

THE US ECONOMY LOSES ITS RESILIENCE ONCE MORE.

Most corporations have now released their financial reports for Q1 2023. Last week the [CBO released its April tax and spend data for the Federal Government](#). In addition, this week [retail sales for April](#) were announced. We are thus in a position to evaluate the current state of the US economy.

I will begin with the Congressional Budget Office Report (CBO) linked above. This covers the first 7 months of the fiscal year beginning in October 2022. Seven months is of sufficient duration for any Covid effect to have receded. Tax receipts fell by 10% while spending (outlays) rose by 12% leading to shortfall of 22%, propelling the deficit to 7% of GDP, an unsustainable gap particularly in an inflationary environment. Even if we account for the [loss of capital gains tax](#) and we account for the sharp rise in interest rates paid, the fall in receipts would still be 8.5% while the rise in outlays would still be 7.2% yielding a shortfall of 15.7%.

Table 1.

Table 1. Budget Totals, October–April					
Billions of Dollars					
	Actual, FY 2022	Preliminary, FY 2023	Estimated Change	Estimated Change With Adjustments for Timing Shifts in Outlays ^a	
				Billions of Dollars	Percent
Receipts	2,986	2,686	-299	-299	-10
Outlays	<u>3,346</u>	<u>3,614</u>	<u>269</u>	<u>397</u>	12
Deficit (-)	-360	-928	-568	-696	236

Data sources: Congressional Budget Office; Department of the Treasury. Based on the *Monthly Treasury Statement* for March 2023 and the *Daily Treasury Statements* for April 2023.

FY = fiscal year.

This tax data does not support the view of an economy which is growing but one which is contracting. Readers will know that I have been banging on about this for some time. But now it appears the mainstream are beginning to recognise this at last. In an insightful [Financial Times](#) article on the US budget deficit on May 11th Chris Giles made the following comment. “*Weak receipts reflected lower realised capital gains than the CBO expected in late 2022, the transformation of the Federal Reserve’s quantitative easing programme from a cash cow to a significant burden and the possibility that the **underlying recovery was not quite as healthy as initial statistics showed.*** (my emphasis) It is gratifying to find the mainstream catching up by gently concluding that US GDP, National Income, and spending is inflated.

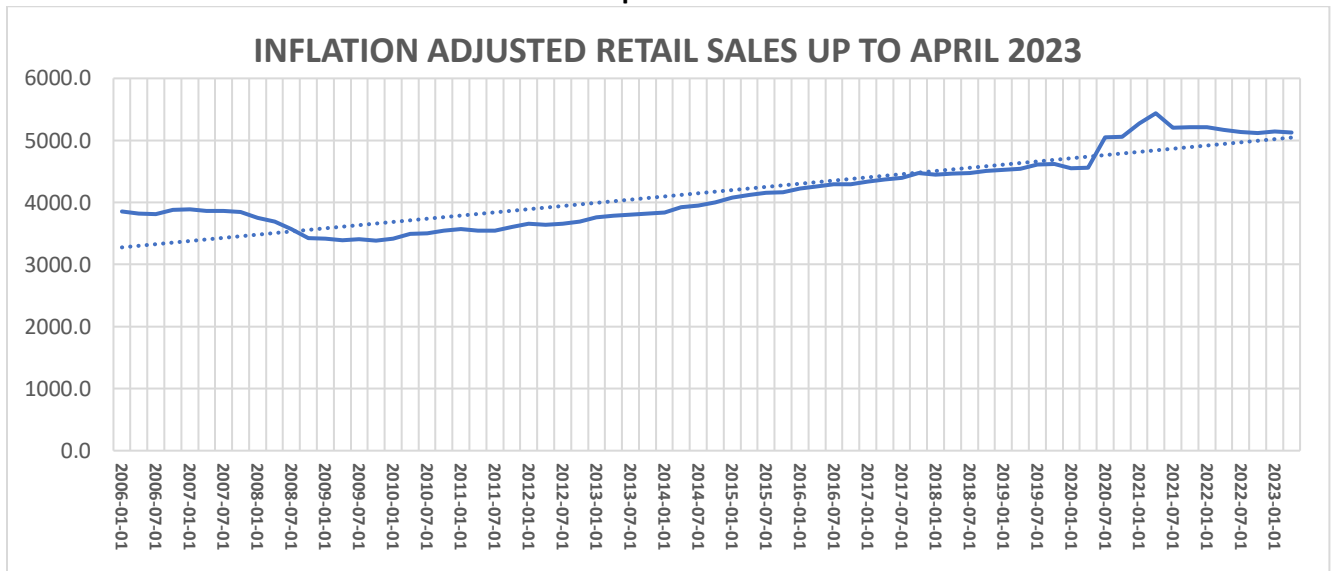
Looking at the matter more closely - specifically taxes on employment - the following comes to light. According to the CBO data, payroll and withholding taxes rose by 4.4% over these 7 months. But when we examine the Bureau of Labour Statistics the following is found. Aggregate hours increased on average by 2.7% over this period while hourly pay rose by 4.64%. (Sources: FRED Table AWHAE for aggregate hours and CES0500000003 for hourly earnings.) Thus total pay rose by 7.34% (confirmed by NIPA Table 2.6) or 3% more than taxes. This suggests the growth in employment is somewhat overstated by the official figures. And if this is the case then the tight labour market is not so tight because the discrepancy of 3% cancels out any growth in the hours worked.

Finally, it is worth paying attention to interest paid by the Federal Government. It is the biggest single increase in outlay at \$107 billion, an increase 25% bigger than the increase in *social mandatory spending* on social security benefits, Medicare, and Medicaid. It will end up being bigger than defence spending.

Retail sales.

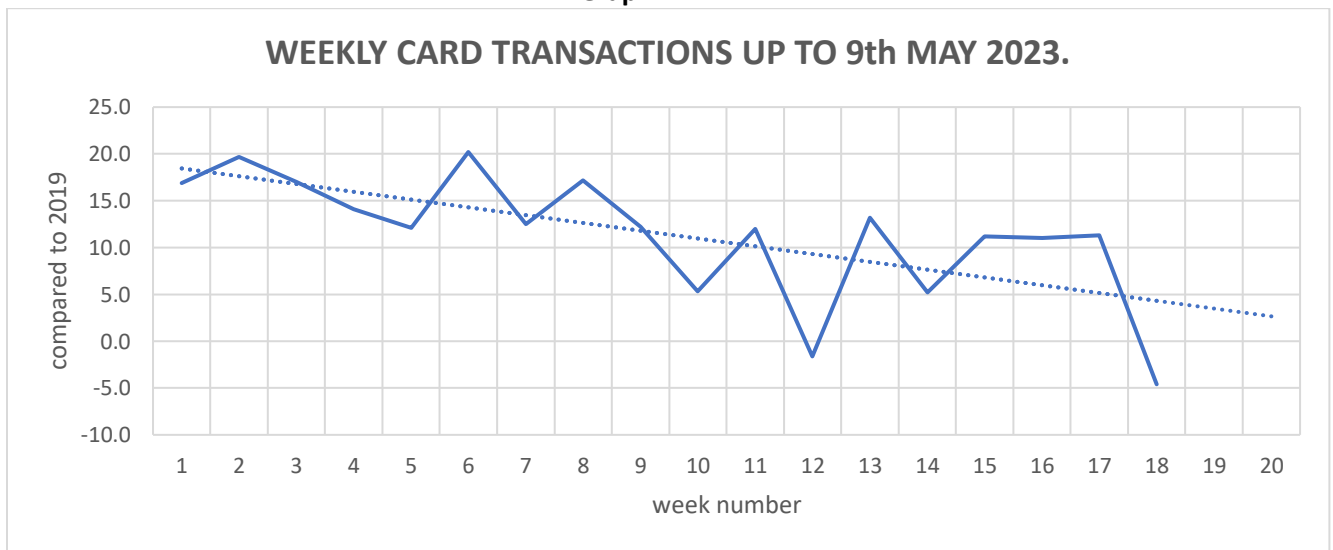
According to the April release, [retail sales rose 0.4%](#) month on month while the 4-month moving average (Jan-April 2023) increased by 2.4% compared to the year before. According to my Retail Price Index which can be found in the accompanying spreadsheet 'RPI up to April 2023' price rises amounted to 4.94%, resulting in a fall in volume of 2.54% over this period. Once again, not indicative of an expanding economy. However as we shall see in the reports on individual corporations, it appears that inflation is understated by 100% meaning that the fall in volumes could be more substantial. In Graph 1 below, the nominal value of retail sales has been deflated by 4.94%, which is higher than the official 3.3% deflator (NIPA Table 1.1.4), and if the higher figure were to be utilised by the BEA, it would reduce Q1 2023 GDP growth by 0.5%.

Graph 1.



Whatever substitute indicator is used, be it card transactions or polling of stores, sales are falling sharply.

Graph 2.



Source: [BEA Near-Real Time Spending](#))

	Q1 2023	Q1 2022	(millions of \$s)
Apple			
Total net sales	94,836	97,278	(-2.5%)
Total cost of sales	<u>52,860</u>	<u>54,719</u>	(-3.4%)
Gross margin	41,976	42,559	(-1.4%)
Total operating expenses	<u>13,658</u>	<u>12,580</u>	(+8.6%)
Operating Income	28,318	29,979	(-5.5%)
Microsoft			
Total revenue	52,857	49,360	(+7.1%)
Total cost of revenue	<u>16,128</u>	<u>15,615</u>	(+3.3%)
Gross margin	36,729	33,745	(+8.8%)
Total operating expenses	<u>14,377</u>	<u>13,381</u>	(+7.4%)
Operating income	22,352	20,364	(+9.8%)
Procter & Gamble			
Net Sales	20,068	19,381	(+3.5%) volumes down 4%
Cost of Sales	<u>10,404</u>	<u>10,326</u>	(+0.8%)
Gross margin	9,664	9,035	(+7.0%)
Total operating expenses	<u>5,416</u>	<u>5,031</u>	(+7.7%)
Operating Income	4,248	4,024	(+5.6%)
Pepsi			
Sales	17,846	16,200	(+10.2%)
Cost of Sales	<u>7,988</u>	<u>7,433</u>	(+7.5%)
Gross Profit	9,858	8,767	(+12.4%)
Total Operating Expenses	<u>7,229</u>	<u>6,580</u>	(+9.9%)
Operating Profit	2,629	2,187	(20.2%)
General Mills			
Net sales	5,126	4,538	(+13.0%) volumes down 4% prices up 17%
Cost of sales	<u>3,461</u>	<u>3,134</u>	(+10.4%)
Gross Margin	1,665	1,404	(+18.6%)
Total operating expenses	<u>947</u>	<u>751</u>	(+26.1%)
Operating Income	718	653	(+10.0%)
Verizon			
Net sales	32,912	33,554	(-1.9%)
Cost of Sales	<u>13,504</u>	<u>14,350</u>	(-5.9%)
Gross Margin	19,408	19,204	(+1.1%)
Operating expenses	<u>7,506</u>	<u>7,172</u>	(+4.7%)
Operating Margin	11,902	12,032	(-1.1%)
United Airlines			
Net Sales	12,189	8,899	(37.0%)
Cost of Sales (fuel increase)	<u>7,504</u>	<u>6,626</u>	(13.3%)
Gross Margin	4,685	2,273	(201%)
Operating Expenses	<u>3,681</u>	<u>3,424</u>	(7.5%)
Operating Margin	1,004	-1,151	(87.2%)
Colgate-Palmolive			
North America	10.0% price increase minus 6.5% volume fall = +3.5% revenue growth.		

Retailers

Home Depot

Net sales	37,257	38,908	(-4.2%)
Cost of sales	<u>24,700</u>	<u>25,763</u>	(-4.1%)
Gross margin	12,557	13,145	(-4.5%)
Operating expenses	<u>7,006</u>	<u>7,216</u>	(-2.9%)
Operating income	5,551	5,929	(-6.4%)

COSTCO (quarter ending February 12th)

Net sales	54,059	50,937*	(+6.1%) excludes membership fees)
Cost of sales	<u>48,423</u>	<u>45,517</u>	(+6.4%)
Gross margin	5,636	5,420	(+4.0%)
Operating expenses	<u>4,940</u>	<u>4,575</u>	(+8.0)
Operating Income	696	845	(-17.6%)

(*Subsequently, Costco sales have increased by >2%, down from 6.1%)

TJX (clothing)

Net Sales	11,783	11,406	(+3.3%) (US sales +4.8%)
Cost of sales	<u>8,374</u>	<u>8,223</u>	(+1.8%)
Gross margin	3,409	3,183	(+7.1%)
Operating expenses	<u>2,238</u>	<u>2,094</u>	(+6.9%)
Operating Income	1,171	1089	(+7.5%)

Target

Net sales	25,322	25,170	(+0.6%)
Cost of sales	<u>18,386</u>	<u>18,461</u>	(-0.4%)
Gross margin	6,936	6,709	(+3.4%)
Operating expenses	<u>5,025</u>	<u>4,762</u>	(+5.5%)
Operating Income	1,911	1,947	(-1.9%)

Walmart

Net sales	162,743	151,525	(+7.4%)
Cost of sales	<u>125,423</u>	<u>115,522</u>	(+8.6%)
Gross margin	37,320	36,003	(+3.7%)
Operating expenses	<u>33,064</u>	<u>31,462</u>	(+5.1%)
Operating Income	4,256	4,541	(-6.3%)

(Also Unilever's total sales increased by 10.5% after price rises of 10.7% disguising a fall in volumes of 0.2%. Unilever being the most globalised brand.)

What is interesting when measured against net sales, is that due to a relative decline in the cost-of-sales, the **gross margins** in the majority of cases increased, while due to the relative increase in operating expenses, **operating income** fell. This was particularly true for producer corporations. We also see that in the retail sector with the exception of TJX there was not only a real fall in operating income, but a nominal fall as well. This suggests that consumer facing corporations such as COSTCO and Walmart have a problem raising prices given customer resistance, in contrast to many of the producer companies who were able to pass on price increases above 10% onto retailers. This suggests their pricing power will be short-lived. The [Financial Times](#) concurs. It is also worth noting, that where volume data was available, volumes in the 1st quarter fell by less than in the 4th quarter of 2022. In addition, where corporations announced their average price increases, these rose in retail by 6%+ and in production by between 10 and 17%.

Much of the increase in operating expenses was due to the increased marketing and advertising effort to secure market share in a stressed market environment (although some press releases mentioned wage growth as well). The overall market for advertising was marked down recently. "[The 2023 ad market is expected to grow 3.4% this year, down from the 3.7% that Magna predicted in December. That figure accounts for the absence of cyclical events, like the U.S. elections and the Olympics. Six months ago it had predicted 6.3% growth.](#)" However, the same cannot be said for digital advertising where this spend is focused. According to *Forbes*, digital ad spending accounted for 57.1% of all advertising spending in Q1 2023 in the US and is expected to increase to 59.5% by 2025. Digital ad spending is expected to grow 10.5% in Q1 2023 from the expected 8.6% in Q4 2021. According to Oberlo, the digital advertising spend in Q1 2023 will rise 10.5% from the \$567.5 billion spent in Q1 2022, while other data suggests 13.9% compared to 2022 ([US digital ad spending](#)) Unbelievably, digital ad spending per person is expected to amount to **\$952.80 per internet user in 2023(!)**. This marks a 12.2% increase from 2022 and compares to \$317.50 in 2017. Since 2017 the annual growth rate has been 20%. Marx talked about throwing money into the sea, but this is throwing money into cyberspace, good for the likes of Google and Meta though.

It should be borne in mind that despite this advertising spend, most corporations with very few exceptions, did not avoid a fall in their operating income when adjusted for inflation. This was a function of the fall in their underlying volumes. In the end volumes are decisive because exchange value relies on use values. This means that their ability to raise prices to compensate for volume falls will be short-lived.

On the flip side analysts such as FactSet who had predicted a fall in S&P profits for the quarter of >6% now note that the expected fall is <3%. This difference of 3% is due to only one factor, revenue growth which beat expectations, courtesy of a wave of price increases at the expense of the consumer. (**Note 1.**)

So what drove price increases.

The \$64 billion question is this, what allowed these key corporations to achieve +10% price increases during the quarter, therefore making a mockery of the official inflation indexes. Every industry or sector is dominated by 4 or 5 large corporations commanding 70% or more of the total revenue. Thus even if the rest of the corporations who lack monopoly pricing power were unable to achieve 10% price rises, this would only have had a minor effect on average prices for the industry.

Here we will look at the various factors stimulating demand. The one factor we will not be looking at is the so-called tight labour market for the following reason. The quarter was dominated by lay offs in tech, finance and consultancies, aka better paid jobs, while any growth in employment was marked by lower paid workers such as in hospitality and leisure. This can best be seen in this [ADP graph](#) for wages which is more useful than the BLS data as it better captures wages in the larger corporations. (ADP prepares more payrolls for corporations than any other outsourcing company.) Thus the overall aggregate increase in employment, even if it was real, has little bearing on the spending power of the working class.

The first factor is the rebound in the stock market noting that the top 10% of income earners spend as much as the bottom 80% of income earners on things other than basics. I tend to use the following study to examine the effect capital gains has on overall consumer spending. The [Harvard Business School](#) which I have cited and used in a number of articles, finds that for every Dollar rise in capital gains, particularly on the Stock Markets, 3.2 cents finds its way into more consumer spending. Thus if we apply this to the [Wilshire 5000](#) which reversed its fall in October 2022 and has since risen by about 20% or about by \$8 trillion, it translates into a spending boost of \$128 billion which seems to be confirmed by the likes of

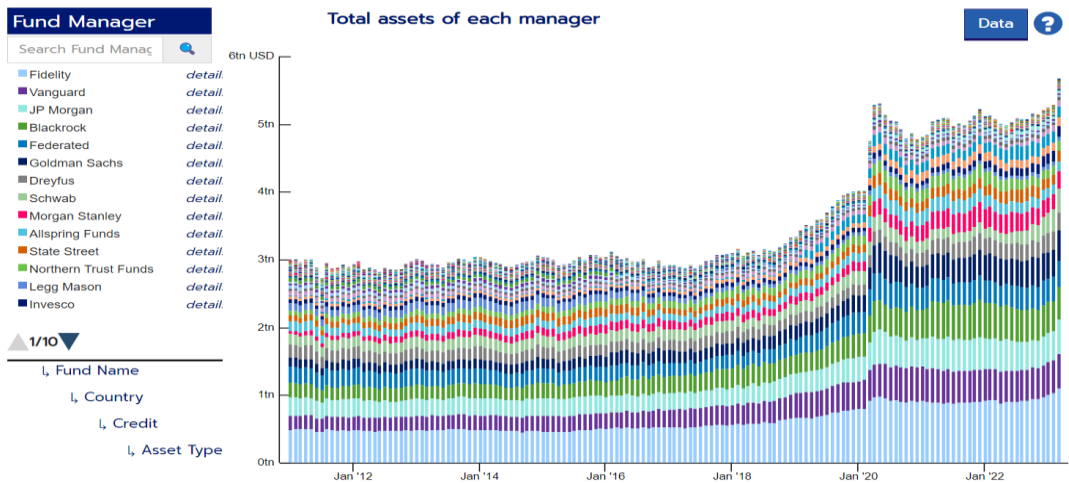
[LMVH](#) with its 17% YoY global growth or [HERMÈS](#) with its 19% increase in the Americas or [Tesla's](#) 27% increase in unit sales. Or better still, the observation that all the major airline companies are sprucing up their first class and business class cabins in preparation for summer because the increase in air travel is mainly coming from their well-heeled customers. In many ways airliners symbolise the growth in inequality as the number of first and club class seats increase while the economy cabin shrinks.

The second is the boost from interest earned. This is not so much due to a rise in deposit rates offered by banks as it is from the migration to money market funds. [Money market funds in 2020](#) amounted to \$3.85 trillion, but by the first quarter of this year they had reached almost \$6 trillion as can be viewed below.

Graph 4.

Investments by any U.S. MMF

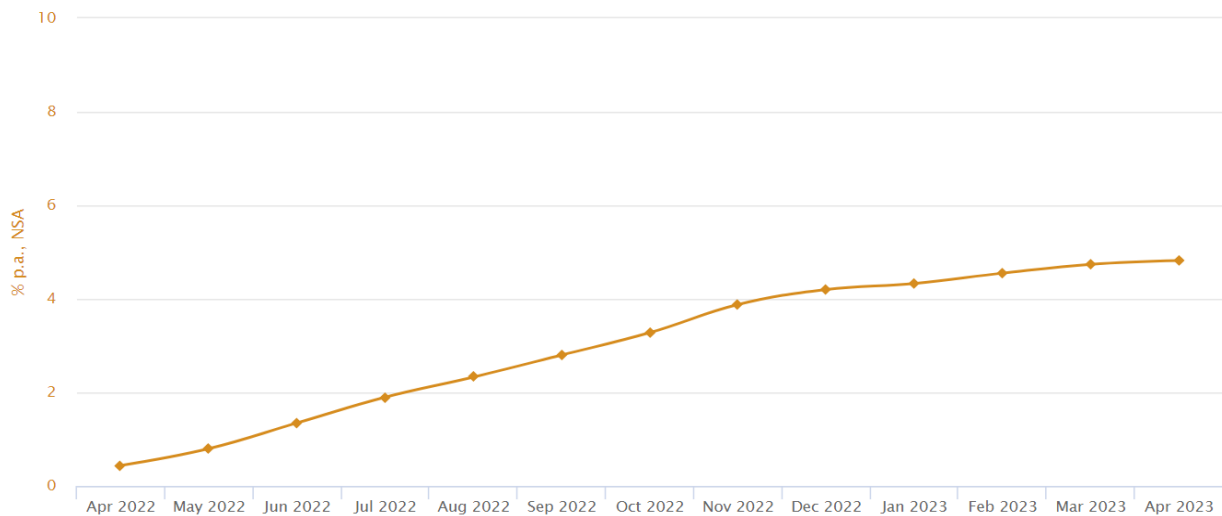
This chart shows the investments made by each [U.S. MMF manager](#) and their individual funds. Start by observing the market shares of all fund managers or search for a single manager. Click on 'details' to choose one fund manager and drill down to see its funds. Continue to drill down to see its investments, which are grouped by country, credit exposure, and asset type.



(Source: [Office for Financial Research](#))

Not only did money flood into these funds but they were welcomed there by higher interest rates.

Graph 5. Money Market Rates



Source: ([Moody's Analytics](#))

Together, the rise in interest rates to around 4.5% when added to a +30% rise in deposits, yielded extra interest payments amounting to \$90 billion. The irony is that despite this \$90 billion boost to interest earned in the money markets, total interest paid barely budged due to banks gouging their customers with low interest on regular savings as well as long term mortgages stabilising interest payments ([NIPA Table 2.6, Line 14](#)). Alongside this rise in money market fund interest paid, corporations continued to maintain their dividend payments as well as share buy-backs. According to the [St Louis FED](#) net dividends paid in the USA increased by \$10 billion between 2019-2020, then by \$120 billion the following year and finally by \$50 billion up to 2022 when it reached \$1.71 trillion. A net increase since 2019 of \$180 billion.

The third is the longevity of residential mortgages in the USA. According to [Marketshare](#), 70% of mortgages based on HMDA data in 2021 were 30-year fixed-rate. This means that most will end up being paid off and only a few will be rolled over. Thus while owner-occupier inflation appears to be high, most of these mortgages were taken out when interest rates were very low. It was only in mid-April 2022 that the [Mortgage rate](#) exceeded 5%. Thus uniquely, the longevity of mortgages in the USA, removes one of the restrictions on current spending.

Fourthly, borrowing continued over the quarter which is unlikely to be repeated as lending standards have tightened and [delinquencies are increasing](#). Credit card debt grew by 20% yoy in the quarter as reported by [CNBC](#). *“Usually, balances fall in the beginning of the year as borrowers start paying down debt after the peak holiday shopping season — not this time.”*

Fifthly, the US government deficit approaching 7%. A significant portion of which went to fund increases in benefits as well as financing investment via the CHIP Act and the Inflation Reduction Act, surely a misnomer. [US pensions](#) were increased by 8.7% in January and will apply to more than 65 million Social Security beneficiaries in January 2023. As these payments amount to between 5.25% and 5.5% of GDP they amount to \$1.4 trillion annually, yielding an increase in transfers of around \$75 billion annualised.

Finally, the first quarter was a minor relief bounce based on lower than expected energy prices despite the war in the Ukraine and all the associated embargoes. Energy and food being the costliest items for lower income households. In fact with commodity prices continuing to ease, particularly oil and gas, the profitability of shale oil and gas in the USA, which made such stellar profits last year, is beginning to approach break even point. Here is the Kansas FED report for the first quarter: [Tenth District Energy Activity Declined Moderately](#) *“First quarter energy survey results revealed that Tenth District energy activity declined moderately and is expected to continue to slow. Firms reported that oil prices needed to be on average \$64 per barrel for drilling to be profitable, and \$86 per barrel for a substantial increase in drilling to occur. Similarly, natural gas prices needed to be \$3.45 per million Btu for drilling to be profitable on average, and \$4.74 per million Btu for drilling to increase substantially. April 14, 2023.”* No doubt should WTI prices, currently at around \$71 per barrel, fall below \$70, the Biden Administration will discover it has to replenish its strategic reserves thereby supporting the price. Once again the US has shot itself in the foot because much of this fall derives from Chinese weakness resulting from the numerous US embargoes.

CHATGPT and unproductive labour.

In ending this article it is worth briefly discussing deep learning. The threat to workers jobs does not come from consumer-based CHAT programmes from the likes of Microsoft, it comes from proprietary deep learning products. These are the ones trained to intervene in specific industries such as accounting, legal, marketing and so on. Capitalism ceaselessly looks for ways to cut down its expenses, what we understand

to be unproductive labour. It is not by accident that the costs of employing this unproductive labour is found on the loss side of the Profit and Loss Account. This form of deep learning is an arrow pointed at the desks of white collar rather than blue collar workers. Wall Street is gleefully banding around job losses amounting to hundreds of millions of office workers and eulogising over the improvement in profit margins this will generate. Of course the culling of this amount of white-collar jobs has its own political risks. It will alienate large portions of voters who have traditionally supported establishment parties undermining rule by consent.

In a global economy where profit margins are compressing, *CHAT* will be a capitalist gift that will keep on giving until workers resist. For this reason, and facing this onslaught, it's such a bad idea to work from home. Working from home isolates individual workers making it easier for their bosses to pick them off one by one.

Conclusion.

The final quarter of 2022 and the first quarter of 2023 must be taken together. When this is done, global production and trade is flat over the 6-month period. The final quarter was dogged by pessimism over energy supplies while the first quarter was lifted when these fears turned out to be less severe. However, by March the downward momentum gathered pace once more and is accelerating. Another factor supporting the first quarter was the reopening of the Chinese economy which raised expectations, but current data from China has disappointed with month-on-month growth non-existent. Predictably that has led to a softening in the price of energy as well as copper and iron ore etc.

US leading indicators as well as high frequency data all point down. The influential Conference Board April indicator fell 0.6% month on month and is down 8.1% over the year. *"The LEI for the US declined for the thirteenth consecutive month in April, signalling a worsening economic outlook," said Justyna Zabinska-La Monica, Senior Manager, Business Cycle Indicators, at The Conference Board (TED).* TED is forecasting a recession by mid-year. [Michael Roberts](#) on his Facebook page also reported that the FED's recession indicator is at its highest point since 2008. This outlook is being repeated in Germany and Japan.

While US profits did not fall as much as predicted, the rate of profit will have declined once again making this the third quarter in a row where the rate of profit has fallen. Despite the better-than-expected profit outcome in Q1, [FactSet](#) is still anticipating a fall in the mass of profits of 6.3% in the current quarter (Q2).

Currently the stock market is obsessed with the debt ceiling, or what is the same thing, the Whitehouse playing American Roulette with Congress. In the absence of rational investing, the stock market is being driven by Quant funds with ETFs in tow as both are momentum plays. Algorithms (Quants) which do not place profitability centre stage are ticking time bombs.

This political game of roulette is only available to a country which is home to the world's reserve currency. However, even if the debt ceiling is resolved in time, it still weakens the standing of the Dollar at a time when it is already waning. The fiscal problem over the next six months, will not so much hinge on spending issues, but falling tax revenues as the economy weakens. This is a more intractable problem than cutting spending. In the meantime the large deficits offset the downward pressures in the economy.

Some observers mulling over the banking crisis are quite sanguine. They should not be. The calm is deceptive. The US is in the eye of the banking storm. The *leading winds* of this storm were driven by depositor flight. But that is the lesser challenge. The *following winds* coming behind will be generated by

events on the borrowing side - bad debts - and as we know with every storm, it is the following winds that are the most destructive. These are beginning to manifest themselves. [Bloomberg](#) got a whiff of something rotten this week. *“By the time the wave of filings was over early Monday, seven large companies had gone bankrupt, a sudden burst that’s without precedent in the 15 years that Bloomberg has been tracking the data.”* *“To some market observers, this is a clear sign — and a moment that might be remembered for years to come — that the long-awaited cull of companies drowning under onerous debt loads has begun in earnest.”* And again: *“Corporate America Faces a Bankruptcy Boom”* says the *New York Times*. *“New data shows that 2023 is shaping up to be the biggest year for Chapter 11 filings in more than a decade.”* The next couple of months will confirm or deny this prognosis. Whatever the case, the time of monetary plenty is over, and we are now in pay back territory.

The current trends are clear. The difficulties facing capitalism are growing and becoming cumulative. The downward trend beginning in October last year is reasserting itself and as it deepens it will set off repeated financial emergencies, and of course facing the economy, is the trapdoor marked ‘weather’.

Note 1. There is an accounting convention to adjust corporate revenue or net sales for currency effects. All these corporations are multi-nationals with subsidiaries abroad producing and trading in local currencies whose exchange rate may rise or fall between periods. Accordingly, the so call ‘organic’ revenue may differ from the nominal revenue. However it should be noted this is merely an accounting convention. It is not real. Subsidiaries in various countries pay their workers and local suppliers in the local currency and bank in the local currency. Payments and deposits are not made in Dollars. The only time when local currency is converted into Dollars or Euros if the corporation is headquartered in the EU or into Yen as the case may be, is when profits or finance charges are remitted back to the head-office. This represents only a small amount of the value produced by the subsidiary.

On the other side, the input side, currency effects alter cost prices due to their impact on import prices. Very few corporations provide an ‘organic’ cost of sales, that is isolating the benefit or loss from changes to import prices. In the case of US head-quartered firms, who rely heavily on foreign inputs, the same strong dollar which reduces unadjusted revenues also reduces cost prices. Thus what reduces the profit margin on the one side, is often more than made up on the other side through the reduction in the cost of sales.

Which is why, on reflection, I am disinclined to consider currency effects when accounting for the profitability of US corporations based on their own set of accounts. Matters stand differently with Gross Domestic Product data, as the SNA relates only to production located within the USA, so currency effects are not material.

Brian Green, 18th May 2023.