GERMANY WHERE NEXT? Q2 DATA INCLUDING RATE OF PROFIT

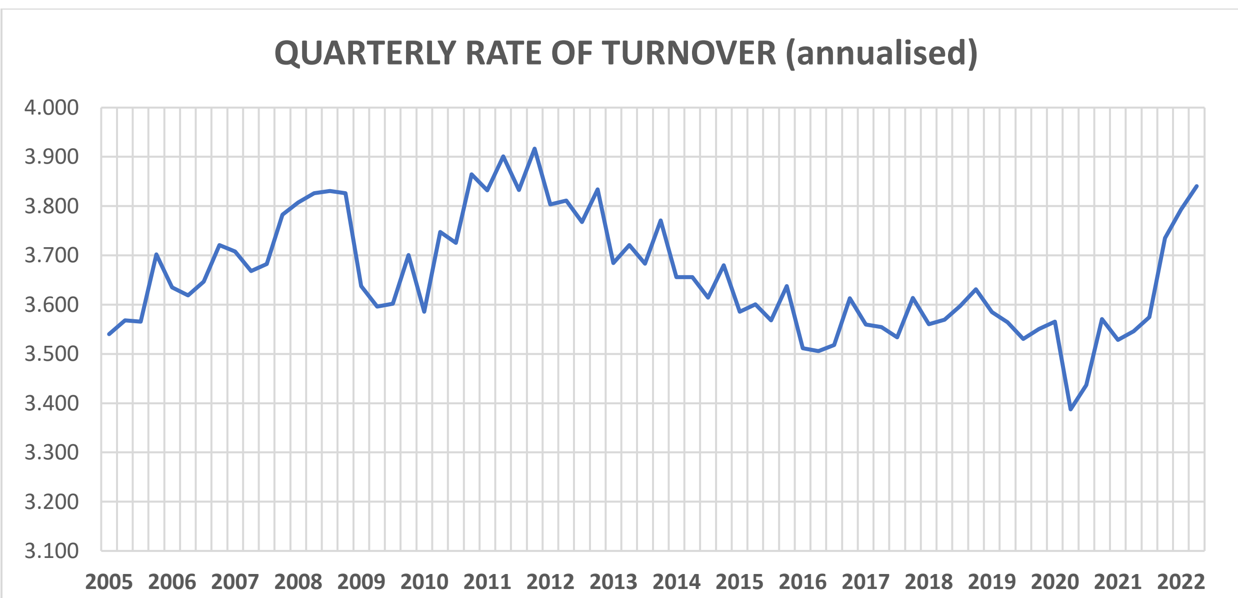
The German Federal Statistical Office (Destatis) has released its estimates for the second quarter of 2022 allowing the preparation of tunrover and profits for the non-financial sector in Germany. Following this fundamental analysis of the German economy comment will be made on Germany's prospects given that it and Britain are most at risk from current market conditions

It strikes me that the data provided by the German Statistical Office is more accurate than that provided by the Bureau of Economic Analysis in the USA. I base this assesment on the trends provided by the turnover formula which are sharper than those found in the USA because the formula is sensitive to the quality of the data on which it is based.

The first graph examines the rate of turnover. It shows a significant acceleration from the low point at the beginning of the pandemic to the current quarter. This is consistent with an acceleration in the turnover of inventory due to supply chain shortages. The same acceleration, though more muted, is found in the USA as well. Whether the rapidity of turnover can be sustained given that Germany has entered into a recessionary stage is unlikely. What is notable is that the rate of turnover has reached levels last seen in 2011 and 2012, the peak of globalisation and the boom in Chinese industrial investment.

(All the data and formulae can be found on the accompanying spreadsheet '*GERMAN DATA 2022 WORKPAGE WITH GRAPHS*'. This data in turn is taken from the Statistisches Bundesamt (Destatis), 2022 Sector Accounts, Code number: 5812104223225)

Graph 1.

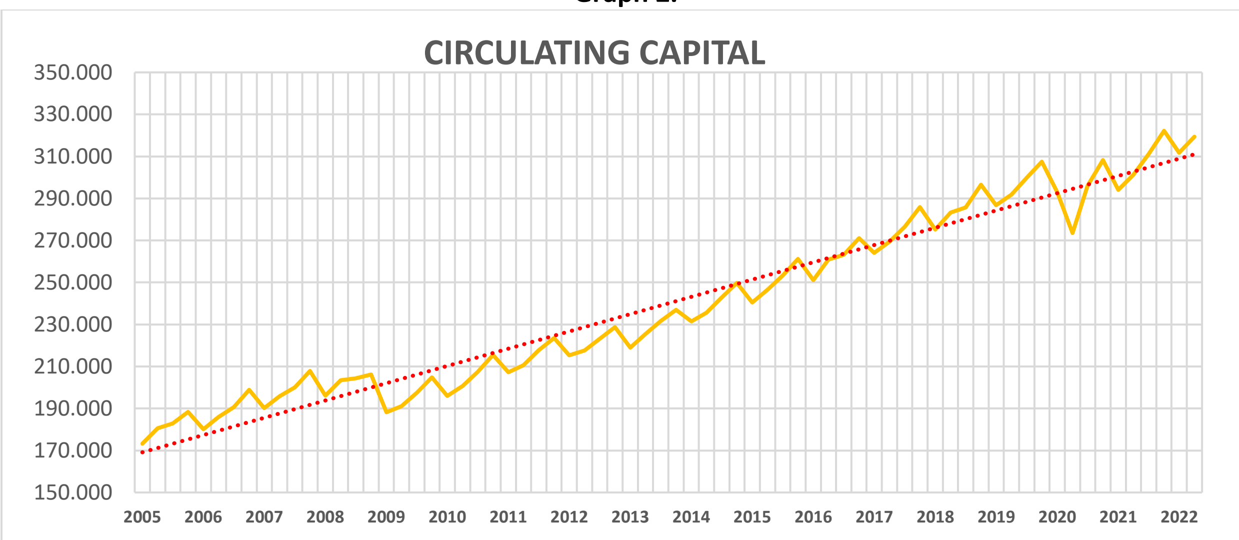


The rate of turnover allows us to determine circulating capital which previously was the missing element in the rate of profit. The formula for circulating capital is annual gross output minus the net annual surplus yielding the cost of annual output which when divided by the number of turnovers, finally yields circulating capital.

There are a number of interesting points about circulating capital to be seen below. Firstly the zigzag pattern, never seen before. (You, reader are amongst the first.) The step-downs are not accidental but speaks to the quality of the data which describes the annual rhythm of circulating capital as it increases into the Xmas period (Q4) involving the build-up of stocks preparatory to the burst of Xmas shopping, followed by first quarter blues when stocks are run-down (traditional January sales) as consumers reign in their spending. This rhythm is not seen in the US figures due to a number of factors including the failure by the BEA to provide Gross Output data for legal entities, aka non-financial corporations.

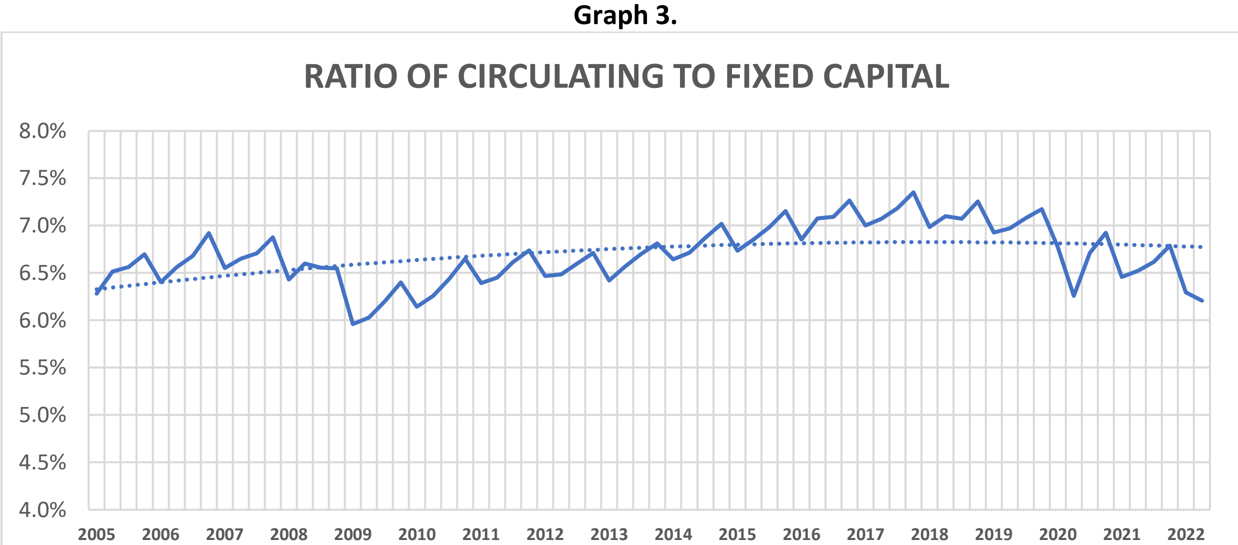
The second observation is that despite much higher inflation in Q1 & Q2 in 2022, the total amount of nominal working capital has been inhibited by the rise in turnovers. This rise reduces the period of circulation and therefore the need for working capital. The period has shrunk by 8 days from 104 days previously to 96 days currently, a seven and a half percent reduction helping offset the rise in prices.

Graph 2.



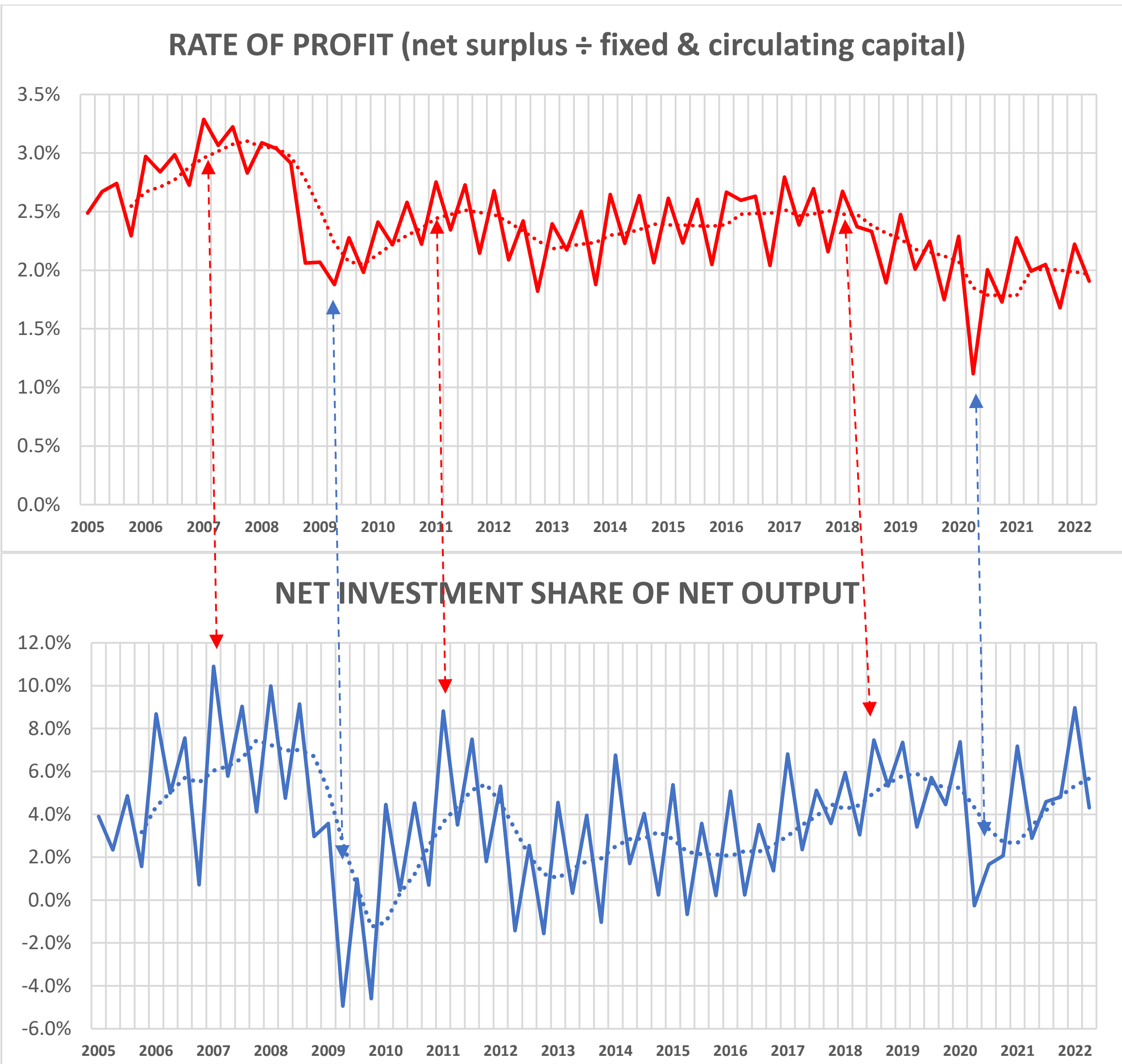
The next graph plots the ratio of circulating to fixed capital which together makes up total capital.

Graph 3.



The above ratio is much lower than that found in US non-financial corporations, because the density of industrial corporations with their higher compositions of capital, is greater in Germany. However, in common with the USA there was a rise in circulating capital following the 2008 financial crash due to lower rates of fixed investment but higher rates of employment to compensate. (The sweating of capital so to speak). Since 2018 the ratio has declined and this relative fall in circulating capital has helped restrain the rise in total capital thereby retarding the fall in the rate of profit.

Graph 4 & 5.



There is a strong association between profits and investment. This becomes clearer using the annual movements (dotted line trends). Rising profitability spurs on investment and falling profitability arrests investment. This can be seen from the two graphs above. At no time is falling profitability associated with rising investment. Moreover the arrows connecting the two graphs are offset to the right as they angle down, due to the movements in profits preceding movements in investment. This tends to confirm once again that it is profits which determine investment and not vice versa.

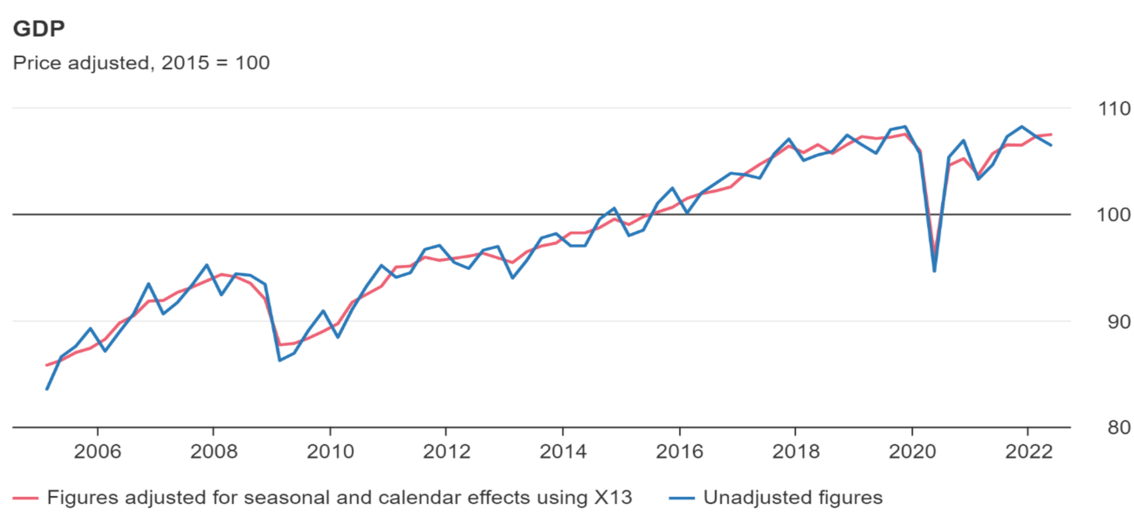
(The following methodology was applied to assess the rate of profit. The net surplus used as the numerator was obtained by subtracting worker remuneration from net output. Circulating capital was obtained using the gross output and gross value added data up to Q2 2022. Fixed capital was calculated quarterly to improve accuracy. The year end fixed capital amount was deducted from the previous year end and the difference was then divided into four quarters and added incrementally to each subsequent quarter making up the year. However, due to the unavailability of data for 2021 and 2022, the stock of fixed capital was estimated using the capital consumption data.) (The resulting rate of profit is similar in profile to the graph found here prepared by Deepankar Basu at the University of Massachusetts.)

Current German data.

The recently released report on 2nd quarter Gross domestic product (GDP), appears to show that Germany just managed to escape a recession by growing 0.1% QoQ (price, seasonally and calendar adjusted) and by 1.7% YoY. BUT, In the 2nd quarter of 2022, the price, seasonally and calendar adjusted Gross Value Added decreased by a total of 0.3% on the 1st quarter of 2022. As GDP should equal Gross Value Added it is difficult to conclude that the economy actually grew.

Taking a longer perspective, the graph below shows that GDP growth is basically flat since 2017-9.

Graph 6.



It is highly unlikely that Germany will escape recession this quarter despite any the spin on the data. *"German engineering companies' orders saw a double-digit fall in July as the economic and geopolitical situation has customers in no mood to invest, the VDMA engineering association said. July orders saw a 14% drop compared with the same month last year, the VDMA said on Thursday, with domestic and foreign orders falling 17% and 12%, respectively. "The wind is blowing in the face of the global economy and thus of mechanical and plant engineering," said VDMA chief economist Ralph Wiechers."* It is also unlikely that investment in machinery and equipment will rise by 1.1% this quarter as it did in Q2. Another key indicator is tax revenue which always falls when economic activity contracts. Value added taxes revenue fell by 1.3% on the year in July 2022. This outcome was driven mainly by a sharp decline in receipts from import VAT, which were down by 12.8% compared to a rise of 5.3% for regular VAT which when adjusted for inflation was down 3% in real terms.

Other data points of interest are that preliminary estimates of labour productivity (price adjusted GDP per hour worked by persons in employment) rose by 0.7% from the same quarter of the previous year, and by 0.3% higher from the second quarter of 2021. The average number of hours worked per person in employment was 0.5% lower in Q2 2022 than in Q2 2021. This Destatis said was due mainly to higher rates of sickness absence and holiday leave.

The Euro.

The Euro has fallen by 15% recently. As of Thursday it is hovering around parity despite the markets being convinced the ECB will hike its interest rate by 0.75% next week. And it is expected to go lower. The number of contracts shorting the Euro has risen to 44,100 the highest since the onset of the pandemic in 2020.

Graph 7.

The weakness of the Euro, while offsetting the fall in German competitiveness is also helping fuel inflation in the country because many of the inflation generating commodities, such as gas are priced in Dollars.

Inflation.

Germany and Britain are the most vulnerable economies to the wave of economic shocks because of the alignment of the German economy with Eastern Europe and the de-integration of the British economy from Europe.

Before the war, Europe was dependent on Russian imports for over 40% of its gas needs and 46% for coal and 27% for oil. In the case of Germany this dependency was higher at 55% for gas in 2021, though Germany has managed to reduce this to 26% currently, and despite the lower Russian imports, it has already filled 83% of its gas reservoirs ready for winter.

Natural gas prices topped $3100 per 1000 cubic meters in mid-August, a 610% increase over the same time last year as measured by the Dutch TTF market, while benchmark electricity prices in Europe have jumped almost 300% in 2022 to new record highs. Taken together, energy prices are ten times higher than the five-year average. "*European natural gas prices are now around 10 times higher than they were on average over the last decade and about 10 times pricier than in the United States. Alex Munton, an expert on global gas markets at Rapidan Energy Group, a consultancy, said European natural gas is so expensive it's like paying $500 for a barrel of oil.*"

The rise in energy prices helped drive up German Producer Prices by 37.2% YOY in July.

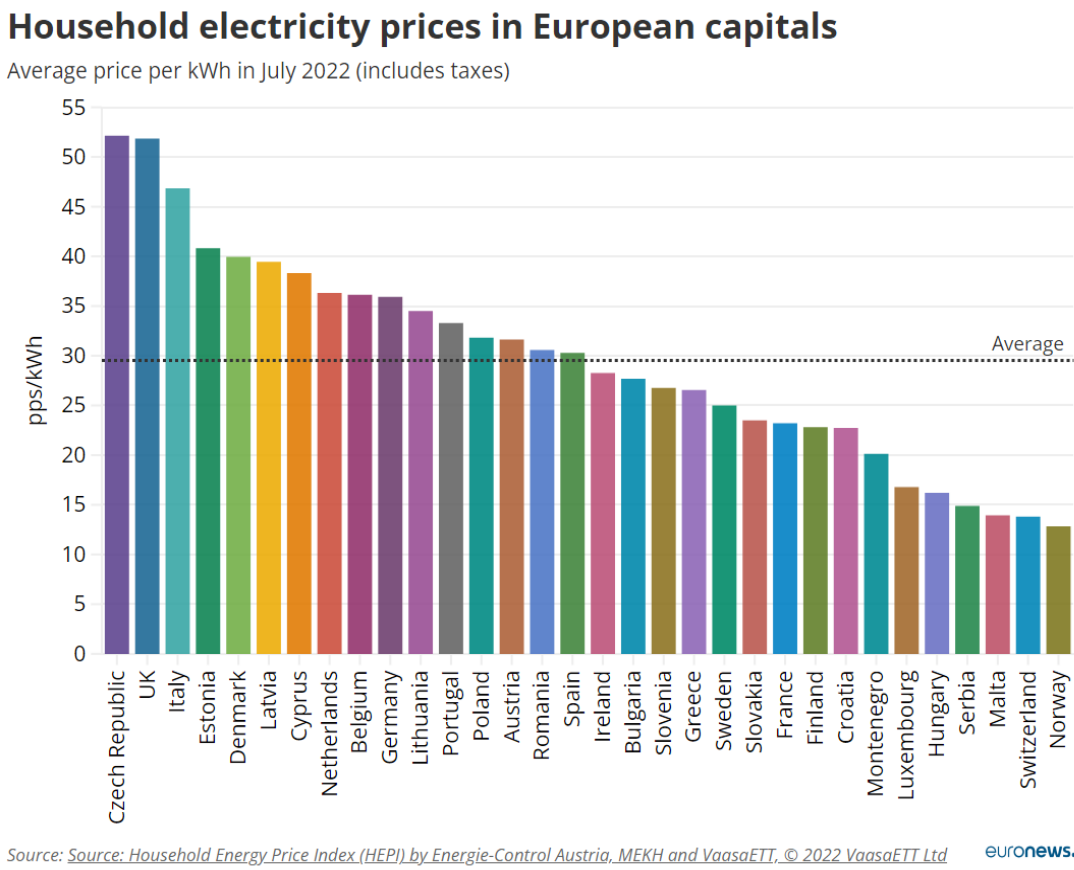
Graph 8.

"*In July 2022*, the index of producer prices for industrial products increased by 37.2% compared with July 2021. **This was the highest increase ever**, compared to the corresponding month of the preceding year." "Compared with the preceding month June 2022 the overall index rose by 5.3% in July 2022. This is also the highest increase ever compared to the previous month." (Source: Destatis)

Headline consumer inflation rose to 7.9% on the year from 7.5% in July, slightly higher than consensus expectations of 7.8%. Meanwhile, the HICP rate rose to 8.8% in August from 8.5% a month earlier. (This index includes owner occupier rents.) Destatis said energy prices shot up 35.6% on the year in August, while food prices rose 16.6%. The normal CPI would have been higher than the HICP were it not for the special measures which the German government has taken to support energy and transport costs.

Because of this support and despite the higher renewable surcharge in Germany, only France has lower household energy costs.

Graph 9.



(Source: euronews.)

One interesting observation is that German consumers who only consume one quarter of the electricity generated end up paying for one third of it. A backdoor subsidy to industry no less even in these hard up times. Despite this hidden subsidy, German utilities are literally burning through the more visible Federal subsidies given them. *Uniper* the largest Germany Utility Company requested an additional €4 billion bringing its subsidy up to €19 billion or half the amount the British government has provided the entire British public in financial support to date.

On Monday van der Leyen announced that Brussels was beginning to work on restructuring the EU energy market with the view of decoupling electricity prices from gas prices as the latter was driving up electricity prices further than they needed to go. She also stated that Brussels was working out how to provide EU countries with emergency financial aid. The privatisation of energy has created the ideal playground for neo-liberalism, that is to say, basing prices on marginal costs. All this has done is to create a mess. There is a definite move back to reality, or what is the same thing, using annual average costs to price electricity. Of course those who most gain from fleecing consumers through marginal costing are opposed to it. *"Finally, signs that the EU is mulling abandoning the marginal pricing for energy - which currently means* *that electricity prices are soaring one-for-one with higher gas prices - could drive down inflation, if implemented. The flip-side, however, is that it also would increase the risk of supply-cuts and rationing, for the simple reason that lower prices would make the production of some wholesale electricity un-profitable, unless subsidised."* [*Claus Vistesen*](), *chief eurozone economist at Pantheon Macroeconomics.* Note the throw away remark: it could drive down inflation, i.e. lead to cheaper electricity.

In an article in Friday's FT titled: *Brussels Eyes Windfall Taxes in Bid to Lower Energy Bills* the newspaper reveals that Brussels is proposing to levy a tax on power companies not reliant on gas in order to lower consumer energy bills. In addition Brussels is proposing a cap on the prices charged for electricity by non-gas using power stations. ("Tax cutting" Prime Minister Truss must be relieved Britain is no longer in the EU.) This is a short-term fix preceding more structural reforms due in the new year focusing on moving the wholesale pricing system away from daily fixes heavily influenced by the need to spool up gas generating plants to increase base loads due to adverse weather events. This is the price consumers were forced to pay, because dammit, the capitalists typically cannot plan outside of war. Had the EU put in place power storage dams and transcontinental high power DC power lines as they should have, this fiasco would not have happened. This proves that as long as nationalism and competition fractures human consciousness, as it does within the realm of capital, there can be no solution to global warming.

Inflation is not the same when it moves down the income ladder because it is most concentrated in energy and food. Food prices increased 14.8% year on year while energy prices went up 35.5%. Excluding these two items the inflation rate reduced to just 3.2%. Clearly the nature of current inflation impoverishes the poorest sections of society who spend a higher proportion of their income on food and heating. Roughly 13.0 million people in Germany were at risk of poverty in 2021. This is 15.8% of Germany's population. While the proportion of people at risk of poverty in the population stayed roughly the same as 2020, this is unlikely to be the case in 2022. In addition with rents rising housing costs increased to an average 23.3% of households' disposable income in 2021.

The main reason why the risk of poverty will increase in Germany is the fall in real wages *Gross wages and salaries of employees in the second quarter of 2022 were 6.1% higher than in the second quarter of 2021, net wages and salaries were up by 5.9%. When calculated as an average per employee, the increase in wages and salaries was slightly less marked (+4.3% in gross terms, +4.1% in net terms).* The key part of the summary is the net amount per person of 4.1%. Given that the price index for household consumption rose by 7.2% in Q2, the real fall in wages in the last quarter was greater than 3%.

This fall is in line with the fall found in many of the more advanced capitalist economies.

Interest rates.

Germany enjoyed the cheapest of money for many years, <0% interest rates. Now with inflation raging interest rates have been rising sharply. "*The yield on 2-year bunds issued by Europe's largest economy has rocketed by 85 basis points this month. That's set to be the biggest monthly move higher since 1981, according to Refinitiv data. Meanwhile, the 10-year benchmark bond yield has risen by over 65 basis points, the highest monthly increase since 1990."*

Given the expected 0.75% rise in the ECB's primary rate, interest rates on German Bunds are likely to continue to rise. In addition, with the ECB seeking to contain spreads across the Euro Zone, particularly in Italy, it is unlikely to dampen German rates by buying German government bunds. Thus at a time of continuing Producer Price Pressures higher interest rates play a disproportionately negative role because these higher prices need to be financed with additional working capital, and this can only be obtained by paying higher bank rates. Corporate solvency for Mittelstand Companies (small and medium sized companies generally family owned) will become acute this winter and many will fail without state aid.

Interestingly enough, the effect of rising interest rates on European Shares has been more muted than in the USA. This could be due to the ECB not being as hawkish as the FED. On the other hand economic conditions in Europe are deteriorating faster than in the USA.

Graph 10. (Stoxx 600)

Ukraine, its *Battle of the Bulge*

As we are analysing Germany the above analogy is appropriate. In late 1944 under the cover of overcast weather and under the direct orders of Hitler the Wehrmacht sought to break Allied lines and capture Antwerp cutting off four US and British Armies. Had it been successful Germany could have focused more forces on the Eastern Front. Instead the opposite happened, the Germans were defeated resulting in a weakening of its defences on the Western Front.

Similarly with the Ukraine, except with this one caveat, the balance of forces was less favourable to the Ukrainians than to the Germans. Just as in the case of the German High Command, the Ukrainian General Command advised against this offensive as did all the doctors in Nikolaev and Odessa when informed of the impending assault. But like Hitler, the 'Churchillian' Zelensky had the final word.

The Ukrainians attacked without air cover and without sufficient armour. Little wonder the Ukrainian authorities have blacked out any news of the offensive under the pretext it will provide information to the enemy. Predictably it was a blood bath with entire regiments wiped out. The doctors were right, the hospitals in Nikolaev and Odessa are overflowing with casualties with many being ferried to hospitals in Bulgaria and Germany. A whole community near the Hungarian border providing soldiers to the counter-offensive in North Kherson are in mourning because of the losses suffered by their regiment.

Instead of strengthening the Ukrainian positions before Nikolaev and Odessa, it has exposed them. The fact is that the Ukrainian generals knew this counter-offensive designed to fill western headlines would fail. Why else did they instruct their reservists to build secondary defence lines closer to Nikolaev just as their troops were moving forward to invade Kherson. The fiasco in Kherson is also likely to deter the counter-offensive around Izyum further East where there has been a recent build-up of forces by Ukraine.

It is also worth pointing out that the Ukrainians tried to send an expeditionary force to the Zaporizhzhia Nuclear Power Plant on board seven speed boats and two barges to interfere with the IAEA inspectors visit to the plant on Thursday. The resulting firefight wiped out the Ukrainian troops but not before Western Headlines once again blamed the Russians for irresponsible shelling around the plant. Really, if a film is made of Zelensky's boys it should be called The Expendables and as long as the Western Media covers up what is really going on, Ukrainian troops will continue to be expendable. Zelensky is not so much a clown as a sado-masochistic NATO pimp.

Another NATO pimp is the co-leader of the Green Party in Germany, Annalena Baerbock, Germany's current foreign minister. *Speaking at an event in Prague hosted by the NGO Forum 2000, Annalena Baerbock said that Germany will continue to support Ukraine "**no matter what German voters think**." "If I give the promise to people in Ukraine — 'We stand with you, as long as you need us' — then I want to deliver. No matter what my German voters think, but I want to deliver to the people of Ukraine,"* (my emphasis) It does not matter if the lapdogs of capital wear a green collar, a pink collar, a yellow collar or a blue collar, they all part of the capitalist establishment. This German foreign Minister knows full well that Germany partnered the US and Britain in provoking the war to weaken Russia in order to compromise their nemesis, China. She is as disloyal to the Ukrainian people as she is to the German people who are both paying the price for the Imperialists crazed lust for profit. She only delivers for capital not for the Ukrainian people. And she is disloyal to the planet as she must have realised a war in the Ukraine would increase greenhouse gasses at a time when Europe is experiencing its worst drought in 500 years.

The article also alludes to the fateful April meeting between the fixer Johnson and Zelensky when the British Prime Minister bullied and blackmailed the Ukraine into abandoning the pending peace agreement with Russia. In this context, when Baerback says she will deliver for the people of the Ukraine, what she is really saying is that she will continue to extend the war to the last Ukrainian soldier. Ahh, the forked tongue of the imperialist servant.

These careerists should be dunked in the Rhine except that it has dried up. It proves being Green is inconsequential as long as Green Parties remains loyal to capitalism.

Conclusion.

Over the last two days Gas Prices in Europe have fallen significantly. The immediate cause as the graph below shows, is the falling price of oil, the dominant source of energy. But the falling price of oil, despite the best efforts of the Saudis to talk it up, is itself symptomatic of the imploding world economy.

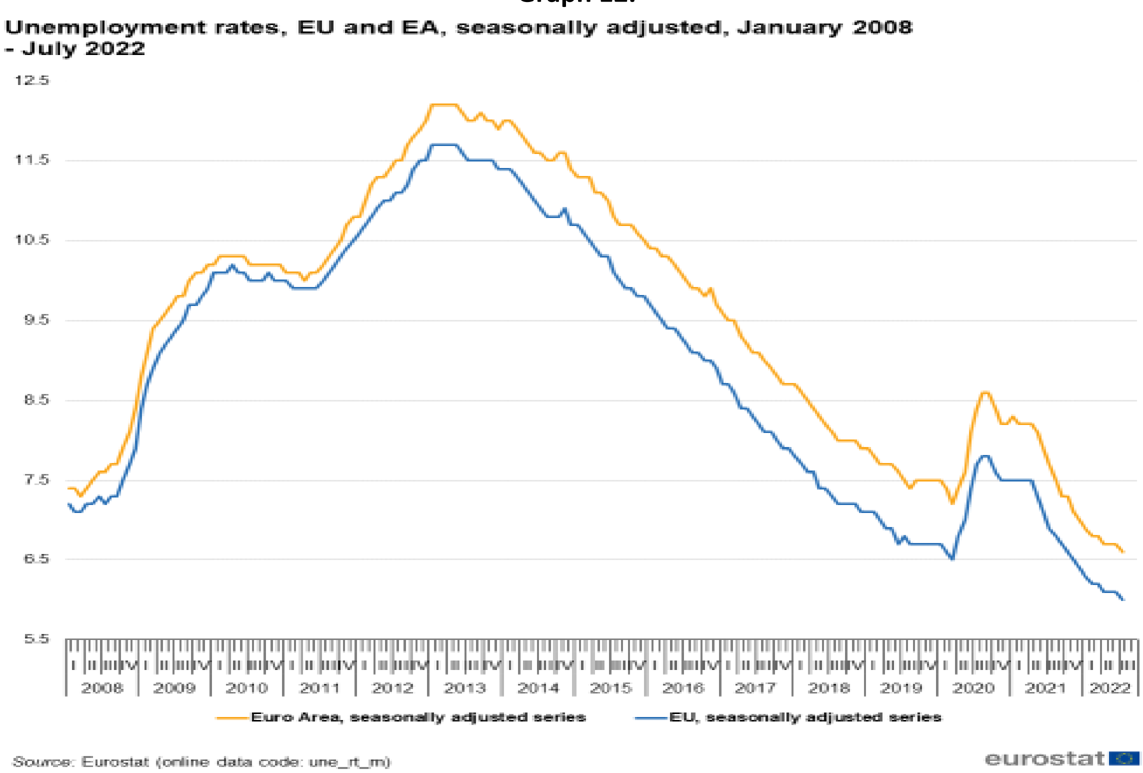
Now that energy prices are falling, it is likely that Putin will increase supplies to Europe knowing that he may have over-played his hand. To maximise Russian revenues amidst falling energy prices Putin may be forced to increase the volume of supply. This may not be as damaging to Russia as it seems because by then Russia will have strategically won the war given the failure of the Ukrainian counter-offensives. No country, including the Ukraine, can afford to continuously lose and bleed soldiers indefinitely, even when they have a NATO bayonet to their backs prodding them away from the negotiating table.

Thus the prospects for stratospheric gas and electricity prices this winter may be over-egged.

Graph 11. (Brent Oil Futures)

What will not be over-egged is the prospect of mass unemployment despite Eurostat recording a lower rate of unemployment in July of just 6% due to a 113 000 fall in the number of unemployed. It is difficult not to be sarcastic about these EU wide figures, one must assume that Eurostat was counting tourists as being on working holidays.

Graph 12.



Germany remains exposed to the contracting world market. The cost of its energy supplies make this export orientated economy highly vulnerable and puts it at a disadvantage compared to the USA, especially its chemical and metal industries. What Germany has lost financially because of the war in Ukraine could have been used to develop the Ukraine economically on the same lines as East-Germany. But this was the price German capital was willing to pay to prevent a rising China overwhelming its economy. Whether German capitalists expected to pay such a high price with so little to show for it, is unknown. What is known is that the coming slump could fire up an already angry German Working Class surprising the German Capitalist Class who thought its enemy was in front of it to the East, when instead it was lurking behind its back.

Brian Green, 2nd September 2022.