotcom bubble that the two multiples swapped positions. I would call this phase of reversal, the emergence of a bubble economy.

For the purposes of this discussion we need to focus on the period post 2013 since when the fictitious multiple has overtaken the real multiple. We have thus been in a bubble economy for the last 6 years, one which neither the pseudo recession at the end of 2015 nor the sharp falls in share prices in 2018, popped. Truly a resilient bubble rather than a resilient economy. Clearly this augers badly for the future, post Covid-19.

To sum up, the underlying health of the global capitalist economy was poor before the plague, but this was obscured by cheap money driving speculative gains which fed back into the economy in the form of consumer spending. Literally, the global economy was suffering from an underlying condition.

This explains why the global economy was on central bank ventilators pumping out cheap money every time the bubble started to deflate.

## **FUTURE PROSPECTS**

We are now in a position to investigate the future. Making predictions is now more difficult than ever. Not only is the virus novel, but so too the economic problems it has thrown up. We are enveloped in the murk thrown up by four imponderables. (1) How long will the lockdowns endure? (2) How quickly can the lockdown be unwound? (3) When will a scaled-up effective inoculation be available? (4) in the event of vaccine failure can herd immunity be achieved through controlled contagion?

The evidence is emerging that lockdowns result in a contraction in economic activity of at least a third. Thus, on an annualised basis, every month of lockdown leads to a fall in annual GDP of around 3% and not the 2% figure cited originally. We recall that with very few exceptions analysts underestimated the economic impact at each stage. US GDP has already contracted 4.8% provisionally in the first quarter and Goldman expects a final -8%. That quarter included only one severe month, March. The second quarter, ground zero for the pandemic, could see the biggest quarterly fall in history approaching 40% according to the CBO (Congressional Budget Office). I believe the fall will be less than 40% but even so, the lockdown and unwinding could lead to a 15% fall in annual GDP, exceeding the 13% fall in 1932. Therefore, in those countries with extended lockdowns and problematic exits, we could expect an irreplaceable and severe loss in value and surplus value in 2020.

The extent of the period of lock down depends primarily on the underlying health of the nation and only secondarily on the success of the measures carried out to limit spread. This is particularly true for a potential second wave of infections in the absence of an inoculation. This becomes clear when we contrast Sweden to England. Bless them, Johnson and Cummings, fresh from their Brexit triumph, opted for herd immunity and it almost killed them, because that option is only open to a relatively healthy nation like Sweden, not a frighteningly unhealthy nation like England blighted by austerity compounding inequality. So, whereas Sweden will achieve herd immunity in its cities sometime in May, England will be only relaxing the lockdown incrementally.

Thus, the countries with the worst health and demographics will be the ones most undermined by this plague. What is the same thing, those countries with the most severe neo-liberal policies, resulting in the grossest inequality, are the ones that will receive the most severe economic battering. Here the possibility of V shaped recession is absent. This of course includes the USA and Britain.

accordingly, when looking forward we can only deal with vague theoretical constructs. In this regard, four questions arise, one of which was formulated by Michael. The first, can this epidemic inadvertently lead to the improvement in the rate of profit by accelerating the death rate of redundant capital, that is lead to the widespread destruction of Zombie capital. The second is the effect on government finances. The third is inflation and the fourth is interest rates.

I will tackle these issues in reverse order. Contrary to popular belief it is the rate of profit and its effect on investment which helps determine the rate of interest, by altering the relation between the demand and supply of loanable funds. Since 2008 central banks have interfered in the market by capping interest rates especially the short-term interest rates most associated with circulating or working capital. This has inhibited the rate of interest from playing the essential role of purging excess capital and debt from the system. This was particularly true at the end of 2015 when a full-bodied recession was averted. Instead of purging debt, low interest rates since then have encouraged its opposite, the taking on of debt, particularly by lower grades of bonds due the compression of rates by those investors hunting for yield.

However, this plague, despite the best efforts of central banks, has led to an increase in interest rates, particularly the lower grades. The rate compression which before averaged 80 bps has now expanded to 360 bps. For more on this please follow the link below.

It is unlikely that the compression will be restored. There are now too many insolvent industries. While it is true that the FED, for example, has promised to buy sub-prime bonds, which is actually illegal under its charter, (but hey laws are only for the little people) it has stepped back. Since the bond markets have stabilised the FED has refrained from engaging with the junk bond or high yield markets, but it may purchase this debt should market conditions deteriorate once more as optimism for a cure fades.

Next government debt. Will the rise in gilt and sovereign bond issuance crowd out private bonds? This describes the monetarist's lament which has not materialised to date. But it is a consideration given the scale of expected global issuance unless central banks buy back their debt or its equivalent. The sums are large. Fiscal deficits around the world are estimated at -20% this year and -10% next year. Thus, most countries will see government debt to GDP spike above 100%. As cited later, the IMF expects a global average of 120% next year. It is likely that some of this issuance will be monetised, some repaid through higher taxation and of course more austerity, the very thing that created this viral paradise in the first place.

Japan has shown that these levels of government debt are tolerable. There government debt is double the size of its GDP. However, with a sharp worldwide issuance of government debt, interest rates could respond, resulting in a general rise in interest rates. Should that occur, then the first point, the destruction of capital will be more probable. Here we should recall that only a handful of nations have currencies which allow debt to be monetised.

Inflation is the elephant in the room. The war on the virus is different to a normal war. Normal wars see the expansion of production even if that means armaments, not the closure of production. Thus, in times of war increased government spending is met with increased industrial production, whereas now, increased government spending is met by a collapse in production. Theoretically this could become inflationary, once inventory is used up, particularly food inventory. If this happens, and if inflation is not patchy, namely confined to non-durable goods, then fixed capital and debt can be depreciated complimenting the physical destruction of capital. Generally, they go in tandem. While inflation assists debtors with existing loans at the expense of creditors, once loans have to be refinanced on expiry at higher interest rates, that reverses, the interest rate rebound favouring creditors at the expense of debtors thereby raising the spectre of insolvency.

Government debt globally was elevated prior to the plague reducing the state's capacity to support Capital. Support is bifurcated. Government injections go towards working capital, while central bank support is intended to preserve fictitious capital. Focusing on treasury or fiscal support, the bulk of assistance is going towards working (circulating) capital, allowing stretched corporations to retain labour and pay suppliers. It is not going towards fixed investment except in select areas associated with healthcare. It is unlikely that governments will have the capacity to stimulate fixed investment after the pandemic subsidies either to expand or modernise production as this will raise the stimulus over two years to 40% of GDP. The IMF estimates that global government debt to GDP will exceed 120% next year. In any case capacity utilisation will have fallen by a quarter which acts as a barrier to additional investment. Under conditions of excess capacity, working capital remains the priority as its increase alone can improve capacity utilisation. In the absence of the rise in working capital absorbing excess capacity, this excess capacity will have to be culled as excess fixed assets drain profits and tie up capital unproductively because of their maintenance costs.

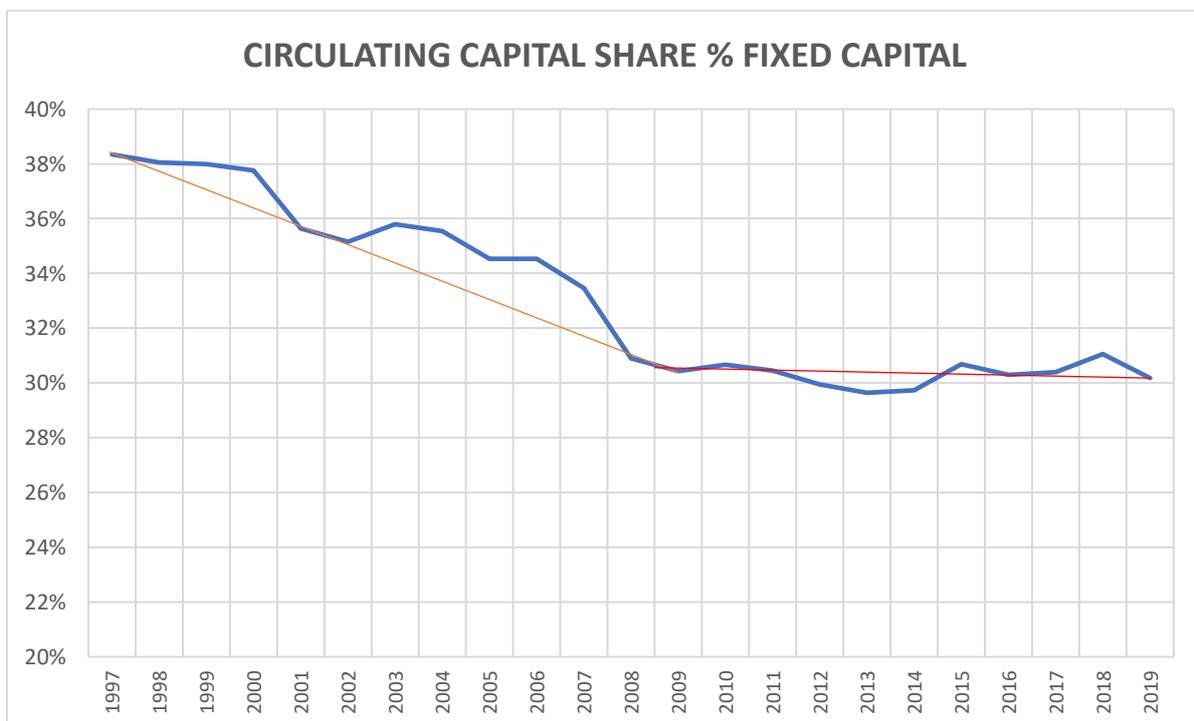
Returning to inflation. Excess capacity of the order we are discussing is normally associated with deflation not inflation. This suggests that inflation should it surge, will do so over a short period only. The longer-term outlook is deflationary.

In conclusion, the combination of low rates of profit, subdued consumer spending, insolvencies, the 20-year old lava flow of corporate debt as well as overburdened government finances, all act as a barrier preventing the global economy bouncing back. Rather they are the conditions which presage a depression. Capitalism entered the plague in a fragile state despite easy money, a fragility exposed by the plague, and it is unlikely it will withstand this viral blow without long term injury.

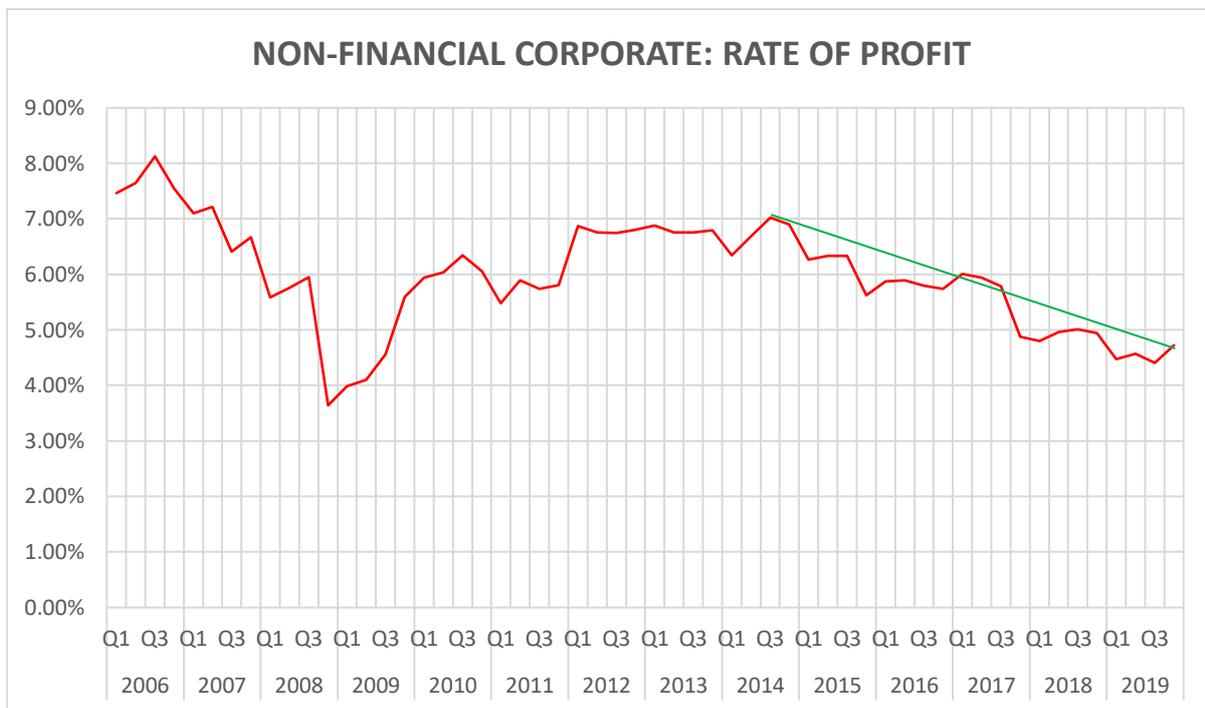
There are no longer any drivers in the global economy other than War. China is economically exhausted robbing the world economy of its last driver. In any case the global economy has fractured and the hegemonic struggle between China and the USA has escalated. The only positive for the capitalist class remains a subdued working class. But this may not continue as working classes around the globe fight for their economic survival in a multi-year depression taking place on an overheating planet.

The probability that capitalism would survive the Financial Crash of 2008 was high. The probability that it will survive the Crash of 2020 is much lower.

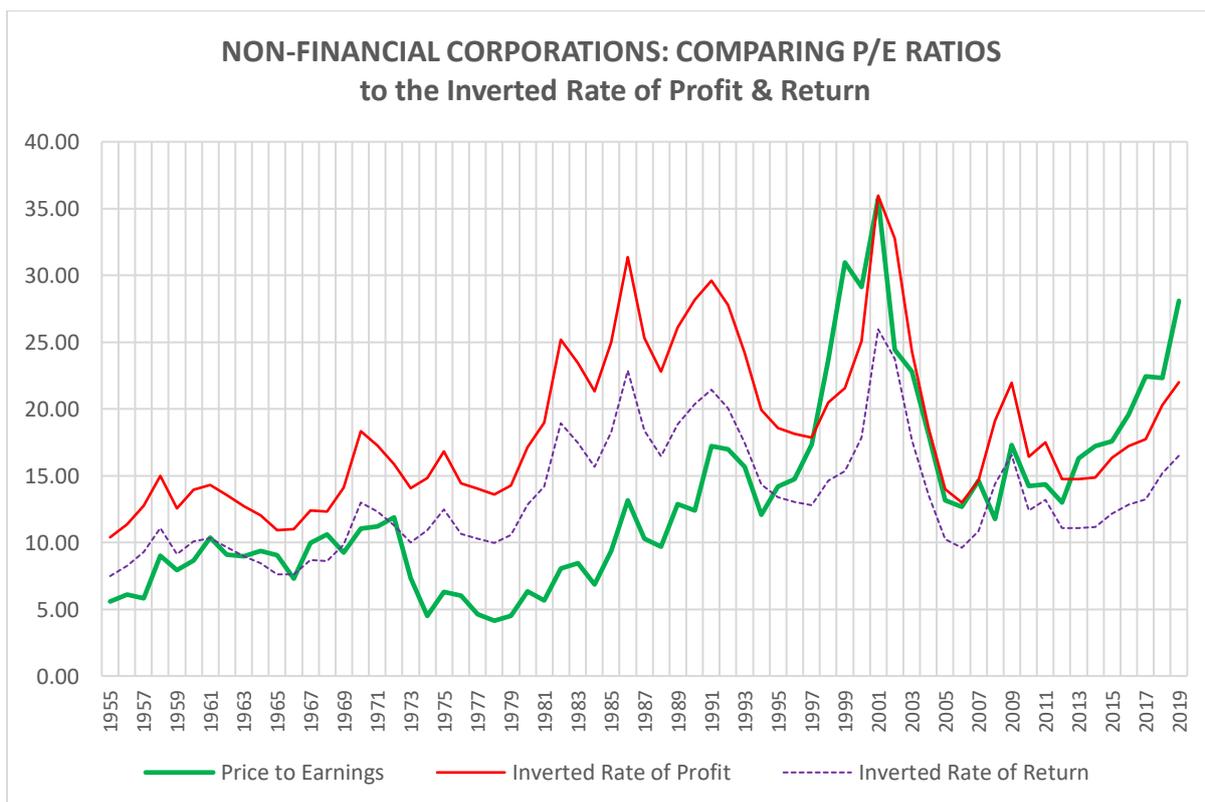
**Graph 1.**



**Graph 2.**



**Graph 3.**



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