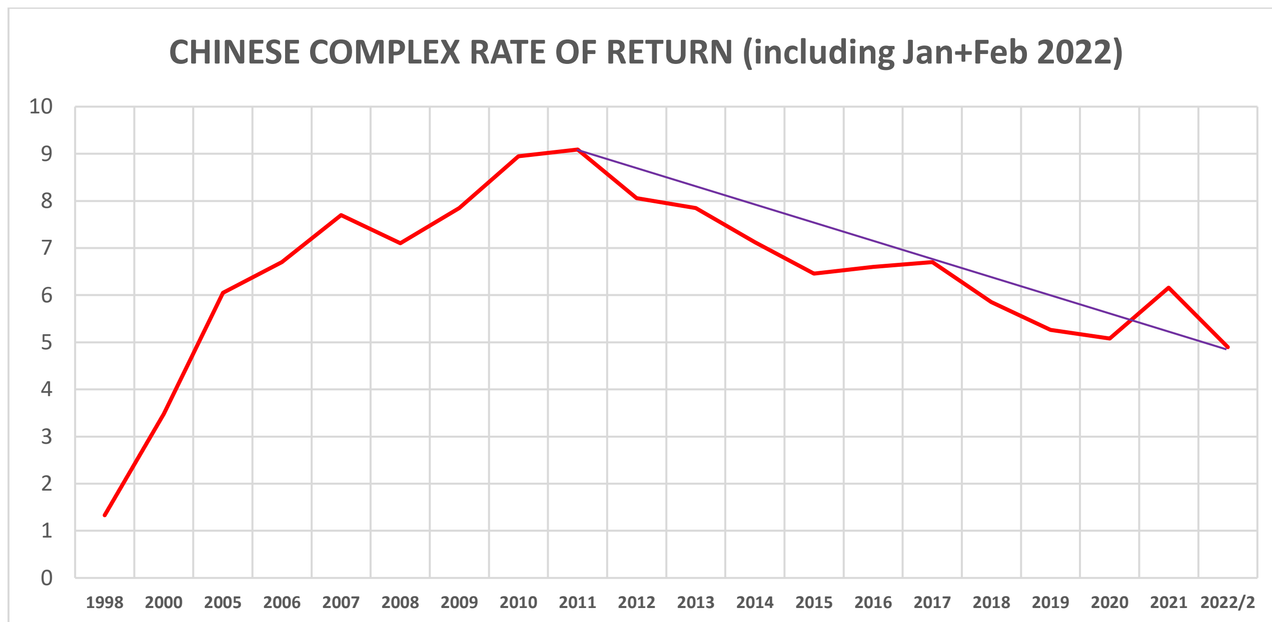
CHINA & USA, LATEST RATES OF PROFIT.

In this article you will find the latest Complex Rate of Return for China up to Feb 2022 and the Rate of Profit for the USA up to the end of 2021. In the case of the USA, a long term annualized rate of profit is provided as well as a shorter-term quarterly one. In all cases for the USA, subsidies have been omitted by adjusting line 23, NIPA Table 1.14, to remove distortions caused by Covid funding.

Recently, the Chinese Communist Party adopted a more friendly stance to the private sector. It is after all difficult to run a capitalist economy without capitalists or at least capitalists unable to embody the needs of capital whose purpose is solely to protect and expand profits. No doubt the change in stance was influenced by Chinese capitalists starting to get itchy feet about where to park the riches they have earned from exploiting Chinese workers in China. It seems Singapore has become their chosen safety deposit box. https://www.cnbc.com/2022/03/30/chinas-wealthy-moving-money-to-singapore-amid-common-prosperity-push.html

The other factor influencing the CCP, especially given the renewed government support for the economy and the markets, is the growing crisis of profitability in the private sector within China. I have attached the industrial profits report issued by the National Bureau of Statistics of China this week. It shows that the fall in the rate of return (Graph 1) was entirely due to the fall in profits in the private sector as well as manufacturing (down 4.2%) "*The total profits of foreign-invested enterprises and enterprises invested by Hong Kong, Macao and Taiwan reached 289.79 billion yuan, down 7.2 percent; and the total profit of private enterprises was 329.13 billion yuan, down 1.7 percent.*"

Graph 1.



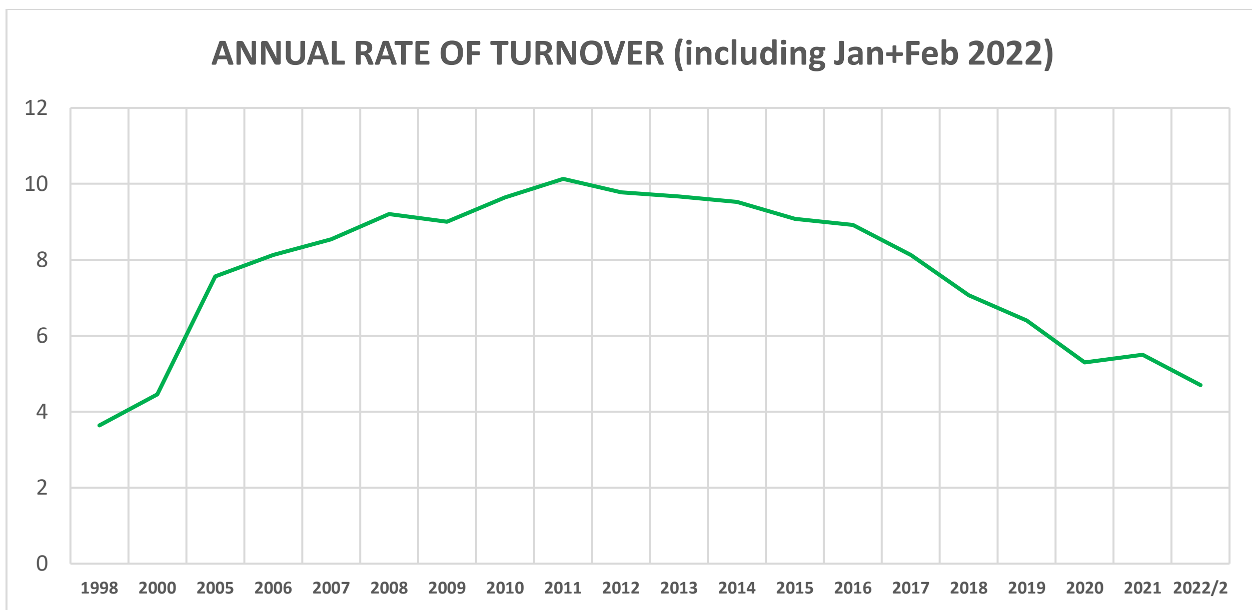
What we see in the profit trend is the end of the COVID uplift in the form of enhanced exports. This is a foretaste of what is likely to have happened in the USA this current quarter. What Graph 1 shows is that the fall in Chinese profitability is back on trend which is why the CCP has acted in the manner it has. At 4.9%, it is currently down by 46.2% from its high of 9.1% in 2011. (Just to remind the reader the Complex

Rate of Return is lower than the usual Rate of Return because Total Assets in China include financial assets which is difficult to separate from produced assets.)

Despite the uptick in retail sales in Jan/Feb the underlying condition of the Chinese economy has softened as evidenced by the deceleration in the rate of circulation of working capital (Graph 2). The rate of turnover has decelerated by an astonishing 54%. Measured in days the period of production and circulation has increased by 34.5 days from 40.1 days in 2011 to 74.5 days today. In other words, Chinese employers have to find more than a month's worth of additional working capital.

Given the similar trend found in the USA, we can see the profit rot which is undermining globalisation. This loss of profitability is happening in China, despite much more surplus value being realised within China itself. This redistribution, which represents a gain for China, means a loss for its competitors deepening their crisis of profitability, but without resolving the crisis in China itself.

Graph 2.



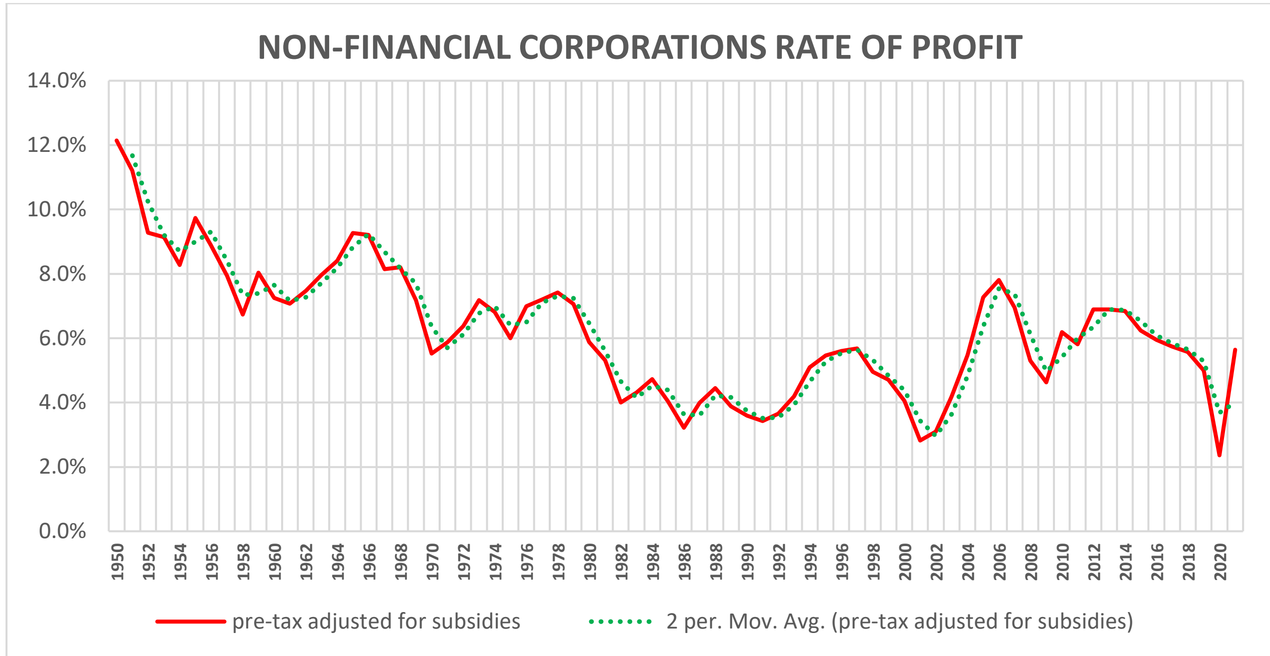
The change in the stance of the CCP was one of the key triggers which has led to gains on stock markets worldwide over the last three weeks, despite the war in Ukraine and its ramifications. Over 80% of the losses in share prices since the beginning of the year has been recouped despite global economic conditions deteriorating. It appears that the intentions of the Chinese government have become as important as pronouncements coming from the USA itself, home to 40% of the world's fictitious paper. Perhaps investors have been reminded of the lessons from 2009, that there is a free lunch, that governments will bail them out should they lose their shirts or Mao jackets.

Profitability in the USA.

Chinese and US profits amount to 40% of the total, more if the Yuan was not undervalued by over 30%. Thus the data from these two giants are powerful enough to situate global profits and their trends. US profit releases are done quarterly unlike the Chinese which are done monthly. Thus the US data is more dated, showing an uplift in 2021 compared to trend. Two rates are provided, annual rates going back to 1950 and quarterly rates going back to 2005. (Source: spreadsheet 'Table 1.14 Annual 1950-2021')

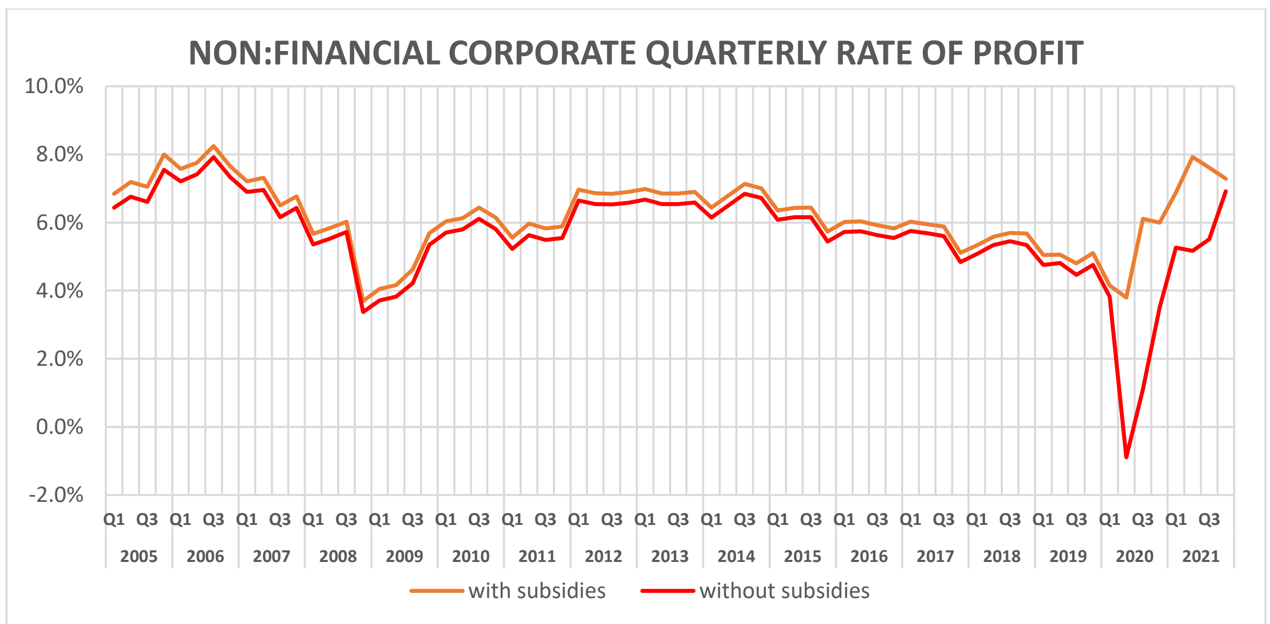
The annual rate, which is stripped of subsidies shows a sharp upturn in profits in 2021 which is still 20% below the 2014 peak. It also shows that the actual rate of profit in 2020 at 2.4% was the lowest since WW2. However, the 2 year moving average shows profits were a mere 4% for the two years as a whole.

Graph 3.



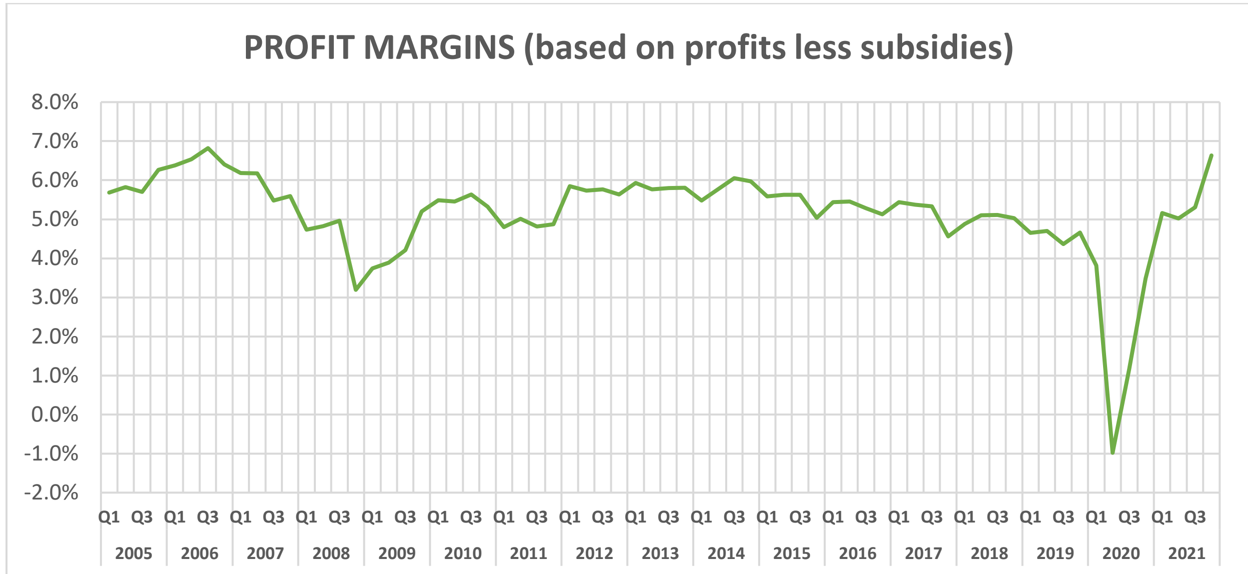
The quarterly data below is more relevant as it shows current movements. It shows a convergence between the two graphs as subsidies have waned. At around 7%, the final quarters' profit was close to its peak in 2014. (All rates are based on pre-tax profits divided by fixed and circulating capital.)

Graph 3.



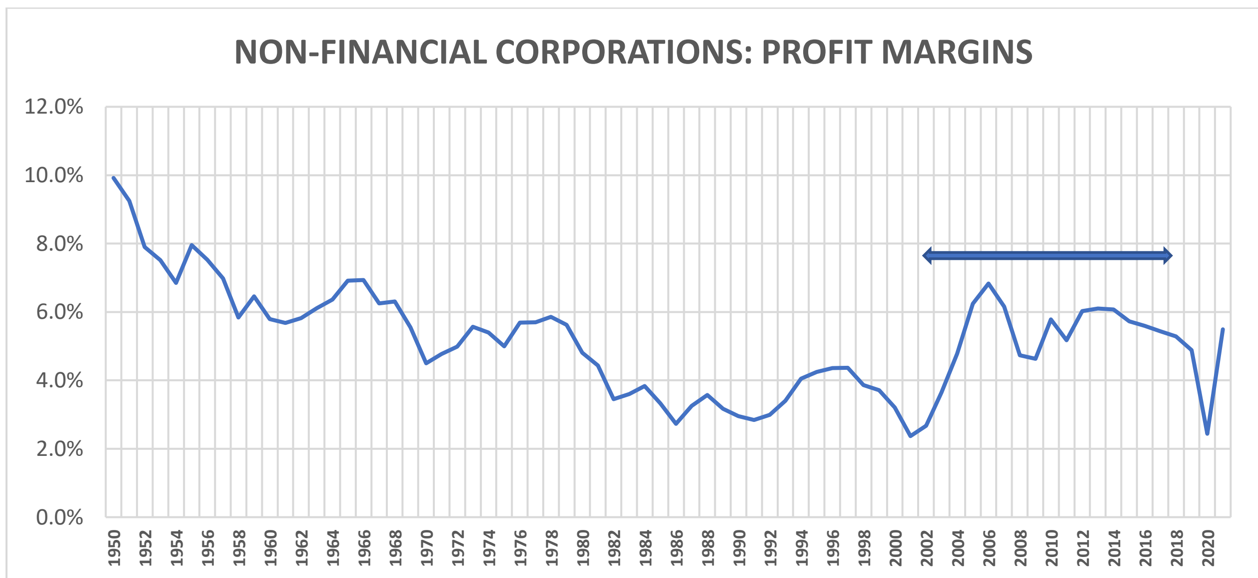
US corporations benefited from COVID in two ways. Directly through subsidies paid to them by the US Treasury through COVID Relief Funds and indirectly through inflation. The benefit of price rises can be seen in the graph below. At 6.6% in the fourth quarter, margins were close to their peak of 6.8% in 2006.

Graph 4.



I have also added in the long term trend in margins because it shows the effect of globalisation. It is this phenomena of higher margins beginning early this century topping 5% which is identified as an extended period of prosperity for US corporations (as defined by Marx - a period where profits are growing abundantly).

Graph 5.



The question posed is this, can the US maintain this level of profitability, or like China will it step down from its 2021 Covid levels. The answer is that the outlook for US profitability is deteriorating, and like

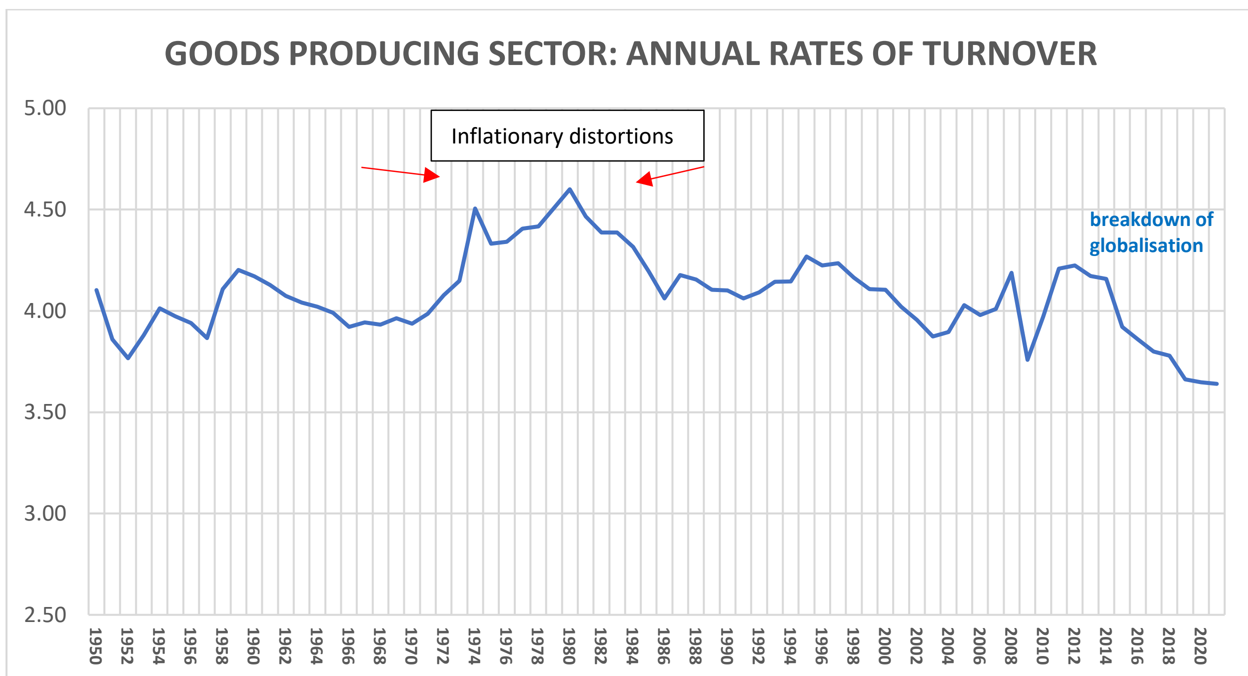
China, it will now lose rather than gain from the Pandemic. *"The estimated (year-over-year) earnings growth rate for Q1 2021 is 4.8%, which is below the 5-year average earnings growth rate of 13.7%. If 4.8% is the actual growth rate for the quarter, it will mark the lowest (year-over-year) earnings growth rate reported by the index since Q4 2020 (3.8%)."* So says the 'FactSet Earnings Insight' issued last Friday. For Q2 the outlook rises marginally to 5.6%. Both imply inflation adjusted falls in profits. As these are earnings per share, and given the scale of buybacks, the real fall in profitability adjusted for inflation will be greater, approaching 10%.

It also should be borne in mind that over the last three-quarters, nominal profits (annualised) were already falling, from (Q2) $2021.9 billions to (Q3) $2006.2 billions to (Q4) $1979.1 billions, therefore a consistent fall from the Q2 peak. In nominal terms profits are down 2.5%, but 6.5% when adjusted for inflation. Hence by the end of Q1 2022 they should be down at least 16.5% and 20% by Q3, dragging down the rate of profit to around 5.2%, the level that capital suffered by the end of 2019.

A quick note on globalisation.

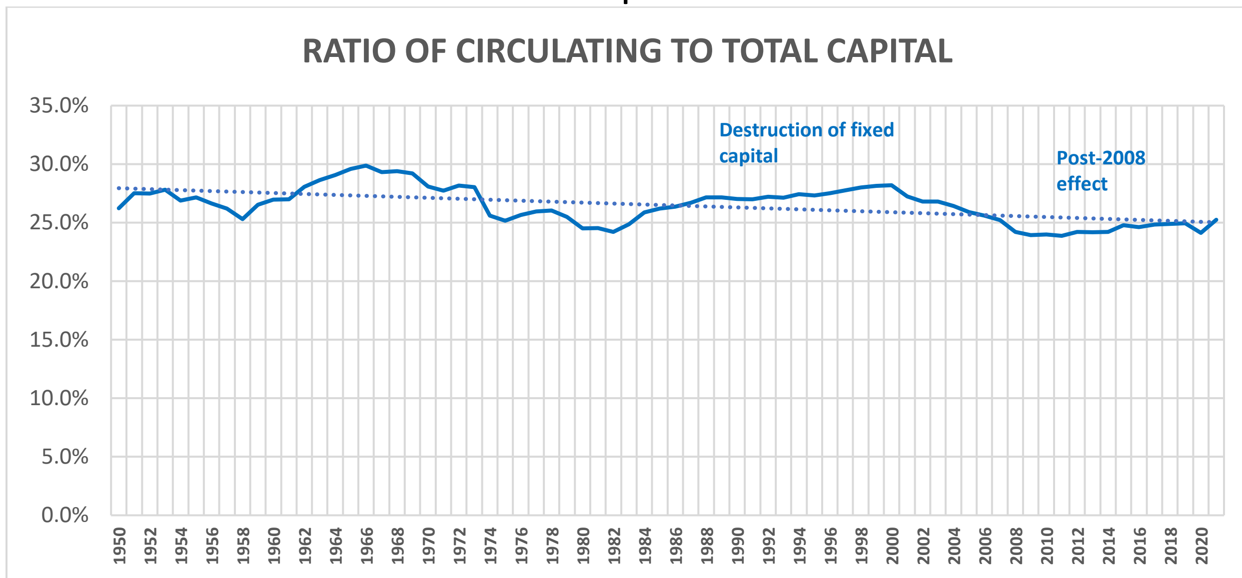
The breakdown of globalisation has been in the news. Graph 6 shows the deceleration in turnover post-2014. The reader can ignore the period following the breakdown of the gold standard and the subsequent devaluation of the Dollar which rapidly inflated import prices resulting in a redistribution of surplus value away from the US and which is reflected in the trend at the time. What is important to note is that despite all the technical advances, the rate of turnover currently at 3.64, is at its lowest point since WW2.

Graph 6.



This sharp deceleration in turnover post-2014 coupled to the increase in employment of labour rather than fixed capital post 2008, has resulted in a rise in circulating capital. The last time this happened for any length of time was the destruction of fixed capital (rust belts) in the 1980s. Nevertheless, the long term trend, as expected, is for a reduction in the share of circulating capital.

Graph 7.



The war in Ukraine is not a Ukrainian war but a NATO war fought by Ukrainian soldiers.

Hence the depletion of Western Armories as weapons are shipped/smuggled into the Ukraine. It is clear from the evidence on the ground that Russia was baited into a trap set by NATO in the Ukraine. Still the outcome could be negative for the West. This is not so much a war for the Ukraine, as it is a war for the Black Sea. Should Russia secure the industrialized East of Ukraine, as seems likely, it will swing the whole balance of the region to Asia and further weaken the EU while bolstering Russia's economic relation with China. It appears, crucially, that Mariupol is about to fall to the Russian. The proof. There is evidence that the Russians allowed two Mil 8 helicopters to land on the outskirts of the Mariupol to collect the Azov leadership bolting from the city, only to shoot them down once they took off. Since then the actions of the 'defenders' has become scattered and erratic.

The outcome in the Ukraine will reset globalisation and speed up the emergence of a bi-polar world economy.

The bounce in the markets.

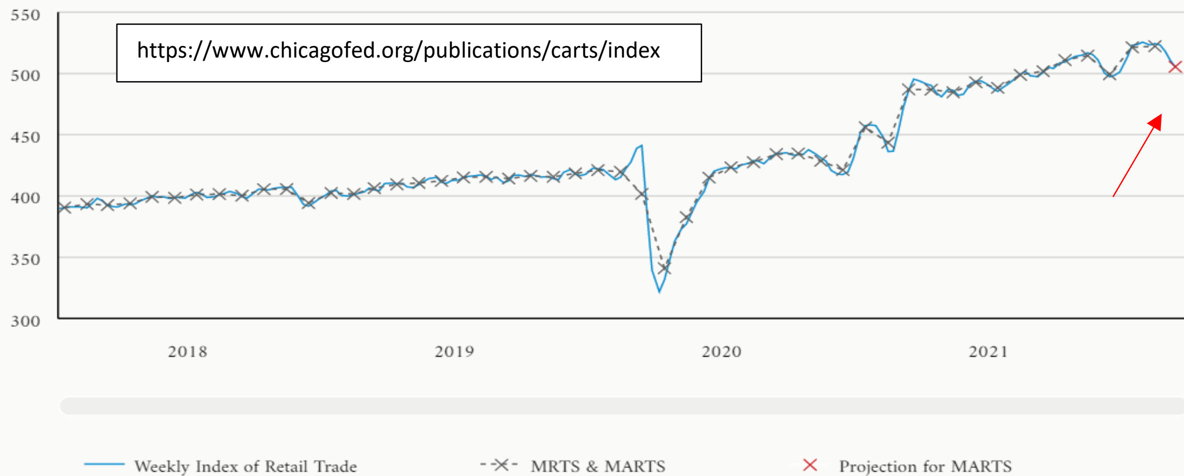
The twilight world of capitalism is populated by zombies and vampires, or companies and speculators. The FT recently reported on the record vampire bonuses paid to bankers in 2021. Quoting from the New York Comptroller of Banks, total bonuses amounted to $45 billion or $257,500 per vampire, up 21% year on year. Pandemic, what pandemic? https://www.ft.com/content/36f1c72a-f63f-4404-87ab-dfbeb335cbd3

The same can be said for the recent bounce of Wall Street. Clearly the street is not shell shocked. The Street is buzzing with ideas about why this was happening. It did begin with China breaking ranks and agreeing to ease monetary conditions in contrast to tightening in all the other major economies. Then there was talk about record amounts of share buy backs to take advantage (sic) of the fall in share prices. In the end this amounted to $319 billion so far this year compared to $267 billion last year. https://www.ft.com/content/e27975fc-a4f6-4e71-9ac8-af8a2418caca Then there was talk of the rally really being a "bear Squeeze" according to the historians, who claim that in every falling market there is an upward rally or two. And of course banks were being hurt by the fall in the markets, so what could be

better than a relief rally into the close of the quarter. And, and of course there was the FED. Its failure to raise rates by 0.5% instead of a teensy weensy 0.25% was a source of comfort to the markets despite the dot plot thickening.

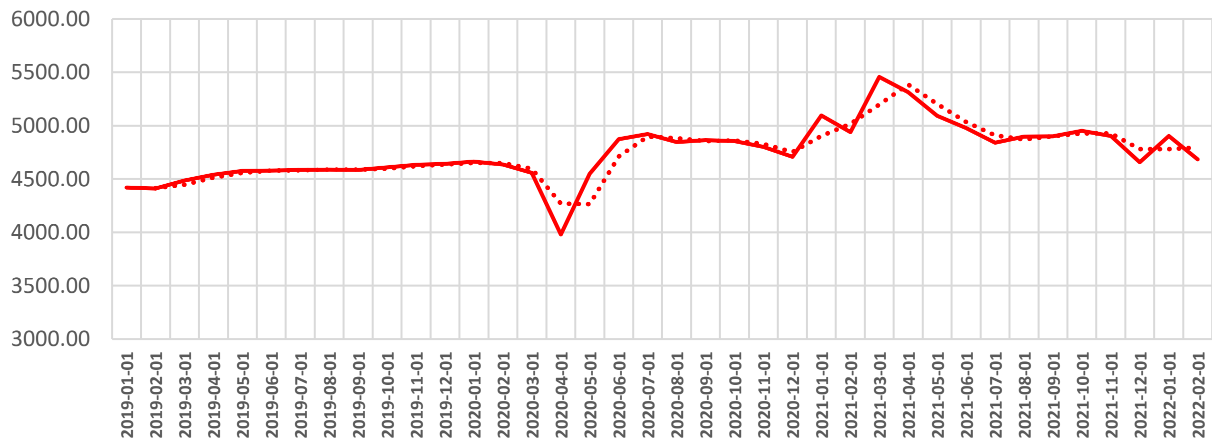
There certainly was no support for this rally based on real world developments. Or to put it in Bloomberg speak, the markets are looking beyond the war! As the graph below from the Chicago Fed shows, the projection for retail sales in the first half of March (red X) has fallen below late 2019 levels in real terms given prices for durable and non-durable goods have risen 25%.

Graph 8.



It is also useful to look at the PCE expenditures released today which fell by 0.4% in real terms, with the fall concentrated in goods purchases rather than services due to spending reverting to pattern. The fall in goods purchases is shown below. The level of goods spending in February was no higher than in 2019.

Graph 9.



With one leg of the two legged stool broken, that is the shibboleth where retail sales remain robust, what about the remaining leg, the resilient consumer, and their buoyant personal savings rate. Well on Thursday the BEA brought out the savings rate as part of the PCE Report, and well, at $1.15 trillion it was the lowest since 2013. Will the Street take notice and change its narrative? After all it boasts continuously about looking forward through the windscreen and never back in the rear view mirror, which is why in all probability, it gets overtaken by events so often. https://www.bea.gov/news/2022/personal-income-and-outlays-february-2022

And then of course there is the dismal outlook for profits and inflation. But the worst is yet to come. With retail sales falling in real terms, and with bulging supply chains (do not believe the hype about shortages which are isolated) not only at sea but in warehouses, an inventory correction is building. It is going to be interesting to see how resilient the discussion is about building resilient supply chains through on-shoring, relocating and duplicating, once this correction intensifies. But there is nothing in the perspectives suggesting profit margins can be maintained. As I pointed out in my previous article on *Globalisation Tears…,* all remedial supply chain actions will raise cost-prices impairing profit margins.

And, and of course there is the housing market burdened by rising interest rates galloping South, no not towards Texas and Florida, but beyond them to below the high water mark. As a CNBC report headlined *MORTAGE REFINANCE DEMAND PLUNGES 60%, AS RATES HIT THEIR HIGHEST LEVEL SINCE 2018* reveals: *"The average contract interest rate for 30-year fixed-rate mortgages with conforming loan balances ($647,200 or less) increased to 4.80% from 4.50%. Refinance applications fell 15% for the week and were down 60% from a year ago. Homebuyer mortgage demand rose 1% for the week but was down 10% from a year ago." https://www.msn.com/en-us/money/realestate/mortgage-refinance-demand-plunges-60-25-as-rates-hit-their-highest-level-since-2018/ar-AAVELoJ?ocid=uxbndlbing&pfr=1* In addition a report today on holiday homes shows that demand there has collapsed in February. Black swans a-paddling.

Conclusion.

In many ways the tables have been turned on China. While the West has gained herd immunity against Covid through natural infections rather than vaccinations (numerous studies including Israeli studies confirms this basic biological fact), albeit at great personal cost, the same is not true for China. Its *zero tolerance policy* means it is now more vulnerable to the more infectious (though less dangerous) strains of the virus such as the Omicron and its sub-variants. This could incapacitate the Chinese economy at a time when its major competitors have more or less removed all restrictions and isolations. It could extend the period of high inflation given that China continues to be the junction for the global supply chains.

With regard to the USA, the first quarter earnings season is two weeks away. It is bound to provide a reality check to the markets. Already FactSet has reported that an above average number of S&P corporations have announced negative outlooks for the quarter. These results should confirm that the rate of profit has resumed the falling trend established since 2014 which has yet to be broken by any recession. We await the employment data on Friday.

The condition of world capitalism remains precarious while the confidence for a global recession occurring this year is high.

Brian Green, 31st March 2022.