IN 2020-2 THE US RATE OF PROFIT HITS A POST-WAR LOW

At 3.6%, the enterprise pre-tax rate of profit for non-financial corporates matches the low of 2008. Unlike 2008 where profits collapsed because of write offs, this time round it was due to the absence of surplus value and therefore profits being produced in the first place.

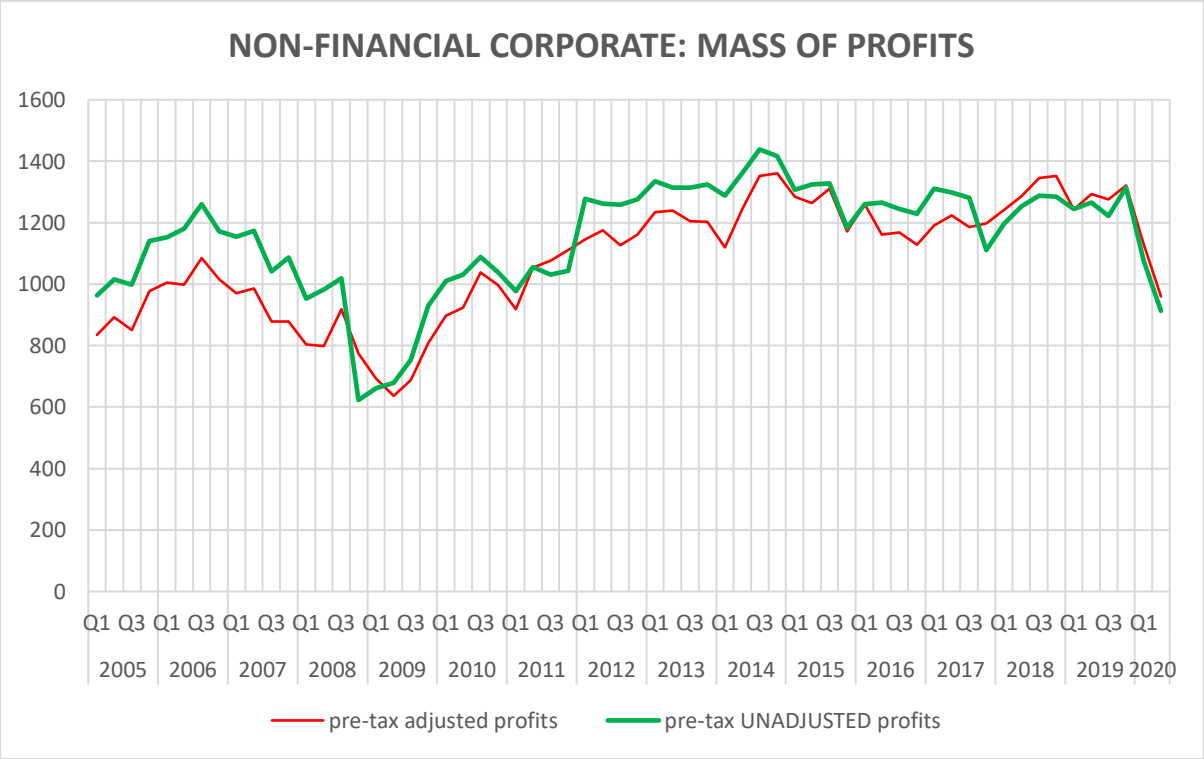
The collapse in the rate of profit this time round should not be confused with the financial crash. In 2020 the capitalist body is anaemic, not because it lost blood as in 2008, but because little new blood was produced because of lockdown. The BEA correctly deducts write downs from profits and there was a deluge of write downs in post-2008. This time round the collapse in commodity production took its toll on profits directly. However, the write downs are yet to come, and come they will.

The annual fall in the mass of profits of 27.8% was below the 40% expected. (See line 32 on the attached spreadsheet "Table 1.14 Q2 2020") The projected figure of 40% was derived from the 34% fall in S&P 500 profits and a 97% fall in Wilshire 2000 profits. (FactSet and Bloomberg data). Had the fall been 40%, then instead of a rate of profit of 3.6%, the rate would have fallen to just below 3%.

The fall in the mass of profits is shown in Graph 1 and Graph 2 below. In Graph 1, both adjusted and non-adjusted profits are provided. Adjusted means adjusted for inventory appreciation or depreciation and adjustments for capital consumption, or, abbreviated, IVA and CCAdj (line 27 versus line 32 for unadjusted). I prefer unadjusted as it is closer to net value added. Pre-tax figures are used to calculate the enterprise rate of profit in order to avoid the distorting effect of tax changes.

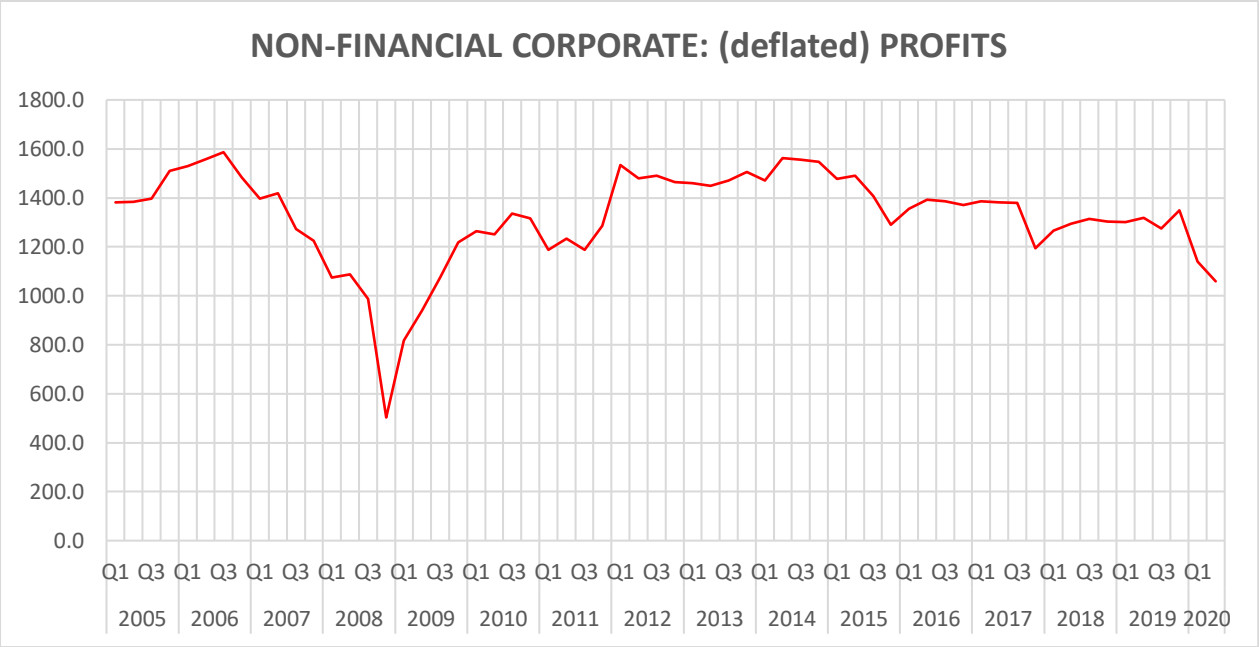
In Graph 2, only the unadjusted figure is used. For the purposes of deflating profits in Graph 2, the chained figures found at the bottom of Table 1.14 are used.

Graph 1.



(Source: Nipa Table 1.14)

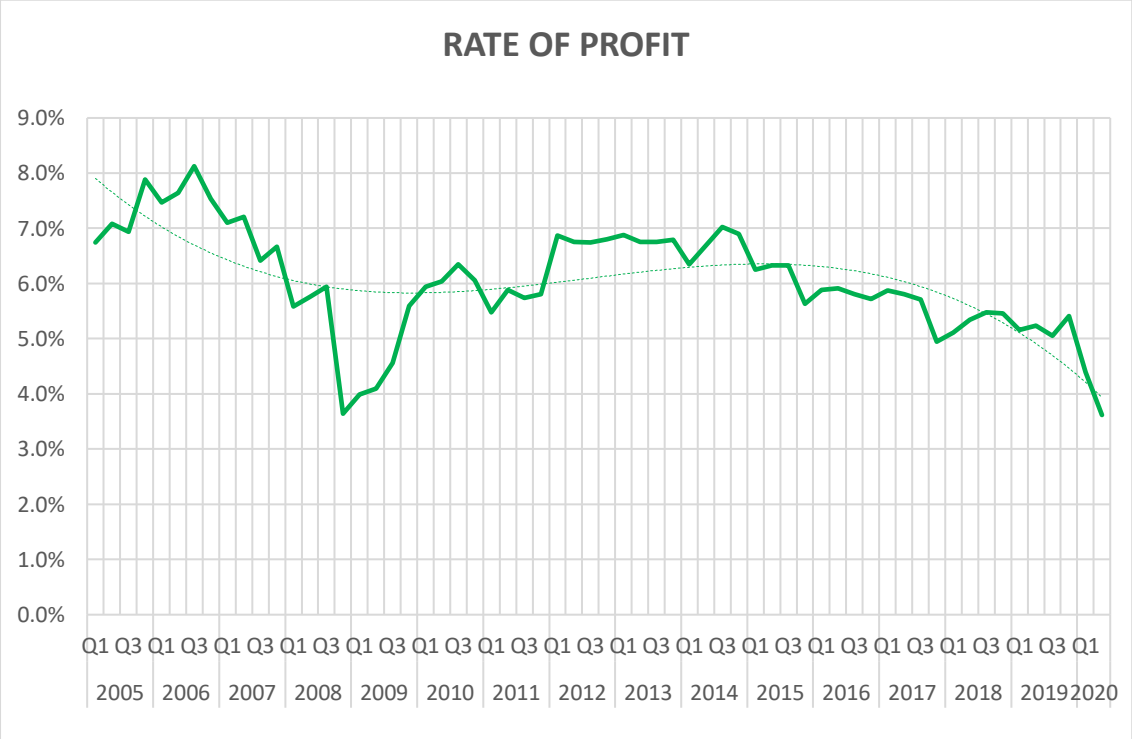
Graph 2.



Turning to Graph 2, we note that peak profits in both 2014 and 2006 were approximate. There was therefore no permanent collapse of profits post-2008. This occurred only after 2014, since when profits have fallen by 47%. In fact, 2020 will be the 6th year in a row when annual profits have retreated from their previous high. This is unprecedented without precipitating a recession.

Clearly such a fall in profits has significantly depressed the rate of profit which has fallen from 7.0% in 2014 to 3.6% currently.

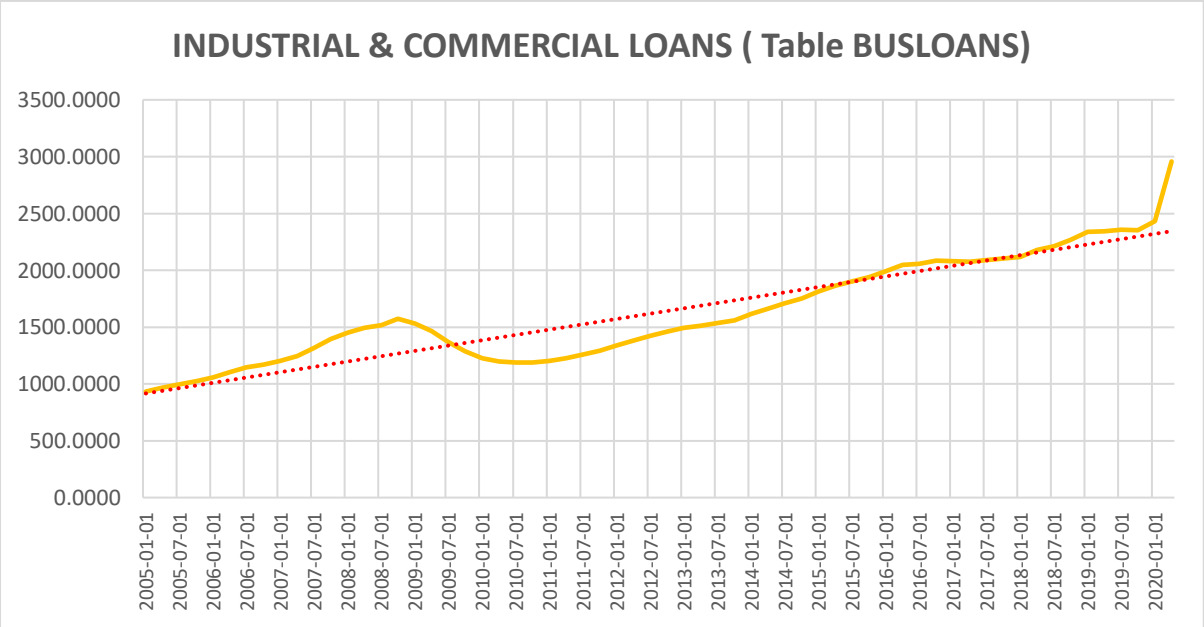
Graph 3.



It may be asked how it is possible to obtain the current rate of profit when the data required for fixed assets was last updated in 2018. The starting point is NIPA **Table 5.1. Saving and Investment by Sector.** In this Table, covering Q2 2020, is found both fixed investment and capital consumption for Domestic Industry. (See attached spreadsheet "saving and investment Q2 2020") By deducting capital consumption from fixed investment, net investment is obtained for the domestic industry. This net investment or the addition to the body of fixed investment is transferred to NIPA Table 4.1 which yields total fixed assets up to 2018. Table 4.1 reveals that the share of assets in domestic industry belonging to non-financial corporate business is approximately 70%. Thus 70% of net investment is incrementally added to the year end 2018 total. The current estimate for fixed capital is thus realistic.

The bigger problem this time around, is calculating circulating or working capital. To calculate circulating capital, it is necessary to first distil the annual rate of turnover of circulating capital for the quarter. Downturns are always associated with rapid deceleration in the rate of turnover, or what is the same thing, the elongation of the period of turnover. Such an elongation requires additional working capital to cover the extension. The second quarter saw the sharpest quarterly contraction in production and circulation for centuries, not decades. This is confirmed by the graph below taken from a recent posting on turnovers for Q1. It shows a spike in additional loan capital in the second quarter indicating a rapid fall in the annual rate of turnover for the second quarter. https://theplanningmotivedotcom.files.wordpress.com/2020/08/turnovers-before-the-pandemic-pdf.pdf (Turnover data is due to be released by the BEA on the 30th September).

Graph 4.



I have assumed a fall in the rate of turnover of 20% when calculating the amount of working capital in Table 1.14. An alternative method of calculating Gross Output, one of the variables in the turnover formula, is to use Total Business Sales as a proxy. This covers the combined sales of the manufacturing, wholesale and retail sectors. Using this data and applying it to the gross output total in the first quarter, reduces it by 10.4%. In turn this yields a rise in the rate of turnover instead of a fall, suggesting that total business sales in Q2 were inflated. (I have criticised sales figures on numerous occasions previously.) In all cases and without exception, the turnover formula always highlights anomalies in the underlying data. If we were to use the data from Total Business Sales, the rate of profit would fall to only 3.9%, rather than 3.6%

In passing, Michael Roberts in his current posting also provides an estimate for the recent quarterly rate of profit (return). It shows only a 10% fall in the rate based on net surplus rather than corporate profit, instead of the 47% fall found in this article. Further down in his article he provides a graph which shows that corporate profits fell by 37% from its peak in 2014 of $1.438 trillion. Given this fall, and, given the rise in the value of fixed assets since 2014, the IRR figure he uses to obtain his rate of profit (return) is unsustainable.

Furthermore, it is negligent to omit circulating capital, particularly during a recession when it swells before it falls. According to the figures used, fixed capital increased by $665.7 billion between the end of 2018 and Q2 2020, whereas circulating capital increased by $1020.2 billion, deepening the fall in profitability. The rate of profit cannot be determined when omitting circulating capital at this time.

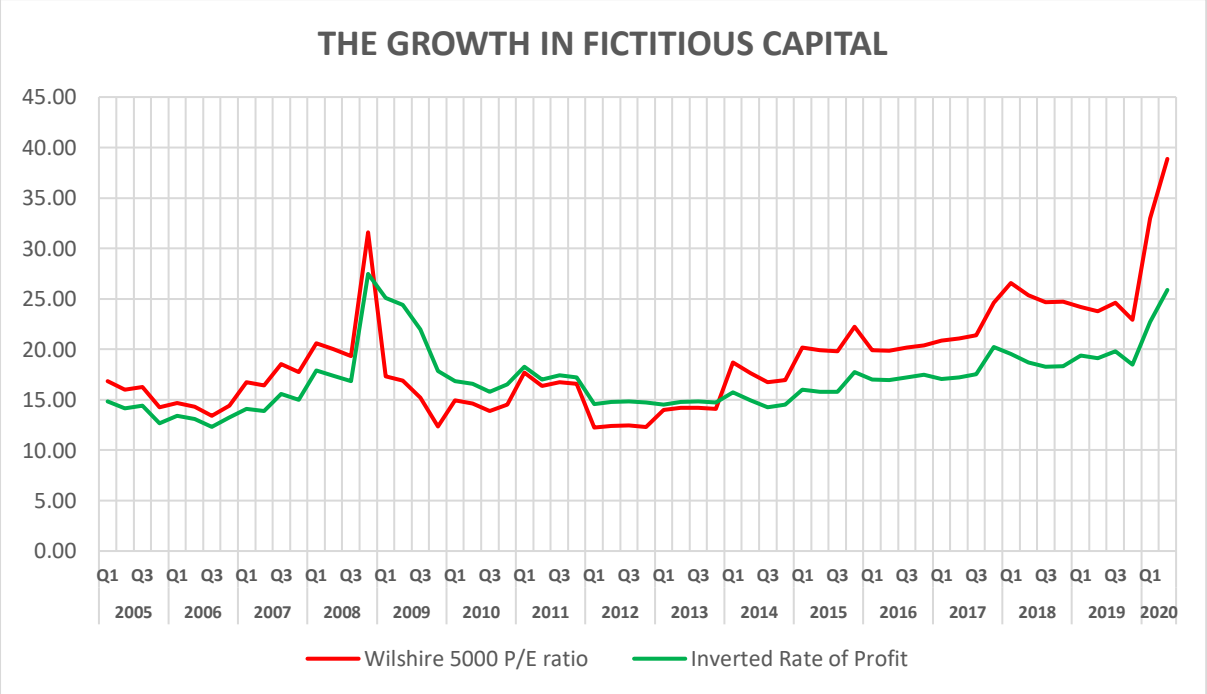
The Holy Fed.

This ongoing collapse in the rate of profit, the heartbeat of capitalism, has not disturbed the stock markets, except briefly in March, that is until the FED administered CPR in the form of a burst of credit. Today the markets have regained their pre-Covid peaks to form new peaks, ignoring economic gravity. Truly, the FED has become a levitator.

An interesting graph which shows the extraordinary levels reached by the US stock exchange can be found by following this link. It shows that when compared to GDP, the market cap of US shares stands at 178% of GDP compared to 141% at the height of the Dotcom bubble and 106% on the eve of the financial crash in 2008. https://www.longtermtrends.net/market-cap-to-gdp/

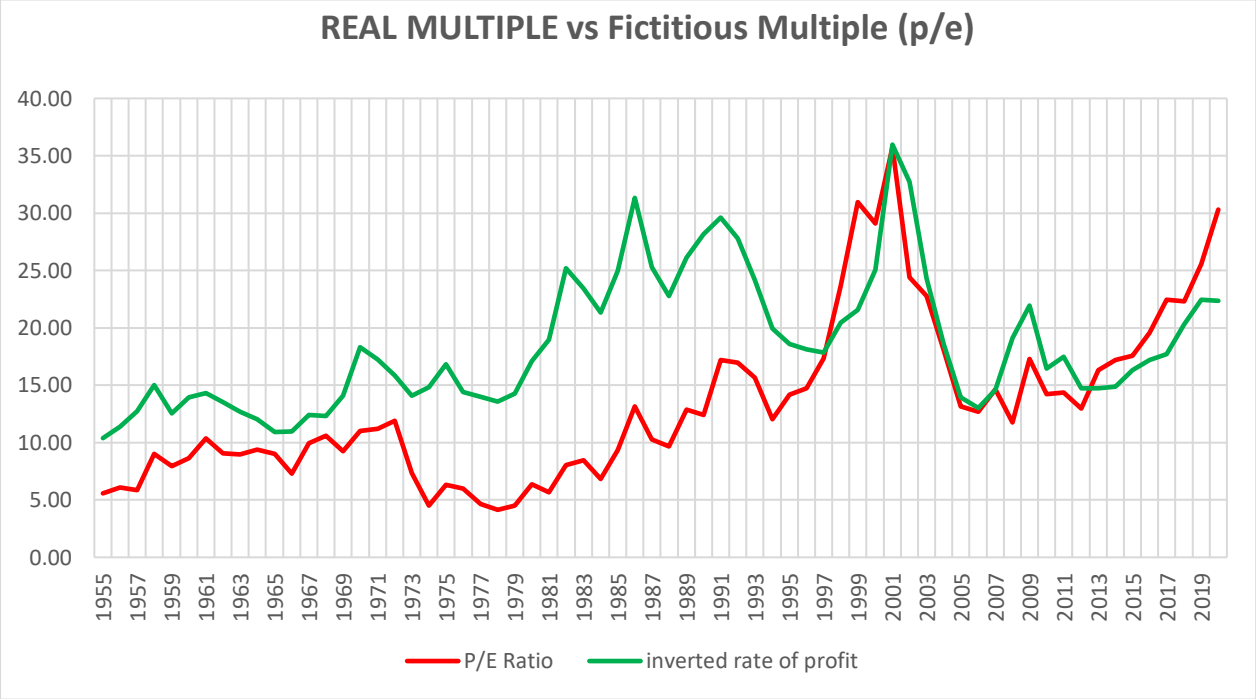
For my part I prefer to compare the real multiple to the fictitious multiple as readers are aware. In both cases, the numerator is pre-tax non-financial profits. (Using total corporate profits would bring both multiples down marginally.) To obtain the real multiple, total capital is divided by profit and to obtain the fictitious multiple, the Market Cap of the Wilshire 5000 is divided by profit. Data for the Wilshire 5000 has been provided by Siblis Research. https://siblisresearch.com/data/us-stock-market-value/

Graph 5.



We note how the red line, the fictitious multiple, has risen above the real multiple as far back as the end of 2013. In 2008 it briefly climbed 15% above the green line. Today it sits 50% higher. Higher than the 44% found prior to the bursting of the Dotcom Bubble. Any time the red line rises above the green line for any period of time, a bubble in shares exists. To put the current bubble in context, I have provided a longer-term Graph taken from an earlier article. It covers the period 1955 to the end of 2019. It shows that bubbles in share prices only emerged in 1997 in the run up to the Dotcom Crash. It then reappeared on an annual basis in 2013. What is unique about the current bubble, and what makes it so catastrophic is its duration, not only its magnitude.

Graph 6.



A further argument is that this bubble is not broad based. According to a recent report in Forbes Magazine, Dan Runkevicius argues that the current driver of the bubble is Tech and FANG. "*Today they make up over than 27.5% of the benchmark index. But if you add in Google (GOOGL), Amazon, and Netflix —stocks that aren't labelled as tech stocks in the S&P— the tech's share in the index swells to a staggering 36.6%.* (**The Stock Market Is Near Correction Levels** The title of his report says it all.) The rise in the share price of these few corporations has seen them secure a share of the S&P 500 higher than the level leading up to the Dotcom Crash, itself a bubble driven by Tech. https://www.forbes.com/sites/danrunkevicius/2020/08/27/the-stock-market-is-near-correction-levels/?ocid=uxbndlbing#7aa37364dee7

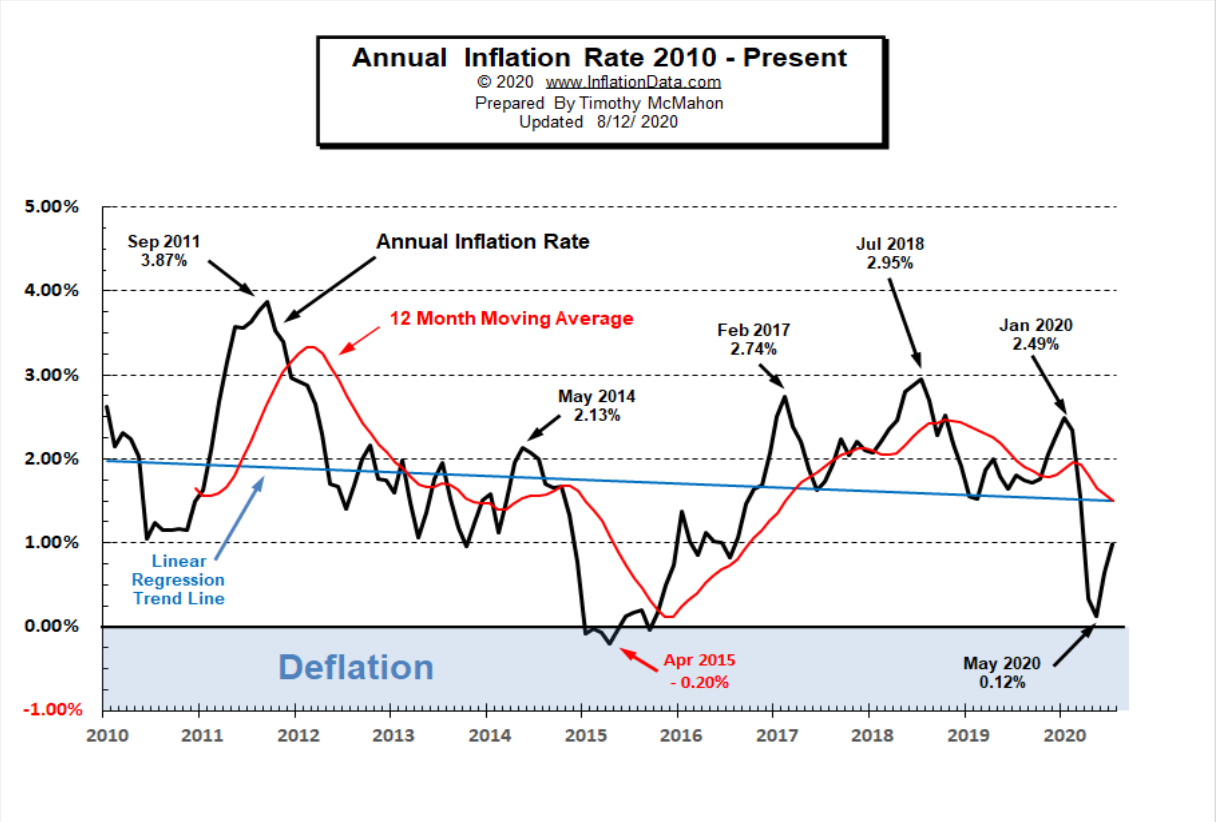
Mr Runkevicius opinion is more pertinent to the Covid era. Taking the longer view, most shares have participated in this bubble. If we compare the data drawn from Siblis' research, then between 2010 and June 2020, the rise in the S&P was only marginally better than that of the Wilshire 5000 which takes in all the small caps and represents the market cap of 97% of all listed shares. The rise during this period for the S&P was 226% compared to 205% for the Wilshire 5000.

Of one thing we can be sure, the imperative for the FED is to keep this bubble inflated. The Bubble is simply too big to fail. If it were to fail it would crater capitalism. The recent declaration at Jackson Hole, that inflation can rise above 2%, if it has been lying below 2% for some time, is an admission that inflation is on its way, particularly if Congress issues a further package of financial support even one

amounting to less than $2 trillion. The FED called for such an infusion knowing full well its implications for inflation and the Dollar.

Already inflation has moved from food to unlikely areas such as second-hand cars and trucks. Below is a useful graph tracking inflation using the same data provided by the Department of Labour Statistics. These figures are up to June. Since then, core inflation jumped to an annual rate of 1.6% in July, or 0.6% month on month, the biggest jump since 1991.

Graph 7.



https://inflationdata.com/Inflation/Inflation_Rate/CurrentInflation.asp?reloaded=true

In reality what the FED has done, has more to do with interest rates than inflation. The FED is making the link between interest rates and inflation more elastic. This means that it will take much higher rates of inflation to move the FED rate. This has been correctly interpreted as a "buy signal" on Wall Street. Additionally, the link between Wall Street and Main Street will become more elastic ensuring that Wall Street diverges more and more from the real world. The FED may be the wind to the back of these sailing ships, but it is driving investors ever closer to the rocks ahead, which investors refuse to acknowledge because that would spoil their party.

The China v US Cold War hots up.

The escalation in the cold war has not spooked US investors. Presumably because they see the US winning this war. This is particularly true for Apple which hopes to profit from the crushing of one of its two rivals, Huawei. Trump's claim of security concerns is deflection. His real purpose is to preserve the technological monopoly of US corporations by means other than competition.

Each day the pressure on China escalates. It is being backed into a corner. To resist or be crushed economically, as Japan was, losing an entire decade, is the choice facing it. Already the pressure is

causing dissent in the Chinese Communist Party between the appeasers and the resisters. The crack down in the party under way has nothing to do with corruption or the misuse of power, it is to stifle the appeasers, those who seek to open the Chinese economy in order to appease US imperialism, those who do not believe that China can complete the transition from contract manufacturer to an independent technological power on its own.

And the cold war is starting to show hot spots. Last week the US flew a spy plane into restricted Chinese air space. The Chinese retaliated by firing carrier and Guam busting missiles in the direction of the US fleet, but ensured they fell far short. More provocations can be expected and should one go wrong, then war becomes a possibility.

China is now going on a war footing. An arms race is in progress. China is raising its military spending to 4% of GDP. But 4% of GDP for an economy that is structured differently to the US, and which has an industrial base quadruple that of the US, means that China will be outproducing the US military by a factor of 3. The US has truly awakened an industrial giant.

In terms of quality (technology), China is beginning to reduce the gap. Its main Achilles heel, engine technology, appears to be overcome. A fortnight ago, China announced that it was satisfied with the performance of its Xian WS-15 engine and that its performance was equal to or better than the Pratt and Whitney F119 engine which powers the F22 Raptor plane. As a result, it was preparing to mass produce its J20 stealth fighters and other jets. These will be pouring out of Chinese factories at a rate the US can only imagine. The US may have fewer technical bottlenecks compared to China, but what it does have, and what it cannot overcome in time, is its industrial bottlenecks or limitations.

It is unclear how the US markets will respond, when the gravity of the conflict between the US and China becomes more apparent.

Of course, from the viewpoint of the international working class, this is a dangerous waste of money and resources. When capitalists fight over markets and profits, it is workers who die fighting their wars. We must prevent this. Time is running out.

Conclusion.

It is important to be specific about the collapse of profits this time round compared to say 2008. The rate of profit collapsed because of the reduction in present profits being produced. It did not result from past capital being written down and deducted from profits. The difference is consequential. In the latter case, the write down of capital, opens the way to the restoration of the rate of profit.

In the former case, none of the underlying conditions dragging down profitability have been addressed. Instead this fall in profits has been substituted by the growth in public debt, itself a drag on profitability. The US Treasury has compensated the losses faced by corporations and their workers with grants which has added to the debt burden of the US government. At the end of the first quarter, US federal debt to GDP was equal to 108%.

Since then it has risen by another 10%. With another Treasury infusion expected, it means that by year end, federal debt could be 20% higher than the figure of 121% reached during the second World War. Can the Dollar act as the world's reserve currency under these conditions of fiscal prolificacy? Unlikely, even when supported by the weight of arms.

Brian Green, 29th August 2020.