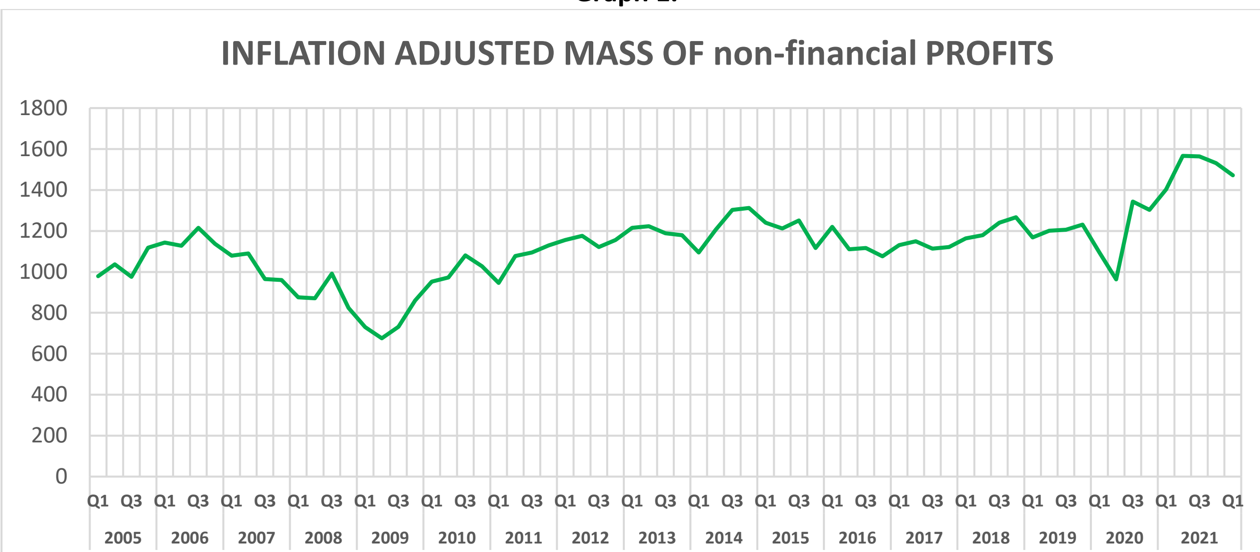
US PROFITABILITY FALLS IN THE FIRST QUARTER, BUT CAN CHINESE STIMULI RESCUE ITS ECONOMY & THE WORLD ECONOMY?

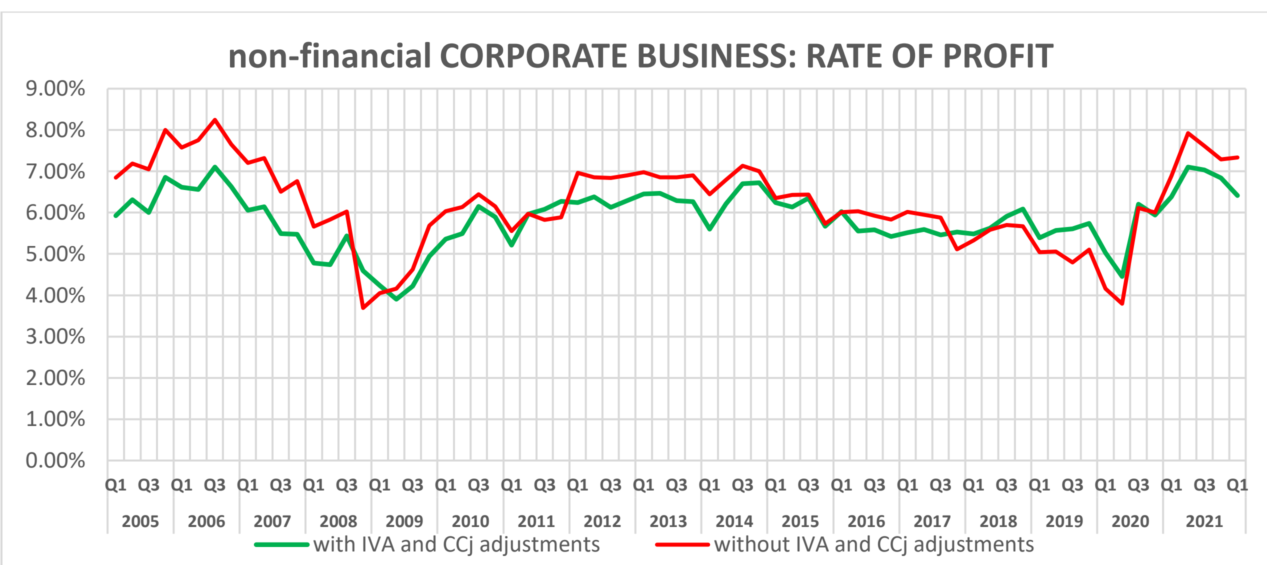
Ah, to be a fly or a tiny drone on the wall at Davos, there to see the capitalist mob crying into their champagne cowering from avalanches, not from the mountains, but from the high street, the markets, and their increasingly disaffected workers. As CNBC commented "the mood was terrible". And for entertainment, all they got was a performance by that delusional and sinister clown, Zelensky. Workers beware, a dispirited capitalist class is a dangerous class.

The article is in two parts. First it examines US profitability based on the figures released this Thursday by the BEA (NIPA Table 1.14) together with general economic conditions, then secondly, it examines the Chinese fiscal incentives announced recently to rescue the Chinese economy from its lock-down slump.

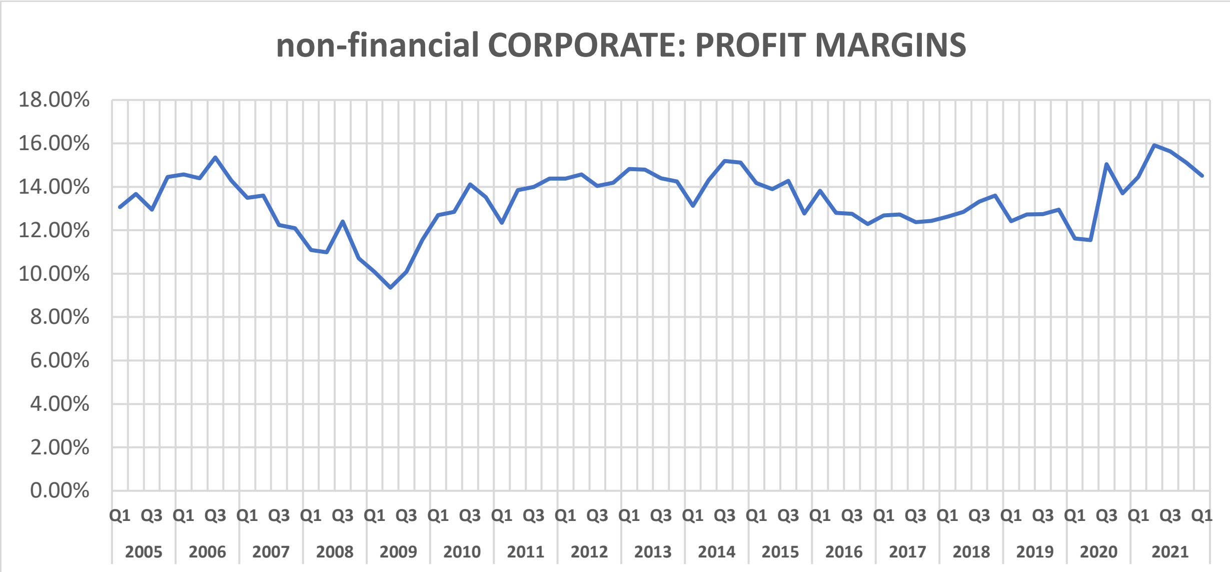
Graph 1.



Graph 2.



Graph 3.



All the data refers to non-financial corporates. I normally use line 37 for pre-tax rate of profits in Table 1.14 (attached) as they are unadjusted and therefore closer in conformity to net value added. However in this case I have used line 27 which includes CCadj and IVA adjustments (capital consumption and inventory adjustments). Because of inflation it has created a number of specific and short-term anomalies with regard to the adjustments. I have also dispensed with adjusting for subsidies as they have now worked their way out of the system.

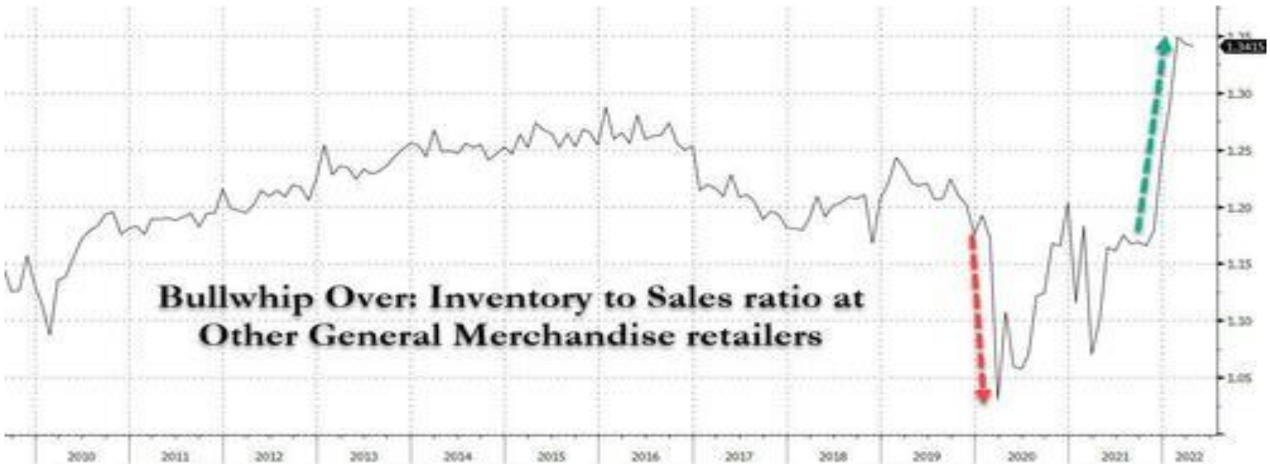
However, in Graph 2 for the purposes of continuity, there are two rates of profit, with, and without adjustments for IVA and CCadj. As always the denominator in the rate of profit includes both fixed and circulating capital. To estimate fixed capital for which no figures exist for 2021 and Q1 2022, I used NIPA Table 5.1 (attached) which enables net investment to be calculated per quarter which was then added to the base year of 2020. This method tends to be 98% accurate, so the rate of profit is real. The evidence shows a fall in profitability since Q1 2021, and given all the indicators, this fall will accelerate in Q2.

I expected the mass of deflated profits to have fallen more than the figures in Table 1.14 suggest. One reason propping up profits has been the surge in profits from the energy sector (oil, gas and refining) As this analysis from CSIMarket shows, the operating margins for this sector in Q1 was double that of the S&P as a whole at 34.4% for the oil and gas industry versus 17.73% for the S&P500.

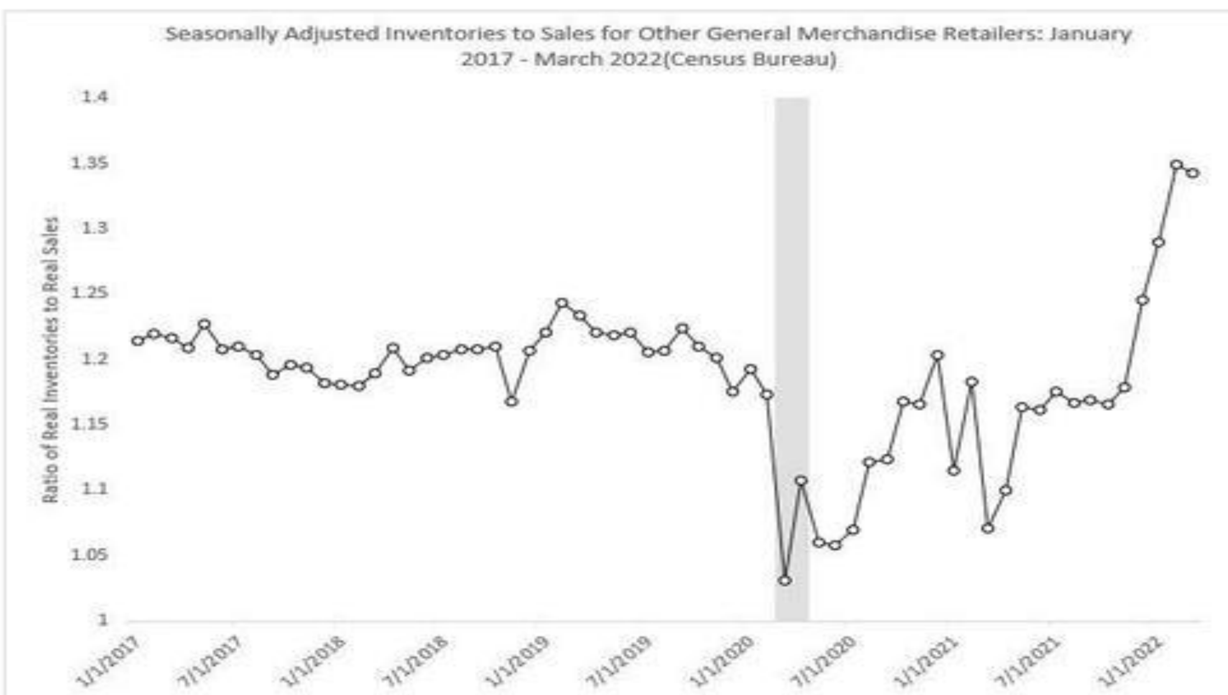
What stood out in this report by CSIMarket is the comment that the "*S&P 500 experienced contraction in Gross Profit by -5.89 % and Revenue by -2.79 %,...*" On the other hand the BEA in its Table 1.14 finds a quarterly fall in total corporate profits of only 2% (row 18). This is unusual because profits for the largest corporations tends to outstrip the smaller corporations. It seems to corroborate my view that the BEA has overstated profits.

I anticipated that there would be a time when falling demand would collide with rising cost prices crushing margins and elevating stocks. That time has come, and it is escalating. The slang for this event is the bullwhip which whips from low to high. The next two graphs illustrate this. They show that stocks at major retailers have soared because they were ordered, in anticipation of a higher volume of sales, not a lower volume. The release of advance wholesale inventories on Friday confirms the inventory build.

Graph 4.



Graph 5.



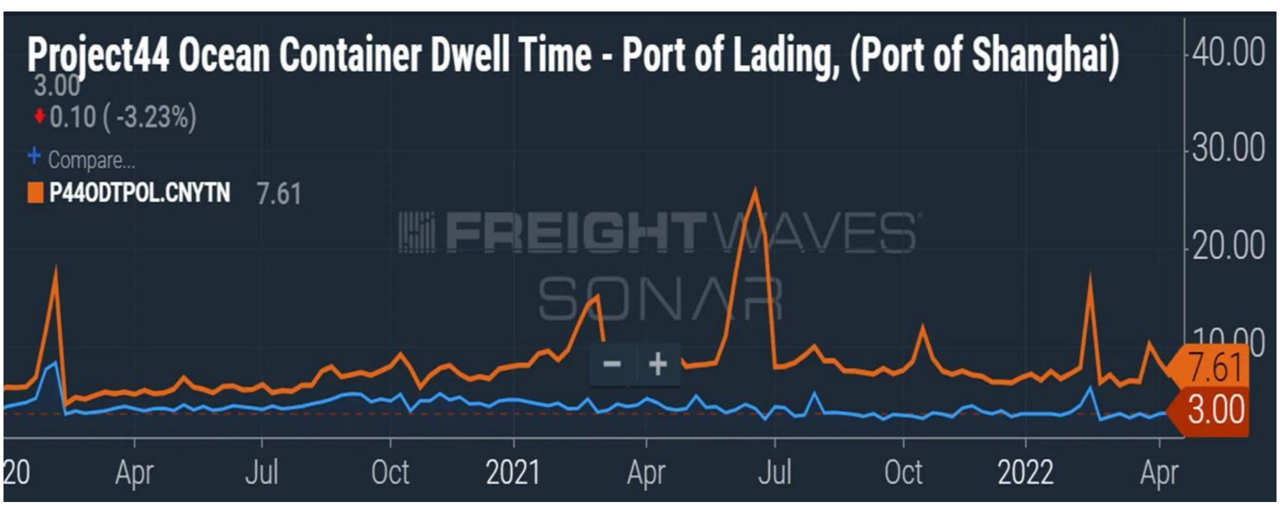
(data analysed by Michigan State University)

Here is the latest comment from FreightWaves . *"The best explanation would be that the decline in trucking spot rates was very quick and caught almost everyone by surprise. We entered 2022 with bullish expectations about the economy and shippers experiencing the highest level of supply chain disorder in history. Few expected the economy to slow and even fewer anticipated that freight capacity would ease so quickly. "With logistics representing 12% of the global economy, the cost of freight has an outsized* *impact on inflation."* Clearly hauliers are finding the going tough as the volume of demand for goods in the US falls to below 2019 levels but costs such as diesel remain elevated.

The container in the room of course is the lockdowns in China. In every way this lockdown has happened at the best of times for the overstocked US economy. It has allowed the system to clear the backlogs in both shipping and freighting. The backlog in ships in US ports is down and the lockdowns have so far not caused bottle necks in China as Graph 7 shows.

Graph 6.

Graph 7.



(American Shipper)

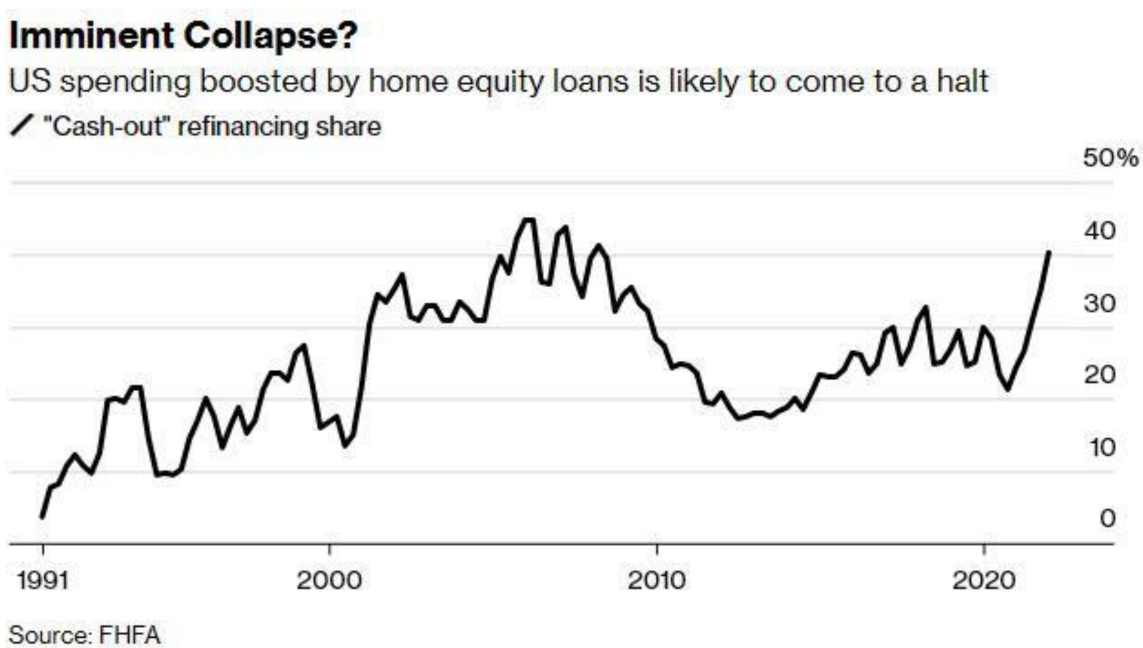
Of course the question arises what will happen at the end of June when Chinese Industry is fully re-opened and supply increases. It is this perspective which is exercising those in logistics. However, given that the world economy is now in recession, that issue may not materialise.

Turning to the level of US demand. While the overpaid economists continue to talk up household savings and the resilient consumer. This applies to the top 1% only. Analysing the recent retail reports from the likes of Nordstrom, Gucci, Rolex, Rolls Royce and more expensive homes, sales have hardly fallen despite Bloomberg reporting that the paper-wealth of the world's 500 richest people has dropped by $1.6 trillion since its November peak. In addition, since the beginning of this year, total losses in the market casinos within the USA amounts to nearly $20 trillion. JPMorgan economists led by Michael Feroli wrote in a note last Friday that the wealth shock caused by stock market losses is set to drag on growth this year. I am not convinced. We need a Black Friday or Black Monday, a real crash, before this extravagant waste of society's labour time is brought to an end. (This is a slight revision to my earlier prognosis modified by the latest sales releases by luxury goods manufacturers.)

Though mortgage rates have retreated as the 10-year yield has reversed, the impact on the housing market remains severe. New home sales fell by 16.6% from March, itself revised down by 8%. All the falls were in lower priced homes which raised the median price of homes sold. Pending home sales fell by 3.9%. Both sets of falls were outside the range predicted by forecasters compiled by Econoday. In addition the supply of new homes reached levels last seen in 2008, and regarding existing homes, which are still in short supply, realtors report a sudden surge of homes brought to market as sellers fear an imminent price crash.

One thing is certain, that under these housing conditions, any benefit to consumer demand from refinancing mortgages will be wiped out as the graph below shows. It relates to what portion of refinanced loans which is spent on consumption. Applications for Refinancing Mortgages now under half the level they were a year ago.

Graph 8.



Conditions in the bond market with the exception of high yield bonds have stabilised as inflation expectations and with-it FED rate rises have moderated. Leveraged finance markets remain nearly frozen. Only two junk bonds were priced in May and there are no further deals in the pipeline. (Bloomberg)

On Friday the personal consumption expenditures were announced. No surprises. Of course the personal consumption data is inflated nonsense, and this is revealed by the ridiculous collapse in the savings rate. (See NIPA Table 2.1 for the woeful tale of savings.) Why do I focus on the savings rate? Because it is the balancing item in the T accounts which make up the National Accounts. It is not a real number. Mess with the consumption figures and it ends up making a mockery of the savings rate.

This week the stock markets will have broken an eight-week run of falls for the Dow Jones and seven weeks for the Nasdaq and S&P500. We are now in the eye of the storm. Things are bound to quieten down for the next few weeks because the triggers - price and interest rate rises - will be dampened. But this will be temporary and only last until such time the markets cotton on to the fact that the reasons for this dampening, are not positive but negative, the result of an imploding economy.

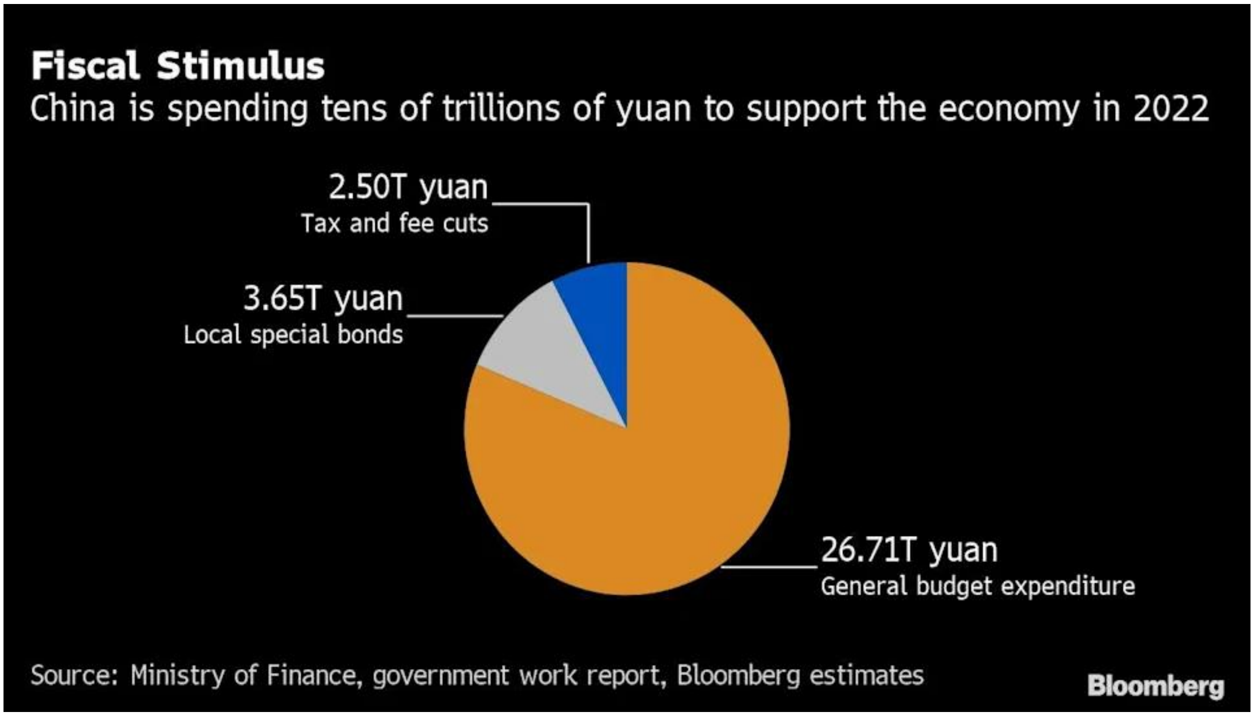
The outlook for China.

On Wednesday Premier Li spoke to thousands of high ranking officials to discuss the state of the economy and a path back to recovery. " *China's economy is in some respects faring worse than in 2020 when the pandemic first emerged, Premier Li Keqiang said, urging efforts to reduce a soaring unemployment rate. "Economic indicators in China have fallen significantly, and difficulties in some aspects and to a certain extent are greater than when the epidemic hit us severely in 2020," Li said on Wednesday following a meeting with local officials, state-owned companies and financial firms to discuss how to stabilise the economy."* The Financial Times reviewing the speech in its Thursday's edition added in further comments by Li. He said that China must grow its economy in the 2nd quarter. The use of the word must rather than can is indicative of a view that China will join the rest of the world in recession in the 2nd Quarter. He also noted the corporate liquidities had risen by 30% in the year to April and most importantly, that the unemployment rate for the youth had reached a historic high of 18.2% and 6.1% for workers generally.

The $5.3 billion stimulus package, which incidentally is bigger than the total $5.1 trillion provided by the Biden and Trump administrations is still less than the stimulus unleashed in 2008 according to BNN Bloomberg. "*Whatever China puts up in support this year, it's still dwarfed by the massive stimulus plan that helped the economy return to its high-growth trajectory after the Global Financial Crisis in 2008. 'There are more challenges to shore up growth now than it was in 2008,' Qu said, adding that interest rate levels at that time were high, allowing the PBOC to unleash greater stimulus. Investing was also more attractive, as the economy was growing at a faster pace. The rest of the world was ramping up stimulus to shore up the global economy, too. It's increasingly been making use of its relending program, which provides cheap loans to commercial banks for targeted lending to small businesses and other areas designated as in need of relief."* As we shall see, while the 2008 stimuli were multi-year, it is actually debatable whether the 2022 stimuli are smaller, both relatively and absolutely, than the one in 2008 itself.

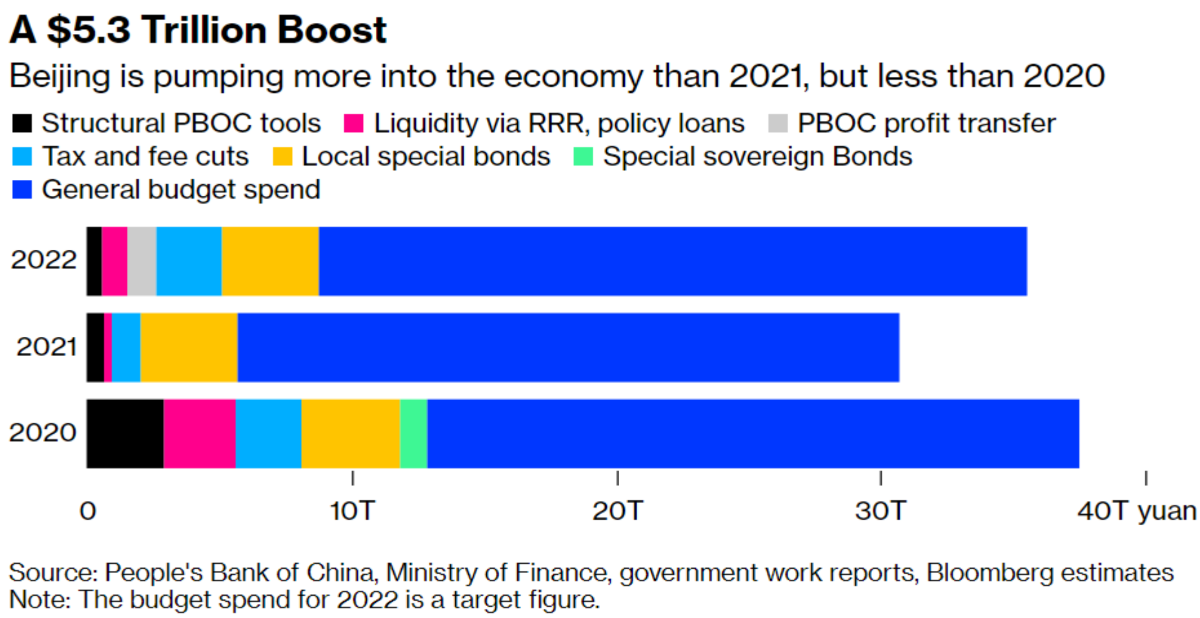
We should remember that in 2008 China's GDP was just under 32 trillion CHY and in the first quarter of 2022 it was 3.4 times larger at CHY 114 trillion. In terms of global GDP it rose from under 8% in 2008 to a projected 19% in 2022. Thus any stimuli that China embarks on will have a relatively larger impact on the world economy. However it is unlikely that China now has the firepower it had compared to 2008. Debt is elevated and profitability depressed. In addition whereas the period of 2008 was deflationary, now inflation has escalated and any substantial surge in fiscal funds could fuel price rises. It could reverse the fall in the Producer Price Index caused by the lockdowns and fall in demand. (See Graph 11)

Graph 8



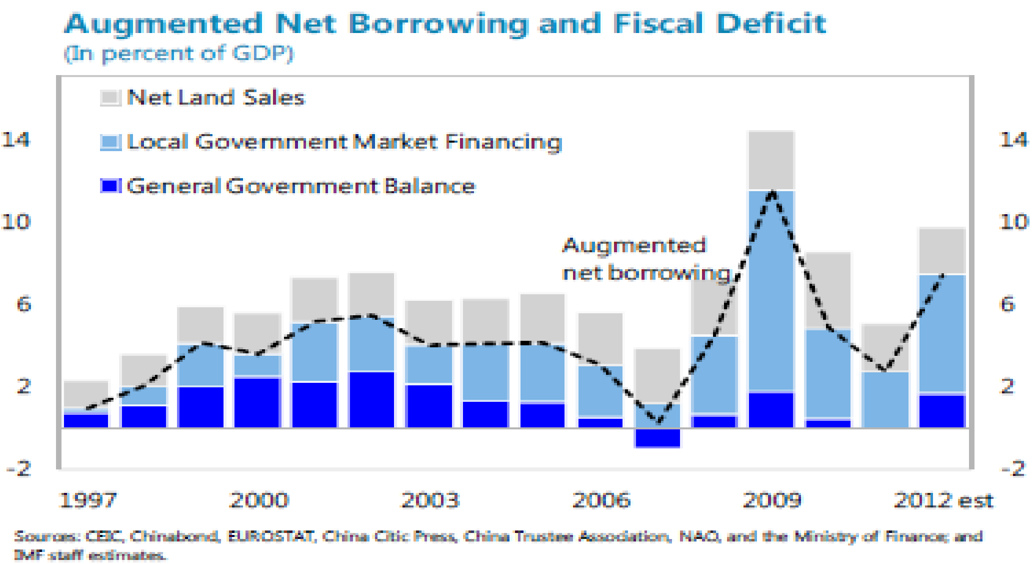
The following graph compares this spending to 2020.

Graph 9.



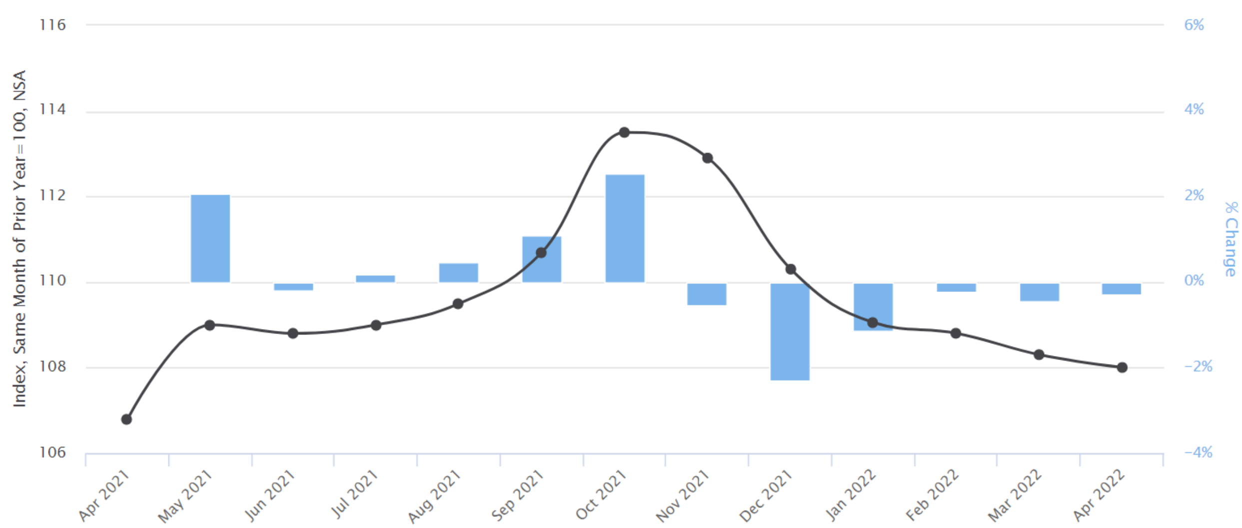
The final graph in this series compares Graph 9 to the monies spend in 2008 & 2009. It shows augmented spending increasing by 8% in the 2009 peak to a total of 14%. However, the CHY >30 trillion boost proposed this year amounts to 26% of GDP, considerably higher. What was different about 2008, was the investment boom which endured to 2013, and which saw investment increase by 50% year on year. It was this deluge of investment which dragged the global economy out of its 2008 rut propelling China to first place amongst the world's industrial nations.

Graph 10.



([China's Augmented Fiscal Deficit)](#)

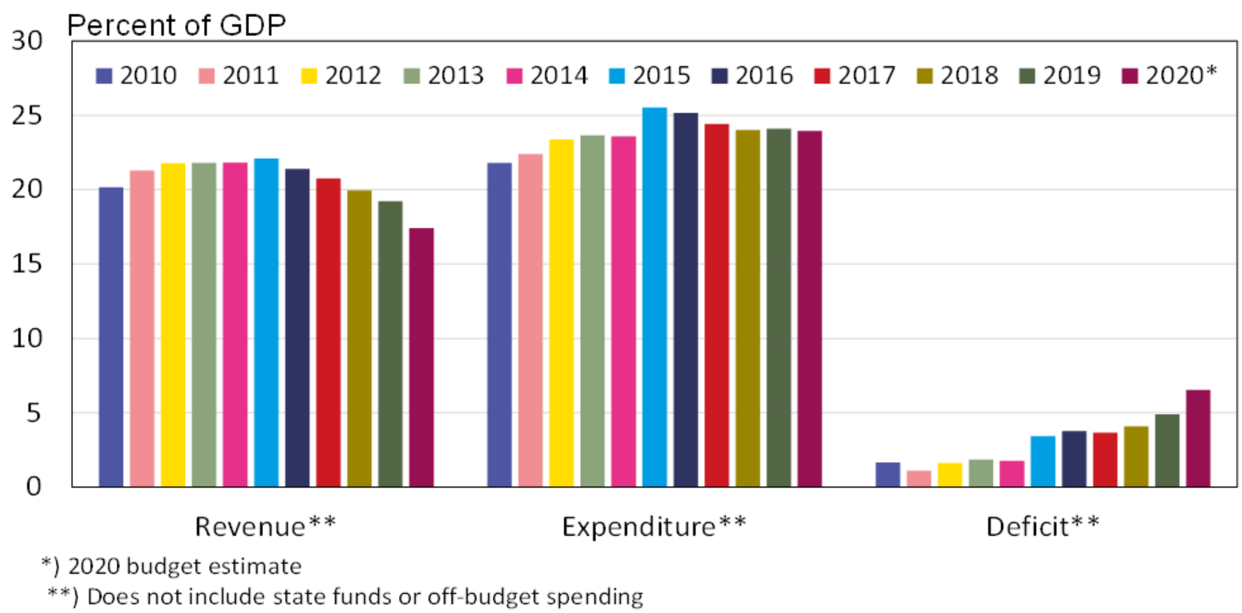
Graph 11. (Chinese Producer Prices)



[Moody's Analytics](#)

Even before the pandemic, the fall in industrial investment and taxation from land sales was causing the Chinese State to become more interventionist as Graph 12 below shows. It has maintained its spending only by growing its deficit. What Covid has meant is an intensification of this trend. This is in contrast to the US where despite Biden's pious pledges, government spending is actually falling in real terms adding to the drag on the US economy. The US budget deficit is currently forecast to fall to $ $1.036 trillion or under 4% of nominal GDP against a current inflation rate of 6.8% this quarter based on the GDP deflator.

Graph 12.



It should also be added that China's containment methods against the virus is very costly, particularly its testing regime. "*Regular mass testing of much of the nation's 1.4 billion people could cost 1.8% of gross domestic product and take money away from other government expenditure in areas such as infrastructure, Nomura economists led by Lu Ting wrote in a recent report.".* In fact local governments have pleaded for extra funds to meet these obligations saying they are spending funds earmarked for areas such as poverty reduction and social housing.

The South China Morning Post expects the opening of Shanghai by June 1. It is too early to say whether or not the economy must not contract in Q2. As Li went on to say: *"One good thing is that we refrained from excessive money supply and mass stimulus in the past few years, and we still have policy tools in reserve."* And while interest rate manipulation is not as frictionless as in 2008, the higher rates of interest prevailing in China still afford a degree of flexibility unlike in the USA for example. As a result the PCB recently cut key interest rates in contrast to Central Banks in the other major economies.. "*China's banks lowered the five-year loan prime rate (LPR), which is tied to the mortgage rate, by a record 15 bps on Friday, triple the amount that economists had forecast. It was the second policy move in a week that was aimed at propping up the ailing property market, after the People's Bank of China cut the floor of the mortgage rate a week earlier."*

What can be said is that while the original lockdowns worked against the less contagious but more lethal Alpha Strain, it is unlikely that it will work against the more transmissible Omicron variant with its even more contagious sub-variants. Given the tensions that exist within the Chinese leadership over the severity of the lockdown and given the growing animosity to these lockdowns especially by the youth, it is unlikely they can and will be repeated.

Will the stimuli unleashed by the Chinese state be sufficient? Time will tell. Will more be added? Time will tell. What is evident, is that while the Chinese economy is now much larger than in 2008, compared to its youth then, it is now arthritic. The reserves found in 2008 are now exhausted by debt and low profitability.

Ukraine.

The Ukrainian military front in Donetsk and Luhansk is collapsing. Within two weeks all the Ukrainian troops are likely to have been driven back over the borders of Luhansk and Donetsk, that is if they have not deserted before then. Even the self-styled governor of Donetsk, ruler over nothing, *Serhiy Haidai* has admitted as much.

The Russian military have taken advantage of Zelensky's doctrine of total defense and his instruction that no part of the region is to be abandoned. As a result the Russian forces attack here then there, forcing the Ukrainian to constantly redeploy, which means they have to leave their fortifications and travel overground where they are easy targets for Russian artillery, missiles, and planes. The Ukrainian authorities refuse to release estimates for their dead and wounded and are now having trouble suppressing information from the front, but if Russian statistics are to be believed over 100,000 have been killed, seriously wounded or captured.

What a price to pay for a few thousand western capitalists who were never reconciled to losing out when the USSR collapsed, and who have continuously hankered after the resources and wealth of Russia they felt they were denied. What a killer self-entitlement is. This is why I call them anti-human, not inhuman. Inhuman implies these capitalists, these neo-cons and neo-liberals, are part of the human race. No, a thousand times no, they stand outside the human race, embodying all that is mean, base, and repulsive, all the emotional residues and attitudes which the human race has to shed if it is to free itself from its history.

The pending defeat of the Ukrainian army is going to unleash three inter-connected crises. The first will be a profound political crisis for the Ukrainian government and Zelensky in particular. They have fed their population on lies and myths. When the awful truth hits home, when it can no longer be buried, when the population realizes they have been duped, with 10 million refugees and a broken country, there will be a reckoning. History proves this over and over, and it is unlikely that Zelensky's government can survive.

It may very well not be a Zelensky government that appears at the negotiating table. But there will be political negotiations whether or not NATO allows it. Just as the talk of the Ukrainian army being invincible was tosh, so too is talk of future counter-attacks by a replenished Ukrainian army. The Russians always saw this as a war of limited and expressed goals, something which NATO muddied, but it is likely they will have achieved their immediate goals by mid-year and without too much economic damage to their own economy. The Russian have always expressed a willingness to negotiate and now if they do, the facts on the ground are in their favour.

The second crisis will be in the West, particularly in the EU. Splits are already appearing. After the Ukraine, the country most likely to be most damaged is Germany. Damaged too is the global financial system with the dollar at its core. The Eastern part of Ukraine will be integrated into the Russo-Sino sphere. The Black Sea will be added to the silk route as part of the new global architecture. And if anyone needed reminding of Russo-Sino unity, there was the joint Russian-Chinese bomber exercise on the 24th of May, a farewell gift to the departing Biden, demonstrating that the two countries stand shoulder to shoulder. In the first round of World War 3, it is the West who is losing.

The third crisis will be in the ranks of the Western Media. This oligarch/corporate owned media coupled to state media, the so-called **free** press that **free**zes out the truth, will now have to account for the defeat of the Ukraine. The West points to the Red Wall Censors in China while denying the presence of its own Blue Wall Censors here. This censorship is in fact is going to backfire when the truth can no longer be suppressed, and questions are asked about the bias in coverage. This corrupt, distracting, sleazy and treacherous press with its lying mouths has treated their populations with contempt, filling their pages and screens with drivel, concocted massacres, eye watering tales of Ukrainian heroism and mouth dropping Russian clodhoppers. It will be interesting to see how they manage the coming 'about-turn' without tripping over their own feet.

Of course there is a possible red line. To avoid the defeat of the Ukrainians, the USA could provide Ukraine with long range missiles. Biden is actively discussing sending the MLRS system which can fire rockets up to 300 km or deep into Russian territory. He is being egged on to do so by Boris Johnson. The chosen enforcer used by NATO to lean on Zelensky not to negotiate is Johnson. It seems it takes one joker to know another. Johnson seems to have some influence over Zelensky, why else would the Ukrainian military reluctantly embark on silly Churchillian type military manoeuvres in the Black Sea which led inter-alia to the debacle over Snake Island.

Should these missiles be delivered to the Ukraine, the Russians have warned of severe reprisals, in other words the war may end up not being contained in the Ukraine, and that is very dangerous for the world.

Conclusion.

The Byline Times received a leaked report about how the establishment is preparing for *Dangerous Levels' of Imminent Civil Unrest in Western Homelands.* Yes, society's cloth is beginning to tear. War, poverty, hunger, intolerable heat, all this marks the potential end of society's first damaging industrial economy. The capitalists in Davos are depressed having seen the gold leaf writing on the wall, we must not be, we need to get organised for the greatest challenge that has ever faced the human race. Truly, the 2020s is the decade of *make or break*, the decade of revolution or barbarism.

27th May 2022.