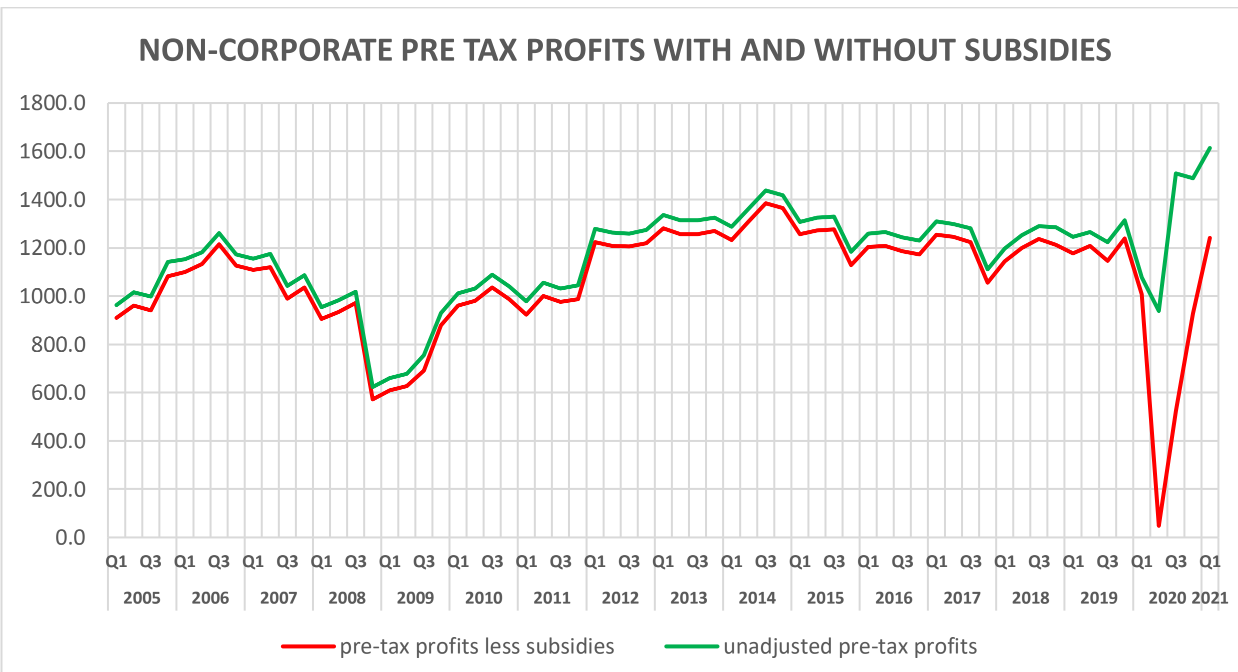
US PROFITS: QUARTER 1, 2021. A SHARP REVOVERY

In this brief report, the profitability of non-financial corporations in the first quarter of 2021 is examined. The mass of profits is presented both with and without subsidies and also adjusted by inflation. In addition the rate of profit is presented with and without subsidies. This differentiated presentation of profitability is due to the presence of extensive subsidies to the corporate world flowing from the various Covid Relief funds. This has tended to cloud the picture by elevating profitability above where it would have been had only produced profits been reported.

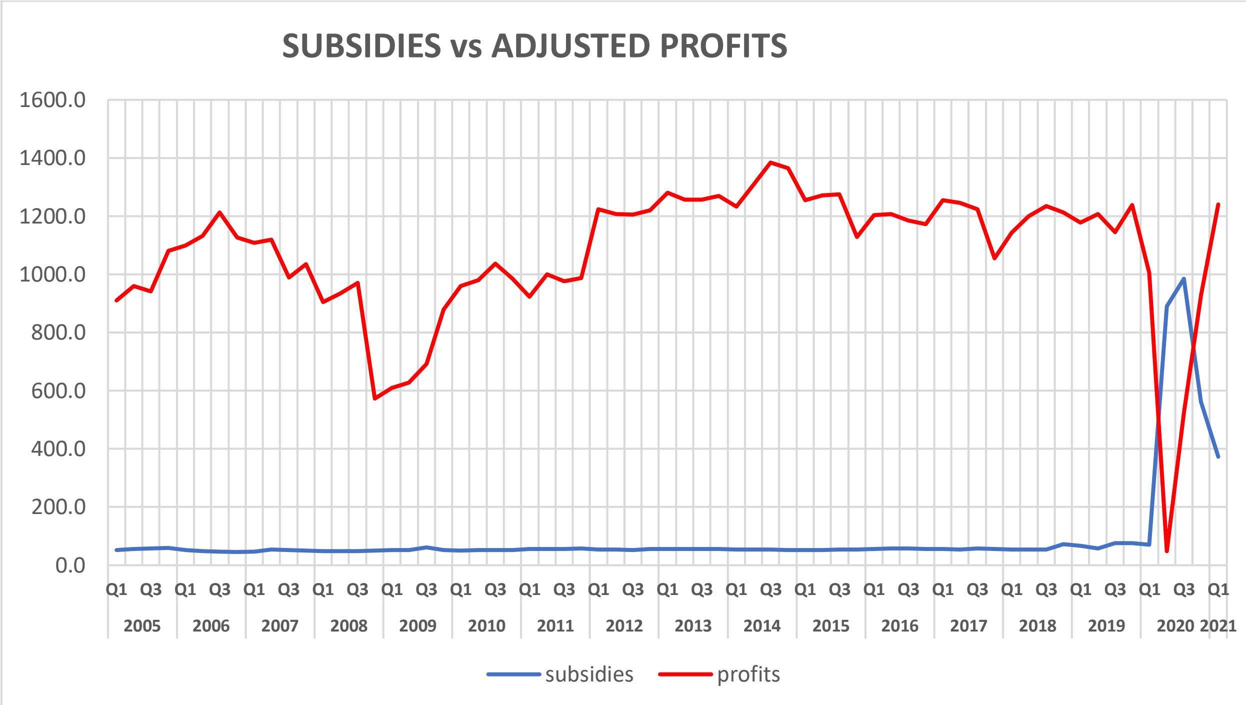
In all cases the profit figure is obtained using row 47 within NIPA Table 1.14 (attached *'table 1.14 profits q1 2021'*). This is unadjusted pre-tax profits. Pre-tax unadjusted profits are chosen because they are unaffected by changes to tax rates and because they are more symmetrical with the net operating surplus (row 31). These profits are then divided by circulating and fixed capital to obtain the rate of profit. Fixed capital is estimated for the last 5 quarters by using capital consumption data which has proved reliable in the past.

Graph 1.



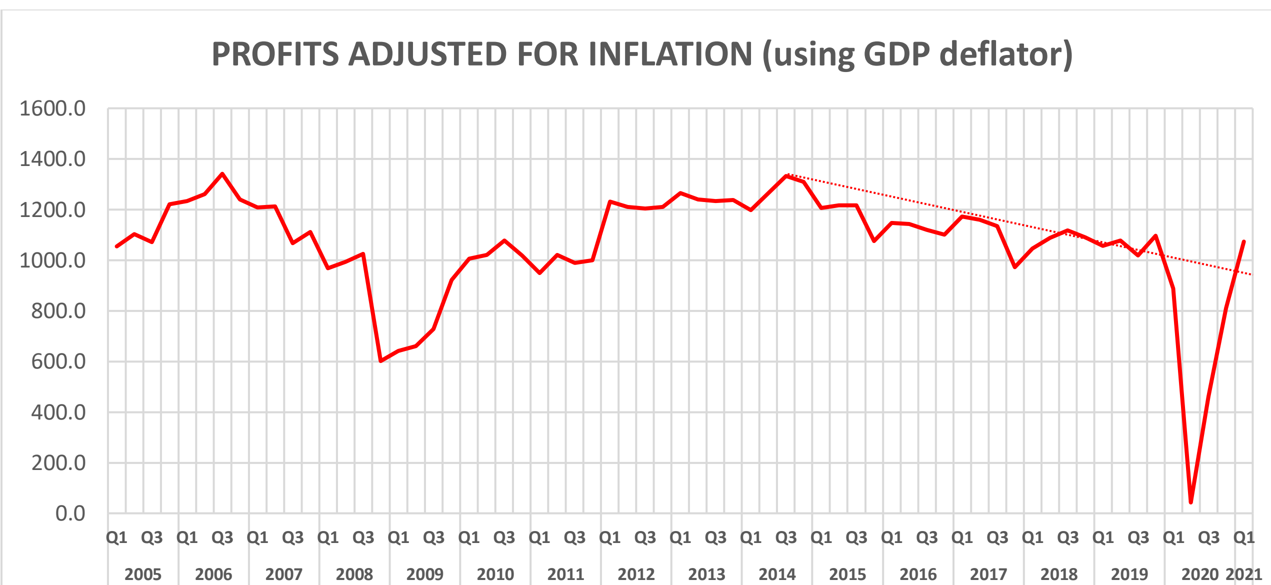
Subsidies are obtained using NIPA Table 1.12. The green graph includes subsidies which have amounted to $1.05 trillion dollars between the second quarter of 2020 and the first quarter of 2021. Thus about twenty percent of the $5 trillion in Covid Relief Funds have ended up in the corporate sector. Graph 2 shows the movement of subsidies and profits stripped of subsidies. The consequences for reported and therefore headline profits have been remarkable. The profit peak in the quarter one is 12% higher than the profit peak found in 2014 in nominal terms. However, without subsidies it is 10.5% lower, a difference of 22.5%. What Graph 2 shows that with the economy opening up, produced profits have revived.

Graph 2.



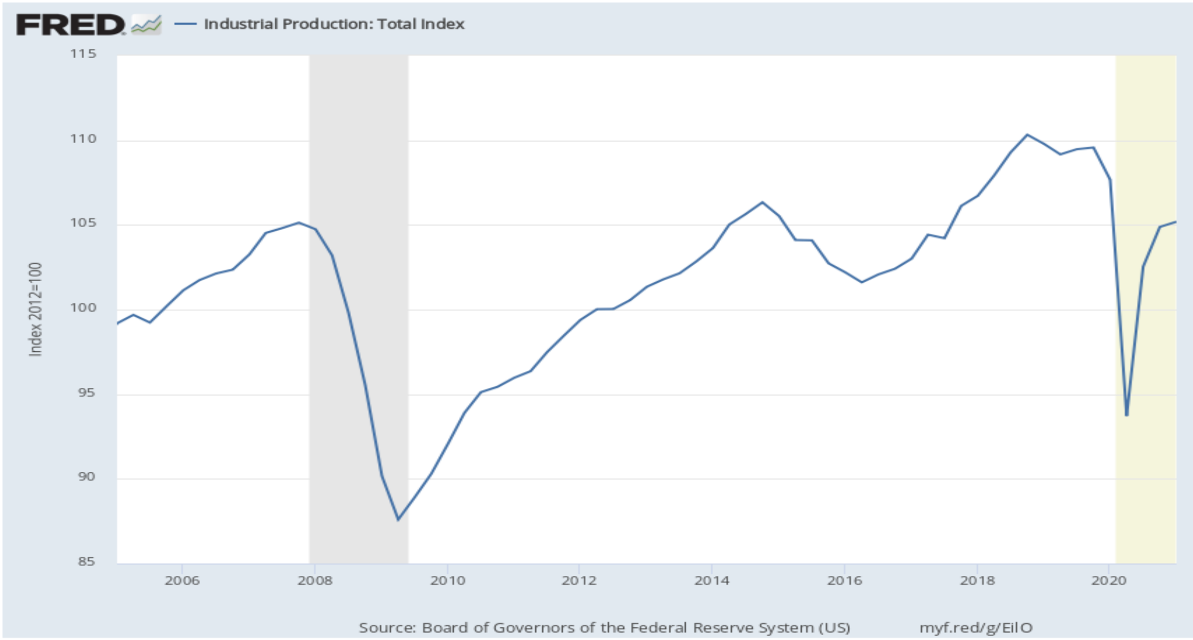
Graph 3 looks at deflated adjusted profits. To deflate profits the Implicit GDP Deflator is used as it is the most comprehensive guide to inflation. On this basis pre-tax profits are down 19% between 2014 and the first quarter of 2021.

Graph 3.



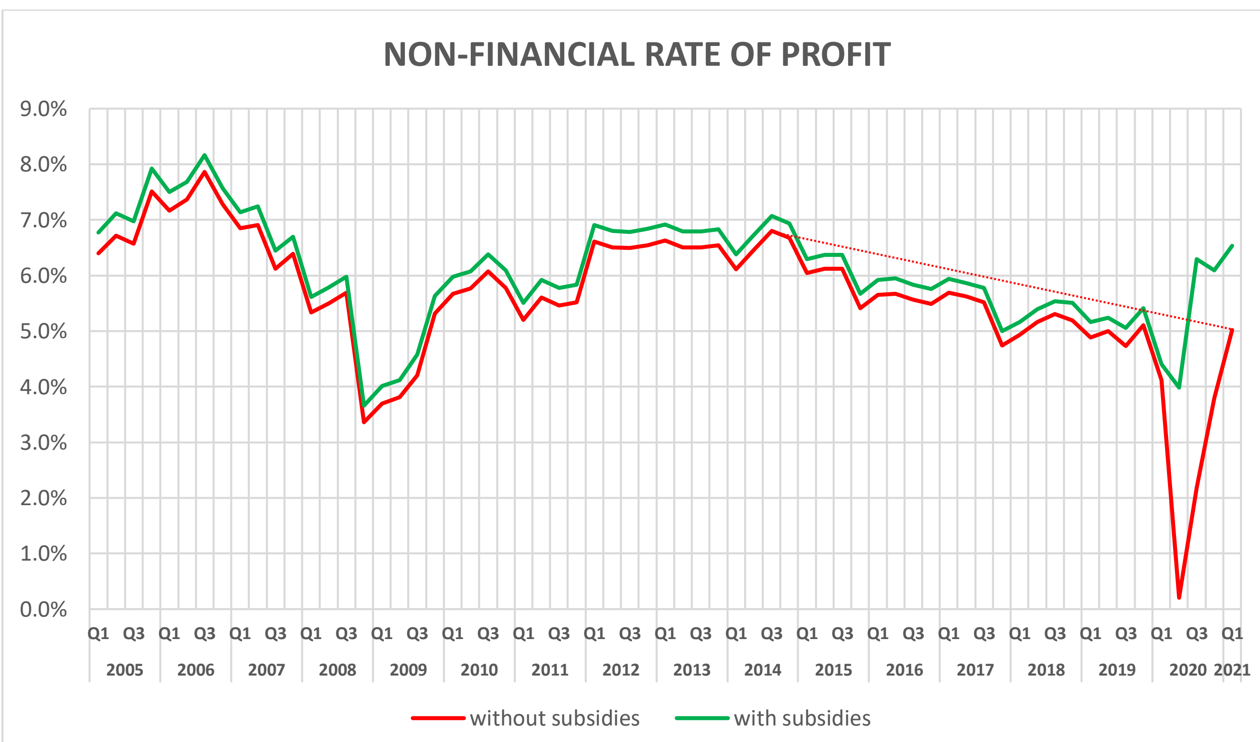
The red dotted line indicates the short-term trend. In the first quarter of 2021 profits broke above the downward trend though this is likely to be short lived. And it has done so without industrial production having fulling recovered.

Graph 4.



Industrial production remains down 5% but is in proximity to production levels in 2014.

Graph 5.

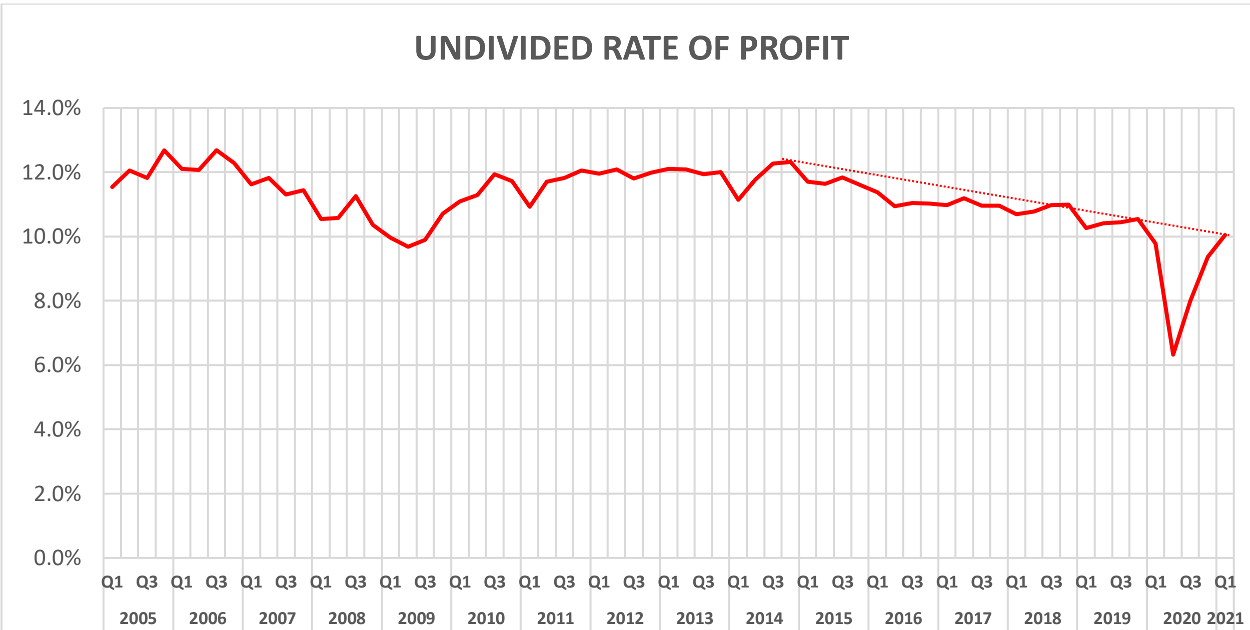


The rate of profit which peaked most recently at 6.8% in 2014 now stands at 5%, down by over a quarter. It is worth noting that the rate of profit fell to 0.2% in the 2nd quarter of 2021, a record post-War low.

Finally, compared to the profit peak of 8.2% in the third quarter of 2006, the rate is down by close to two-fifths.

The final rate of profit looks not at enterprise profit, but the undivided rate of profit, obtained by subtracting worker compensation from net value added or row 26 minus row 27.

Graph 6.



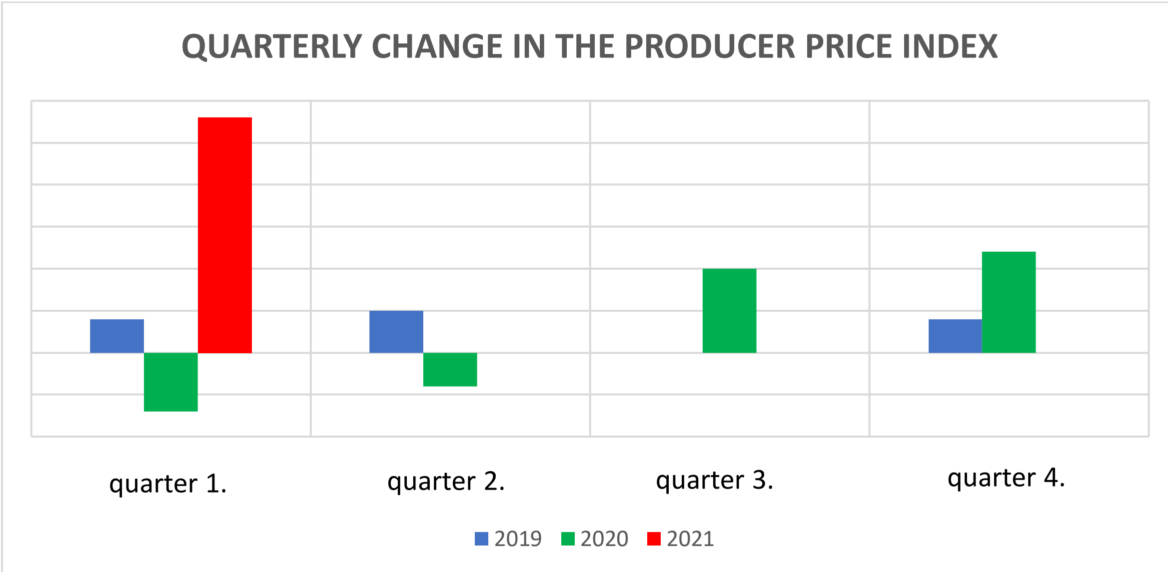
The profit figure used here is before interest, transfer payments and taxes have been deducted. This gives a slightly different profile. Firstly, the profits peaks in 2014 and 2006 are now commensurate. Secondly, there has been a fall of only 1.5% in the net surplus between 2014 and q1 2021 compared to the large fall when using pre-tax profits. Both rates have their merits. The enterprise rate of profit found in Graph 5 influences investment decisions rather than the undivided rate of profit. On the other hand, the virtue of the undivided rate of profit is that it highlights the total volume of surplus value being produced in relation to the value of the means of production and labour power being used to produce it. Without a rise in the undivided rate of profit there is unlikely to be a rise in the enterprise rate of profit.

The best way to account for the symmetry between the volumes of surplus value has to be laid at the doors of the employers and their ability to hold down real wages. Finally, if I happened to be a technical investor, or Chartist, on Wall Street, I would look at the trend in Graph 6 and bet that the q1 2021 peak will not be beaten this year.

Nor have profit margins recovered.

The uptick in the rate of profit is not volume driven but price driven. Industrial production is down 5% from 2019 but profits are similar. (See Graph 4.) This can only be accounted for by the demand generated by the Relief Funds. Graph 6 below shows by how much the Producer Price Index or PPI has jumped in the first quarter (red column) courtesy of the recent Biden administration's $1.9 trillion financial injection.

Graph 7.



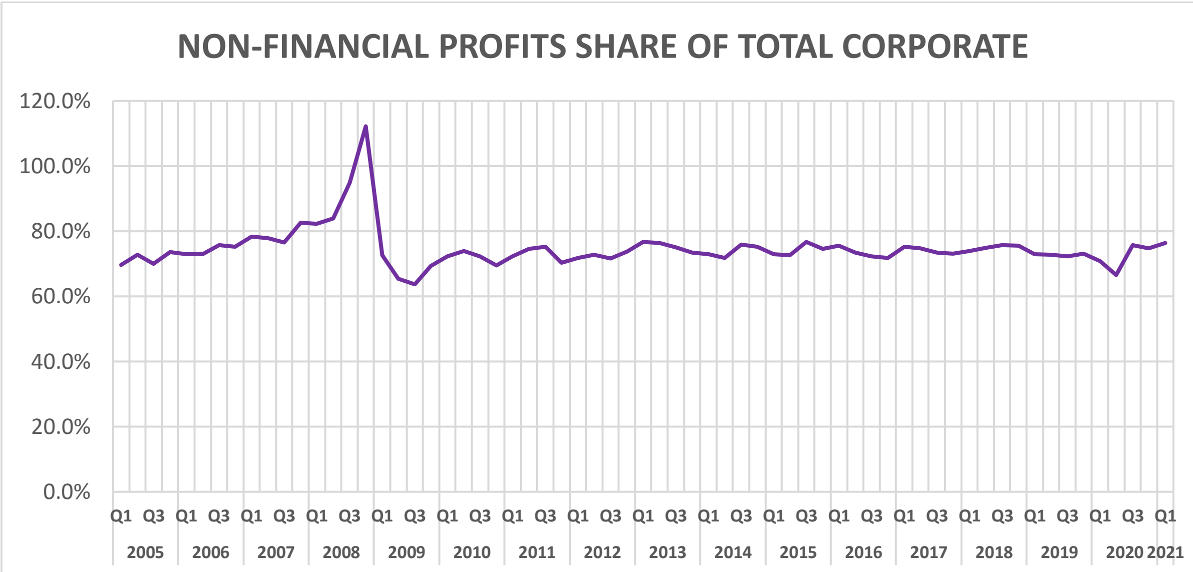
Demand driven profits tend to be short-lived boosts, particularly when the fuel driving them is itself even more short-lived. That demand has been the Relief Funds whose effects will have petered out before the end of this Quarter. Today, Friday, the latest month on month income data showed a plunge in personal income of 13.1% as Relief Funds dried up. This did not completely reverse the spike in income in the previous month. As such, they will still be supportive of profits this quarter but less so than in the first quarter. By the second half of the year the vaccinated economy will have to stand on its own two feet, and only then will we see the economic damage this pandemic has inflicted.

Thus there is no fundamental reason to assume that capitalism has broken the seven-year spell of falling profitability. If anything, the ongoing disruption to the global supply chains, both unplanned (Covid) and planned (China-US rivalry) will add to cost prices thereby depressing profit margins.

What is interesting, is not only how these profits have perked up because of demand, but because Relief Funds have mainly been spent on industrial goods both durable and non-durable rather than on services. Industrial workers on average tend to add more value and therefore surplus value due to their higher skilled labour and also to a pricing system compensating for the higher compositions of capitals found in industry. The bulk of the profits on the major Stock Markets come from industry, not services, and this uptick in the mass of profits is yet further confirmation of this.

Further, the shares of profit between financial and non-financial has also been fairly consistent as the graph below shows. These profit shares have not been adjusted for subsidies.

Graph 8.



Conclusion.

A debate is raging amongst central bankers as to whether monetary policy should remain so loose. There is even dissension within the FED. Kaplan from the Dallas FED, who is currently a non-voting member of the monetary committee fears that; *"We're now at a point where I'm observing excesses and imbalances in financial markets".* In the UK, the Bank of England is debating reducing its purchases of Gilts. In the EU, the European Bank has observed "*remarkable exuberances*" in financial markets. The key debate is whether inflation will be short-lived or not. Opinion is divided. If inflation collapses due to a collapse in demand it will impact markets, and if inflation endures it will also impact the markets because of its effect on interest rates.

For the time being, the economy viewed from Wall Street remains in a sweet spot. The vaccines are working and the economy is opening up. However, investors are now only weeks away from the inflationary issue resolving itself, and indebtedness revealing itself.

Brian Green, 28^{th} May 2021.