THE US ECONOMY BEFORE THE VIRUS STRUCK.

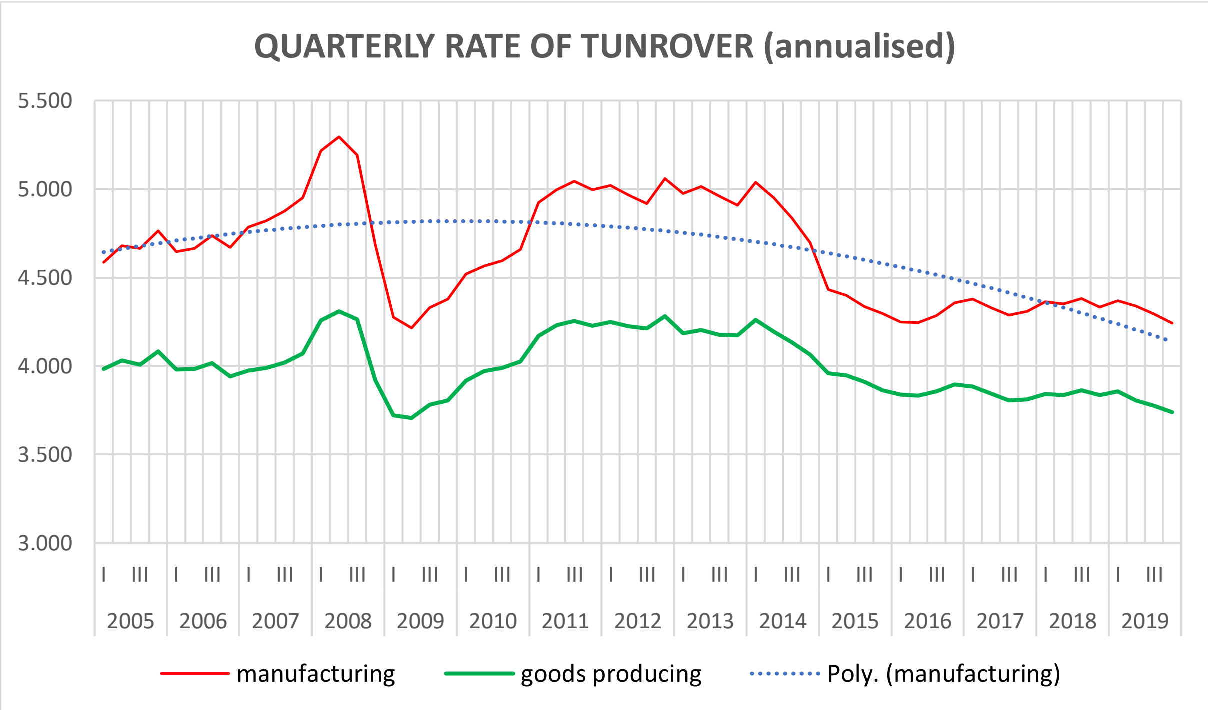
The purpose of this article is to determine the health of the US economy before it sickened from the virus. Why is this important? It is importance lies in this; the impact of the lockdown on the future of the US economy will be mediated by the state of the economy prior to the pandemic. A robust economy will exit this lockdown in better shape than will a non-robust economy.

The data is in for the final quarter of 2019. This is the last quarter unaffected by the pandemic which struck the US economically in the second half of March. This means that for the foreseeable future, data will be unreliable, which makes the unaffected final quarter of 2019 particularly important.

The rate of turnover.

As is customary with this quarterly report we begin with the rate of turnover for manufacturing as well as the entire goods producing sector of which manufacturing forms the largest component.

Graph 1.

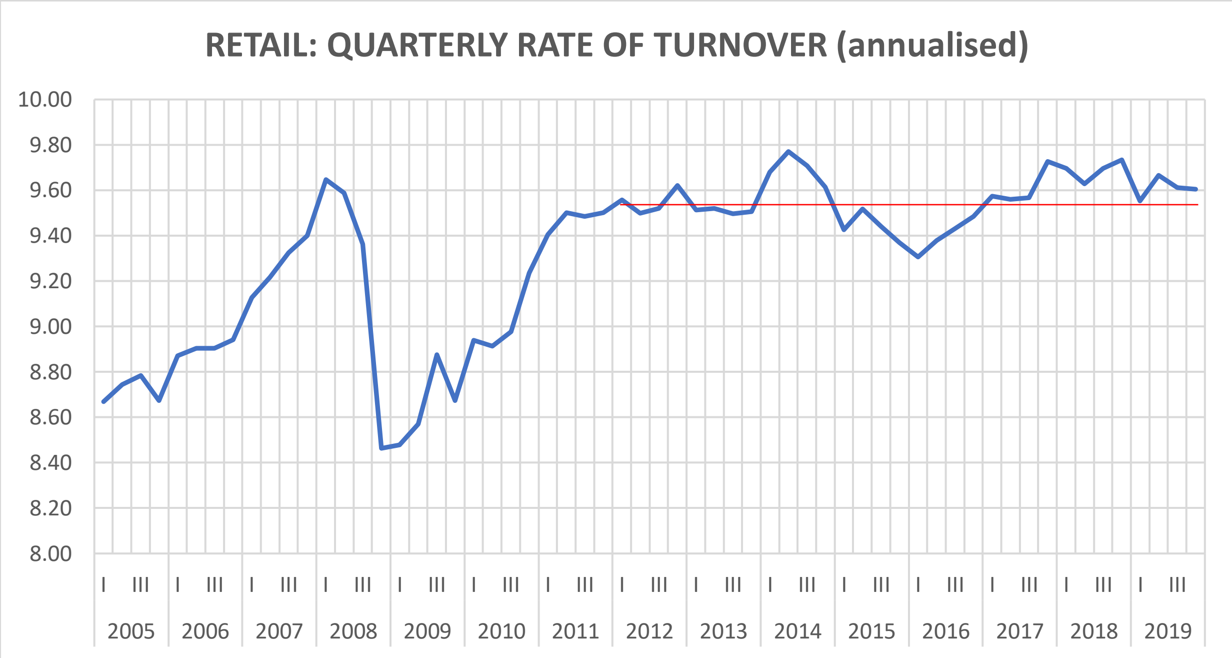


(Source: BEA Interactive GDP-by-Industry tables gross output and gross value added series.)

We note that in both cases, 2019 saw a consistent fall in turnovers. The slight improvement from 2017 courtesy of the "Trump Bump" was more than reversed during 2019. Manufacturing rates of turnover have fallen by 16% from their peak in 2014 elongating the period of capital circulation from 72.4 days to 86 days, an additional 13.6 days or almost two weeks. The same applies to the goods producing sector.

As we have seen previously, the rate of turnover for the retail sector, in contrast, has held up. This can be seen in Graph 2 below. This is consistent with robust retail sales resulting from some of the spectacular capital gains being cashed in by speculators to be spent on themselves, their families and mistresses or mastresses. The red line indicates the 9.56 average running from 2012 to 2019. It shows that retail turnovers remain on their near-term trend but are no longer rising despite the growth of e-sales.

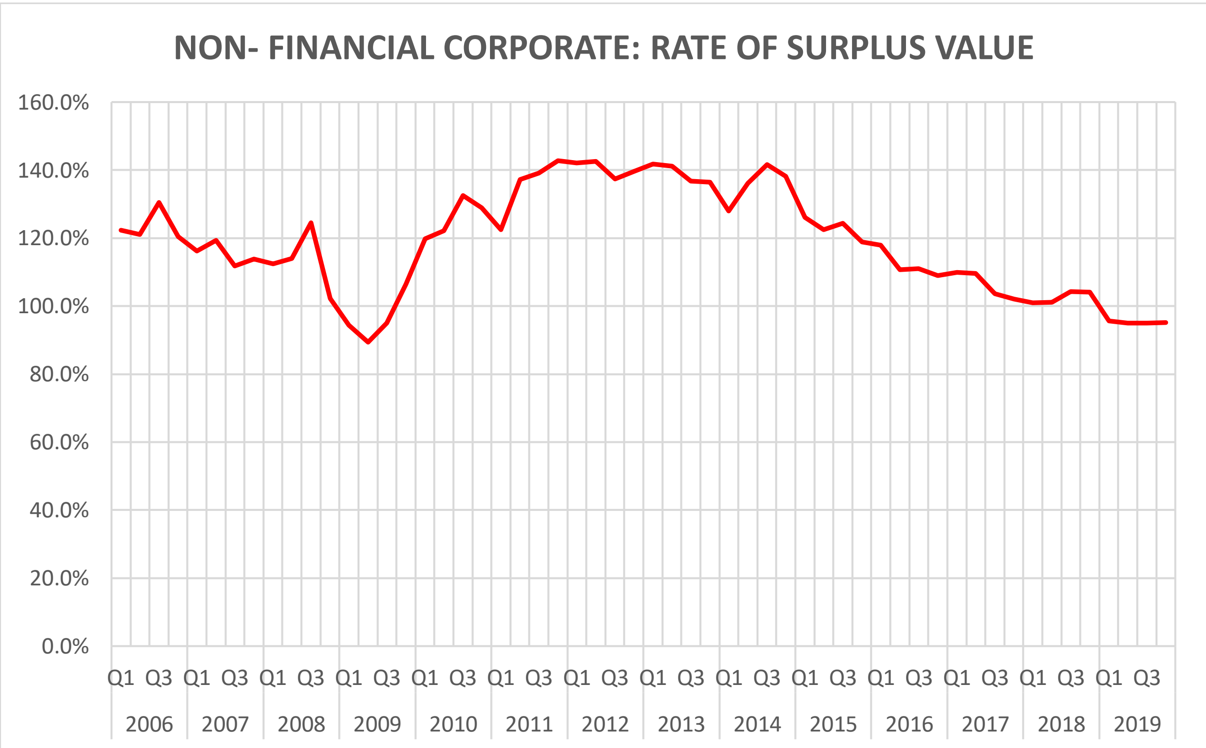
Graph 2.



Exploitation and profitability.

At this point we will now turn to non-financial corporations (NFCS) because the data found here is more up to date. As before, the rate of turnover applied to NFCs is the rate found in the goods producing sector. (Unfortunately, the BEA does not provide gross output data for the NFCs because they are not considered and industry but a legal entity.)

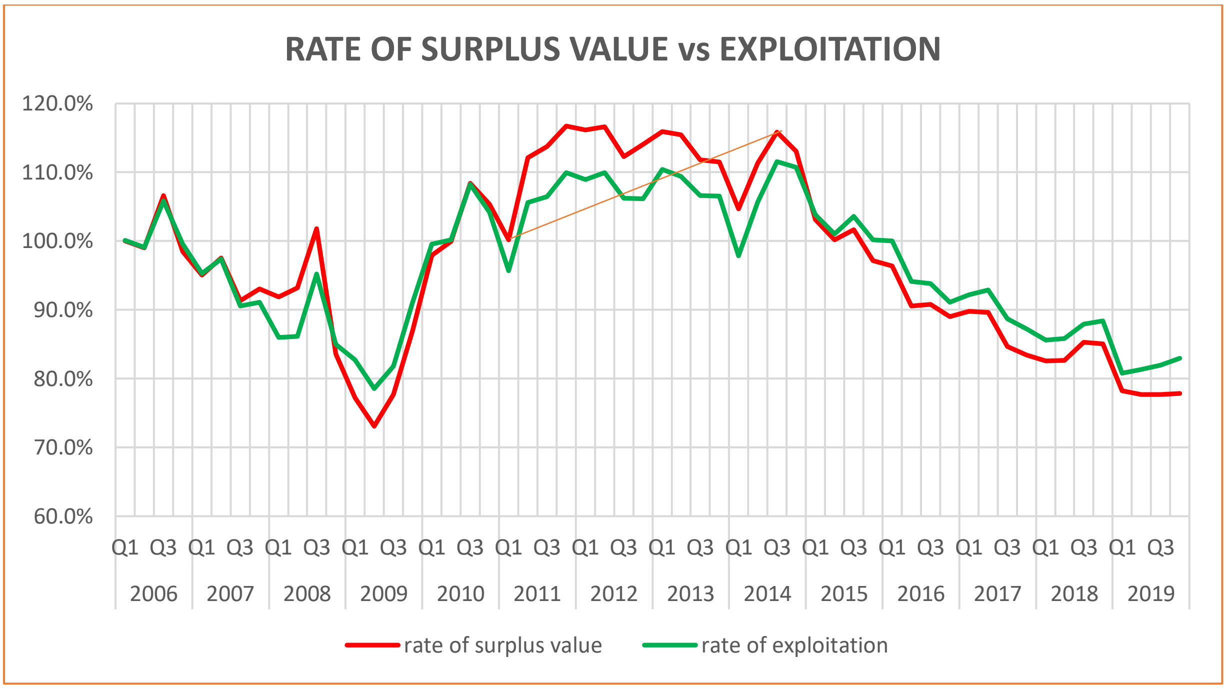
Graph 3.



To recap. The rate of surplus value is not to be confused with the rate of exploitation. The rate of surplus value is the sum composed of the rate of exploitation multiplied by the rate of turnover to yield an annual figure. In formulaic terms it is s/v versus s^n/v where ^{n} stands for the annual number of turnovers. The rate of surplus value will fall if both the rate of exploitation and the rate of turnover falls simultaneously, and it will fall, though the fall will be less pronounced, if one rate rises while the other falls provided the fall exceeds the rise.

In the case of 2019 the aggravated fall in the rate of surplus value was the product of a fall in both rates. This can be seen by turning to the attached worksheet "TABLE 1.14 QUARTERLY UP TO Q4 2019" which shows both rates. It is necessary to repeat the following law: the mass of profits cannot rise for as long as the rate of surplus value trends below the rate of exploitation.

Graph 4.

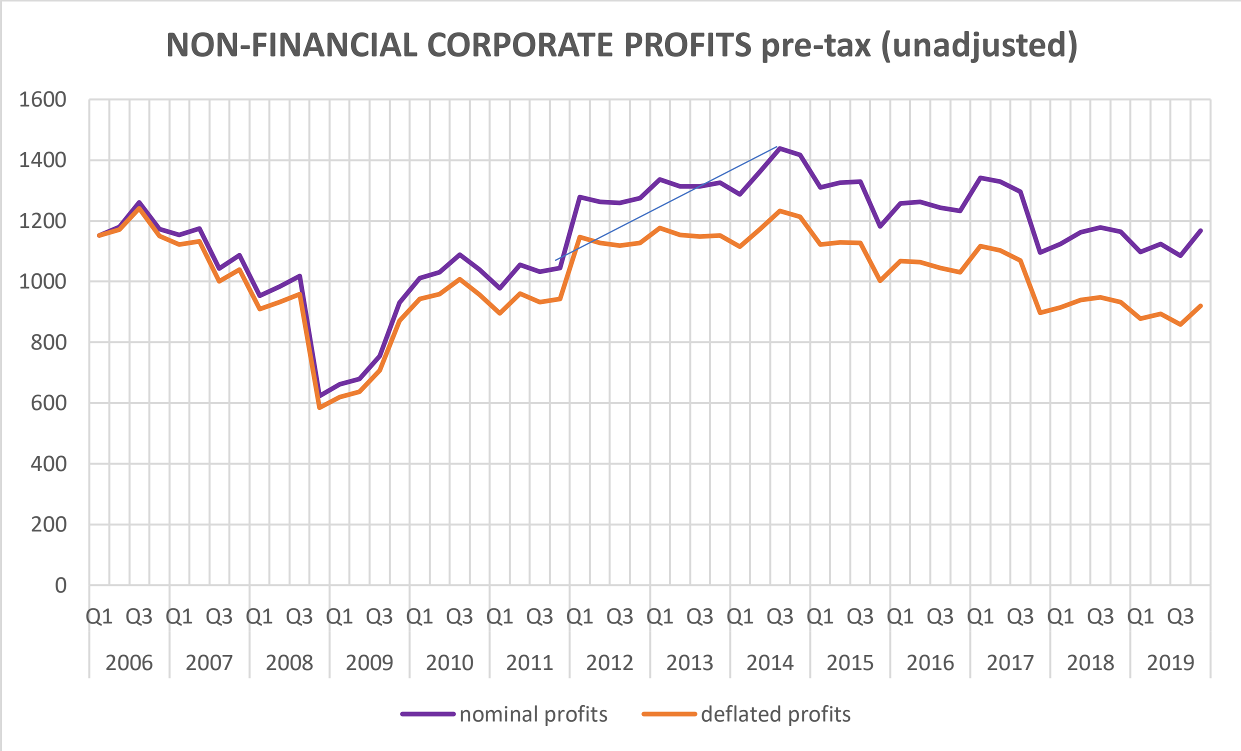


Source: "TABLE 1.14 QUARTERLY UP TO Q4 2019"

We note that in the run up to 2014, the rate of surplus value was located above the rate of exploitation. From that positioning we may assume the mass of profits were on the rise. Post 2014 the rate of surplus value swopped position to sit below the rate of exploitation. Once more, from that, we may assume the mass of profits was falling. Graph 5 below confirms both hypotheses. It records the movement in the mass of non-financial profits before tax and unadjusted. (line 63 of the attached Table 1.14) The use of unadjusted profits provides a more direct relationship with the important Net Surplus figure found on line 44 of the Table.

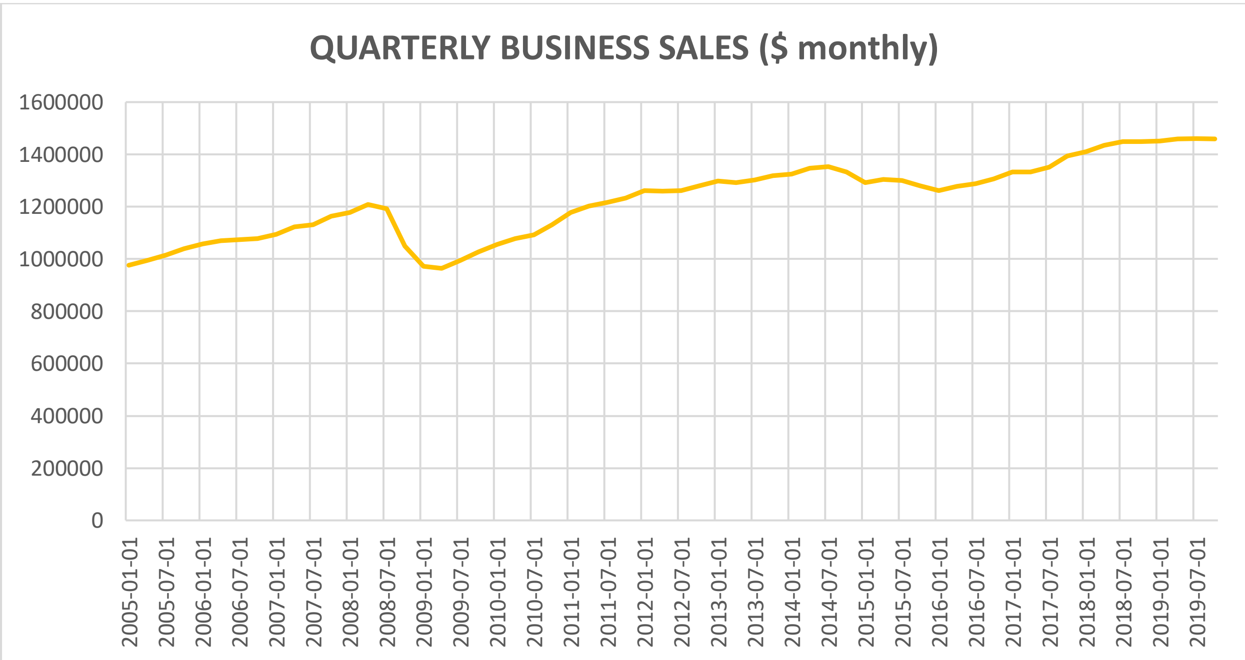
I have introduced a line in both graphs to show the symmetry between the rate of surplus value and profits from 2011 to 2014 in both cases.

Graph 5.



The uptick in profits in Q4 2019 is unexpected and anomalous. There is nothing to support it in the underlying data. While the share of compensation relative to net value added rose annually it was down quarterly. Nor was it derived from rising revenue unlike in 2017-8. Business sales is the sum of manufacturing, wholesale and retail sales. It is thus a good proxy for corporate sales, and it shows these sales were essentially flat over the last 6 quarters.

Graph 6.



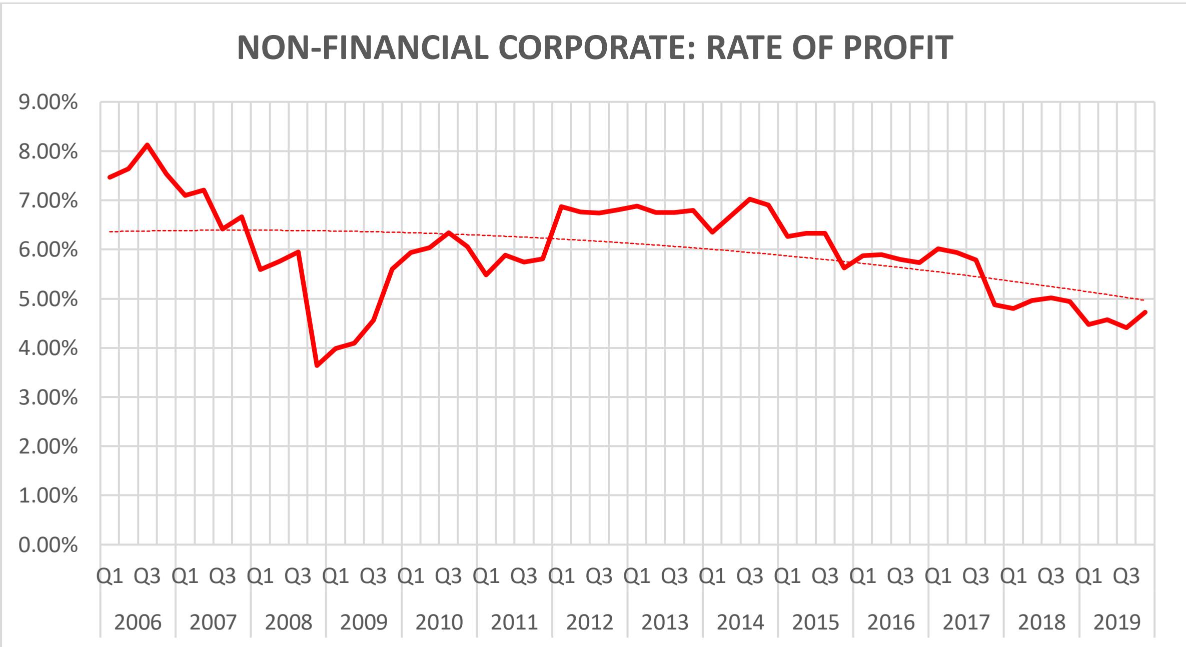
(Source: FRED Table TOTBUSSMSA)

Thus, the uptick in profits is not supported by the rate of surplus value nor revenue. The last time this happened, the BEA revised profits down subsequently. There is one isolated factor that may explain this, and it is the Trade War truce signed during the quarter which may have allowed corporations to book profits they were not expecting due to anticipated higher tariffs. In correspondence with Michael Roberts after the release of corporate profits, I pointed to this one-time phenomenon which would have affected corporate bottom lines. The support for this assumption is that while annualised profit figures barely rose or fell, depending on which line is looked at, the jump was only on a quarterly basis.

Discussion.

The equivalent ECG test for the health of capitalism is the rate of profit. The rate of profit recorded below is the most accurate possible because the denominator is composed of both fixed and circulating capital. The numerator is pre-tax and unadjusted non-financial profits. Pre-tax is chosen because it avoids the distorting effects of tax changes giving a cleaner trend. The rate of profit for 2019 is an estimate based on adjusting the 2018 fixed asset number provided by the BEA by the difference in capital consumption between the fourth quarter of 2018 and 2019. The figure of +5% is similar to the growth of fixed assets between 2017 and 2018. Ideally fixed assets should be taken as the average for the preceding year end and the current year end. As this is not possible until the BEA brings out fixed asset numbers later in the year, the rate of profit provided here is marginally lower.

Graph 7.



There was a quarterly uptick in the rate of profit because of the uptick in profits discussed earlier. However, despite the uptick the rate of profit is still 4% lower in relative terms compared to the final quarter of 2018. More importantly the current rate of profit of 4.7% is down one third from its 2014 peak and annually the rate of profit has fallen for 5 years in a row, which without a recession is unprecedented. From this we may conclude that US capitalism remains in a chronic condition.

As noted previously this condition has passed unnoticed by the speculators. 2019 was one of the best years ever for stock market gains as Graph 8 shows. It meant the economy was driven not by healthy investment motivated by a rising rate of profit, but by cashing in capital gains motivated by a rising stock and bond market.

Graph 8.

Source: (FRED Table WILL5000PRFC)

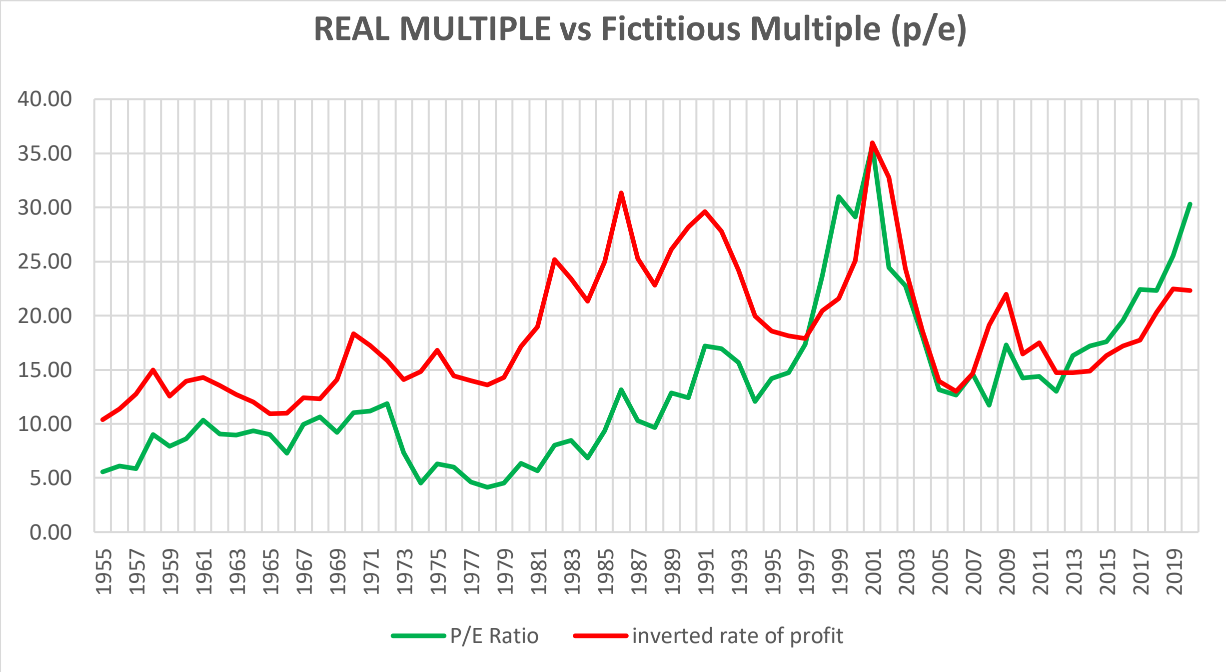
The stock market peaked on the 19th February. Between January 2019 and February 2020, it rose over 24%. It then fell 35% before recovering one third of this loss in the last two weeks. It now remains just within bear territory, down 21%.

Last week was extraordinary. The market fell on only one day, rising on four in what is called, a classic bear squeeze. This abrupt rise in the market was as large as it was unexpected, including by this author. Two reasons are given. Firstly, that the market felt the worst of the corona virus is over given the flattening in the curve of new admissions. Secondly, the $2.3 trillion stimulus by the FED on Thursday to take the sting out of the unemployment figures announced later that day.

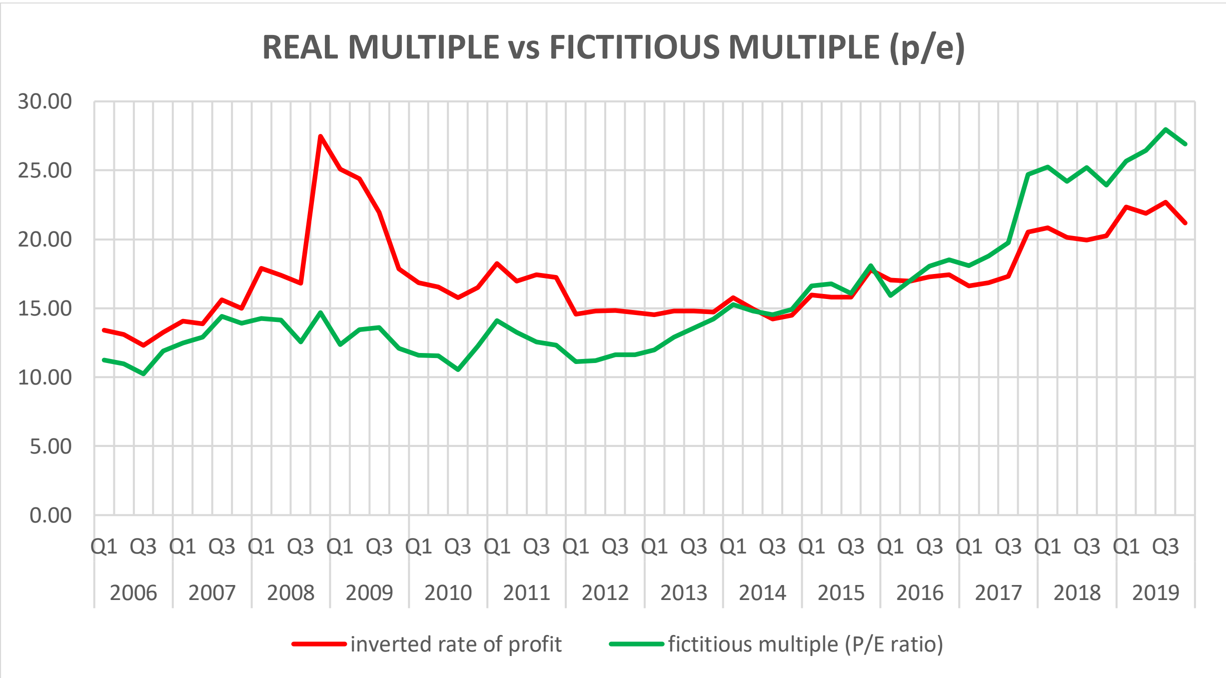
The toxic combination preceding the outbreak of the virus will deepen the recession and delay any recovery. This combination is made up of over-extended borrowing particularly by indebted corporations together with consumer spending resulting from capital gains. Despite the largesse of the FED, this recession will flush out indebtedness and the impact on capital gains will erode consumer spending. Only a sharp rise in investment can offset this, but once again the rate of profit suggests that profitable outlets from investment do not exist. Could the state invest on behalf of society rather than private corporations, that is the $3 trillion question. A recognition that this may happen is to be found in the discussions in Congress around a Roosevelt type infrastructure programme. But even here the omens are not good, because before that gets off the ground, this year's budget deficit is likely to be around 20%. This is just below the average levels found during the Second World War, when the US was waging war on every continent on earth. https://www.thebalance.com/us-deficit-by-year-3306306 It is also double that of 2009.

There are many ways to measure "fair value" for stock markets. In my view there is only one accurate measure. It is to compare the market cap to profit multiple (the fictitious multiple) to the total capital invested in production to profit multiple (the real multiple or inverted rate of profit.) The fictitious multiple in healthy circumstances should always reside well below the real multiple. If it resides above the real multiple, it means that share prices exceed the value of the fixed and fluid capital invested in production. Further not all profits can be handed over to shareholders as by some has to be retained for tax, emergencies, and additional investment. Thus a P/E ratios need to reside below the real multiple to make allowances for these provisions.

Graph 8.



Graph 9.



We notice that up to the mid-1990s, a healthy correlation existed. P/E ratios remained below the inverted rate of profit. This changed in the second half of the 1990s in the run up to the dotcom crash in 2000 and 2001. What is interesting, is that this did not take place in the run up to 2008. Graph 9 gives a more detailed picture of this. The same cannot be said post-2014, when the rate of profit started collapsing. Now for the longest duration, though not in absolute annual terms, the two multiples remain inverted. That is a bad omen for share prices going forward.

Finally, a note on inflation. The behaviour of the gold price this week together with rising prices in key areas like food, suggests that some investors are anticipating a sharp rise in inflation. This is expected from the scissors effect caused by falling production on the one hand and rising injections of monetary support on the other. We need to be observant, because escalating inflation is a game changer.

Conclusion.

In the coming fortnight two major events will occur. First the reporting season for corporations covering the first Quarter, which is a negative. Secondly, the first results from a number of trials for reducing the severity and duration of the infection by the corona virus. This is a positive for the markets. Once again, we have the tug of war between two polar opposites.

It must be remembered that during the 2014 Ebola outbreak, no new drugs emerged because there were no double-blind tests only uncontrolled single armed studies. While gold plated randomised double armed tests are the standard accepted by the medical profession, it is also widely recognised they can do more harm than good in an epidemic. As Medscape quoted from a researcher at the time of Ebola by the name of Kalil, "This tragedy of not discovering new therapies during an outbreak cannot be repeated"

Given the widespread nature of this plague, it appears researchers are being more fluid in their approach to obtaining a remedy. In response to Anti-Capital and his disdain for Hydroxychloroquine, there are currently 18 active trials of Hydroxychloroquine on its own or in combination being conducted in the USA alone. https://www.epocrates.com/e/guideline/03_19 Perhaps it would have been better had Trump not opened his mouth about this drug.

Another breakthrough is better use of ventilators. The guidelines used have over-pressured Covid infected lungs, increasing mortality. It again shows that the conservative use of rule-based systems have their own issues. The outcomes from the differential use of ventilators is quite startling. **https://www.medscape.com/viewarticle/928236?nlid=134960_1842&src=WNL_mdplsfeat_200410_mscpedit_wir&uac=140240SV&spon=17&impID=2342236&faf=1#vp_2**

The net result could be more lives saved and quicker recovery times freeing up valuable ICU beds through shorter stays. Shorter stays in ICU cannot be emphasised enough as critically ill patients can occupy an ICU bed for up to 16 days, raising the requirement for ICU beds. These interventions should not be confused with cures or preventions such as vaccines, but rather medical procedures that go beyond the exclusive reliance on breathing machines.

If this turns out to improve outcomes, then the mortality rate around 0.4% (community based) should fall further towards that of seasonal influenza. If this occurs, it will show that in the end, it is not the lethality of viruses that is decisive, but the general health of the population (as well as the capacity of the health sector). We have already seen how the corona virus is disproportionately affecting African-American patients, because many of them live in the poorest part of town, particularly in cities like Detroit deprived of health services.

In the UK NHS figures show that 70% of patients in ICU are grossly overweight. Viruses have a blind function in the architecture of life. Besides sponsoring and protecting diversity they improve the quality of life. Through our personal eyes we see this as cruel, as the targeting of those in ill health or old of age. But let us be clear. In the vast majority of cases, it is not the fault of the impersonal virus, but capitalism itself and the inequality it has engendered together with the mismanagement it has fostered. It is not viruses as much as capitalist greed that is the killer.

Religion also kills. NHS figures once again reveals that 2% of ICU deaths are Jews, a rate of death ten times per head of population. Of course, religious people never blame their god for their predicaments. How can they, for after all, have they not created their god themselves, and who but the Devil, would imagine an imperfect god. So, they end up blaming themselves instead of abandoning their beliefs.

Finally, we are approaching the mature phase of the plague when interventions become more frequent and effective making lock-downs less onerous and necessary. Accordingly, we should start looking forward. When the plague ebbs, it will leave exposed the hidden timbers shoring up capitalism. The virus will turn out to be only the detonator, whereas the explosive is the rotten core of capitalism itself – the fissile combination of low profitability and high debt. And in the end is it is this explosive which will reshape the economic landscape.

Brian Green, 12th April 2020.