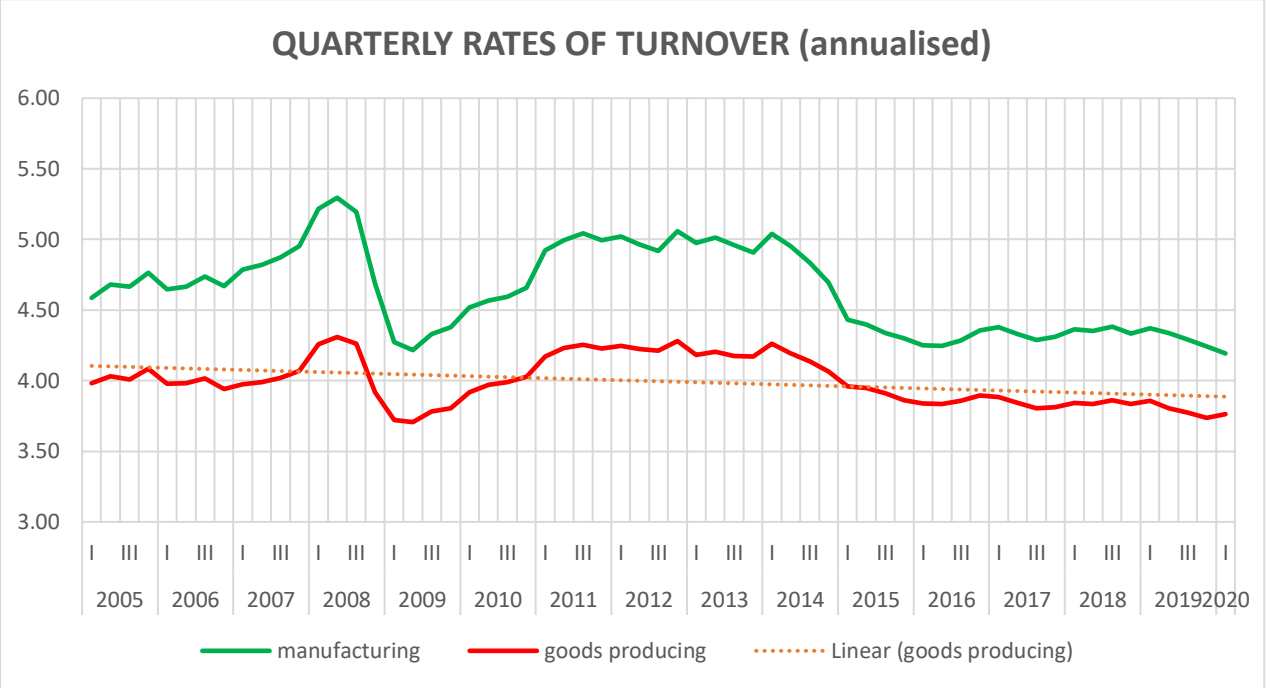
TURNOVERS BEFORE THE PANDEMIC USA AND CHINA

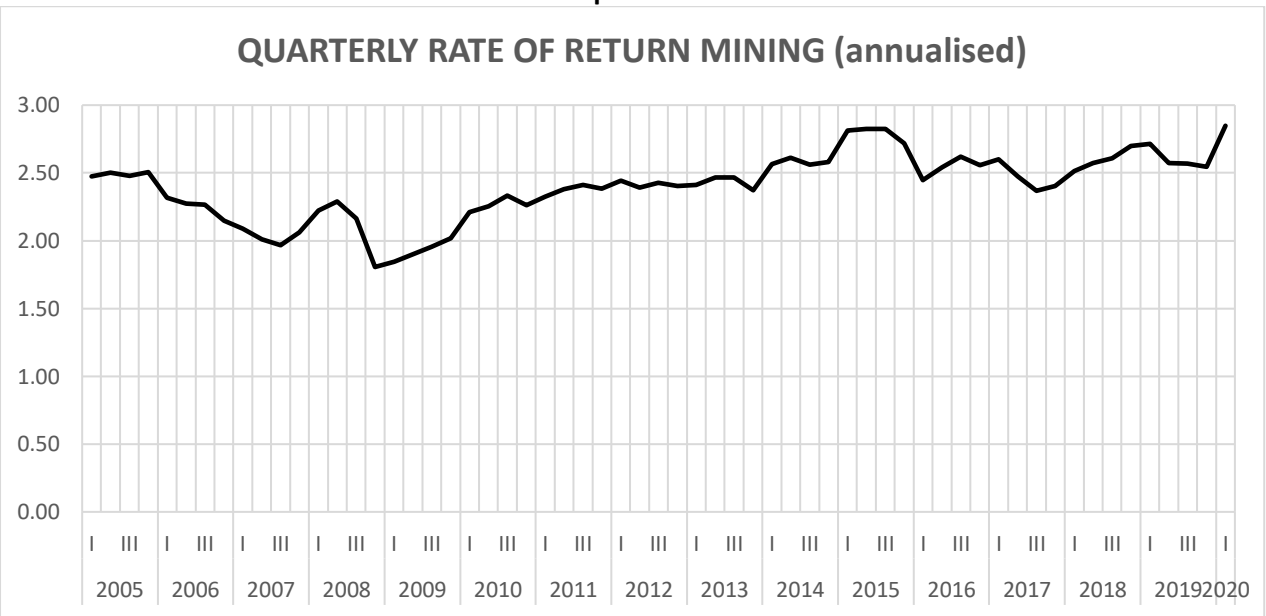
This is the last opportunity to obtain data before the pandemic disturbed the data. It therefore forms the baseline for investigating the 2nd quarter, the deepest and sharpest contraction in history. For the first time I have introduced the turnover for the service sector, if it can be called that, because of all in the imputed sales found within it, as this will throw further light on the 2nd quarter.

Graph 1.



(See attached spreadsheet "GO up to Q1 2020 for data.) In the Manufacturing Sector the rate of turnover continued its fall, down to 4.19 turnovers per annum. Measured by period rather than the annual rate, the current turnover period is 87.1 days compared to 72.4 days in 2014. On the other hand, the rate of turnover accelerated in the goods producing quarter on a quarterly basis.

Graph 2.



One of the reasons for this was the mining sector due to its weight within US goods production. The collapse in the price of oil always diminishes the realised value in this industry and hence GVA which measures the value of oil sales itself. The resulting fall in GVA relative to Gross Output represents a structural shift which is captured by the formula as presented in Graph 2, showing an acceleration in the rate of turnover for this industry. This corresponds to the actual state of affairs because the oil industry, particularly shale oil, initially runs their wells hot pumping more oil with minimal inputs whenever prices tumble. This tends to differentiate oil from other industries where the brake on production is slammed on, at the onset of crisis.

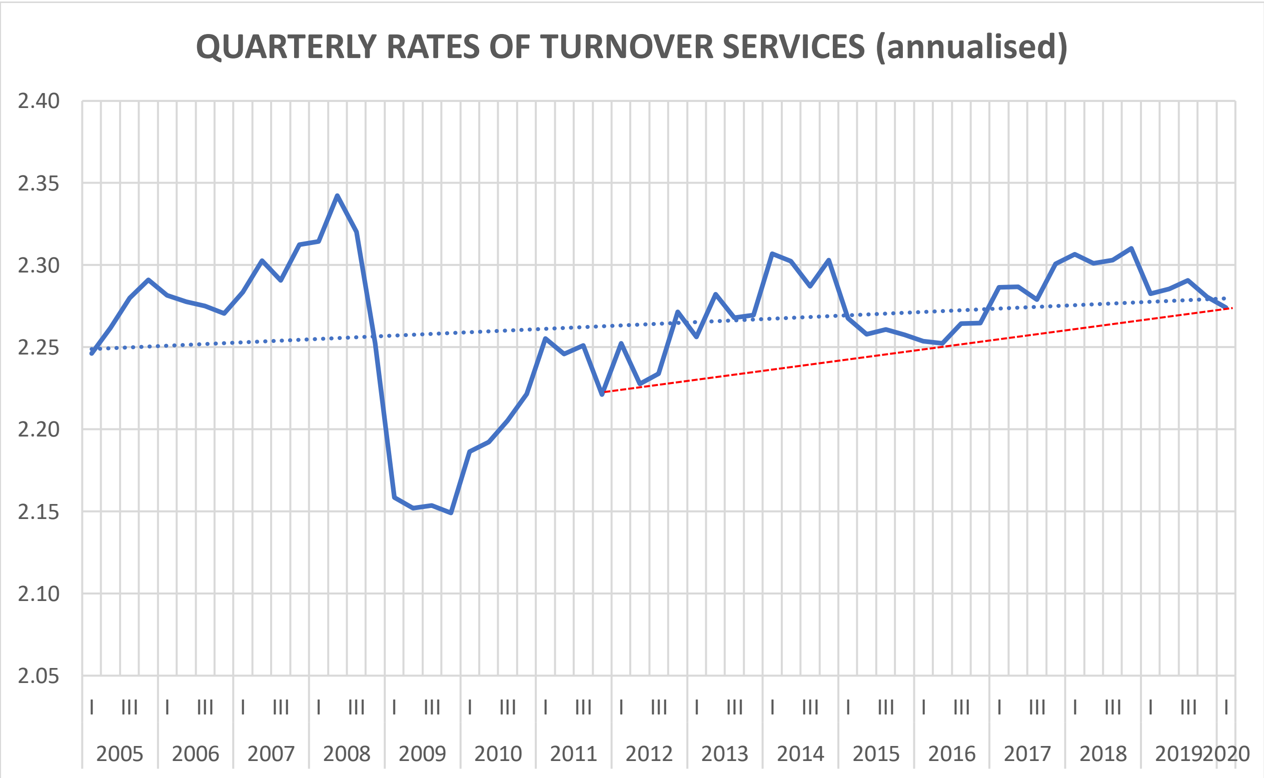
The Service Sector.

This is the first time the turnover rate for the services sector is applied. As this sector is riddled with transferred value from the goods producing sector, and, because it is home to much duplication, the formula necessarily yields an abnormally low turnover figure. For these reasons I have been loath to use it.

However, these are definitely not normal times. Therefore, it will be used to try and understand the scale of the recession in the second quarter. Data for second quarter turnover will be released by the BEA in early October. Over the short term this data can be used because the degree of inflation of the data underlying data, will not have varied significantly between quarters. To substantiate this observation, the period around 2008 is illustrative. There we find a fall in turnover of 8%, which though smaller in relative terms compared to the goods producing sector, is nonetheless significant.

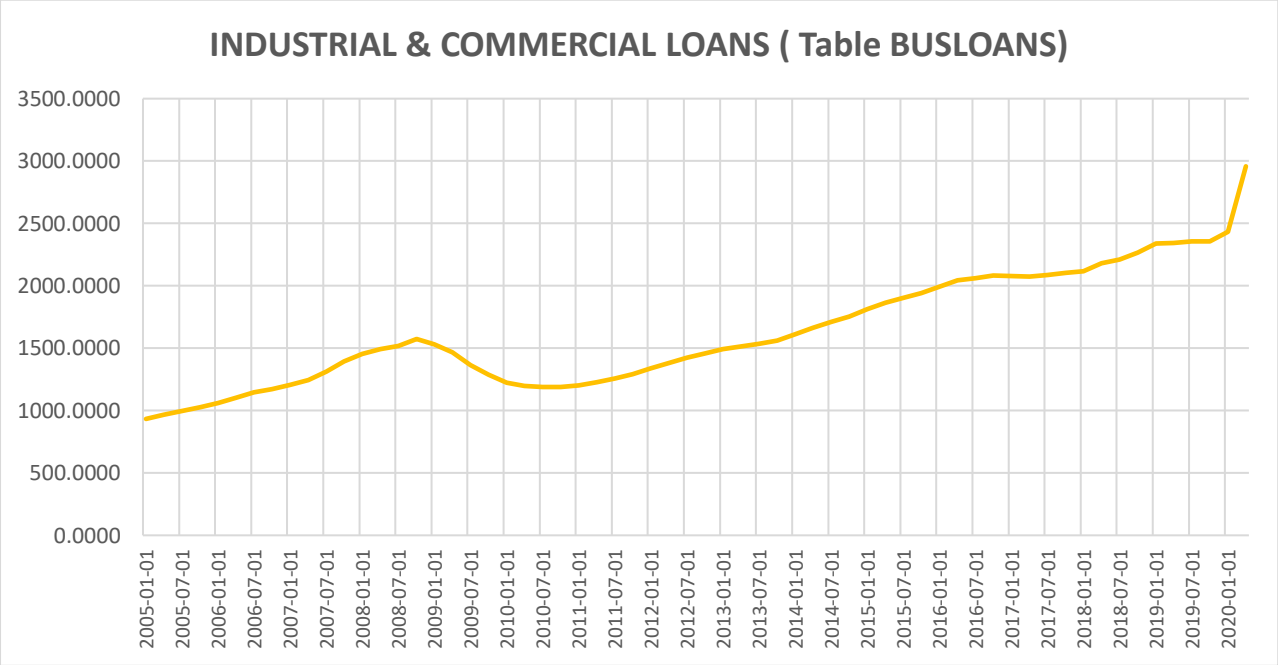
One significant element to observe are the trend lines. While goods producing trends down, service producing trends up. I will not comment on this discrepancy as the quality of the data for services does not warrant it. This upward trend also coincides with the rise in the economy wide rate of profit post 2010. See contrasting graphs at the end of the following linked article. https://theplanningmotivedotcom.files.wordpress.com/2020/07/which-rate-of-profit-pdf.pdf

Graph 3.



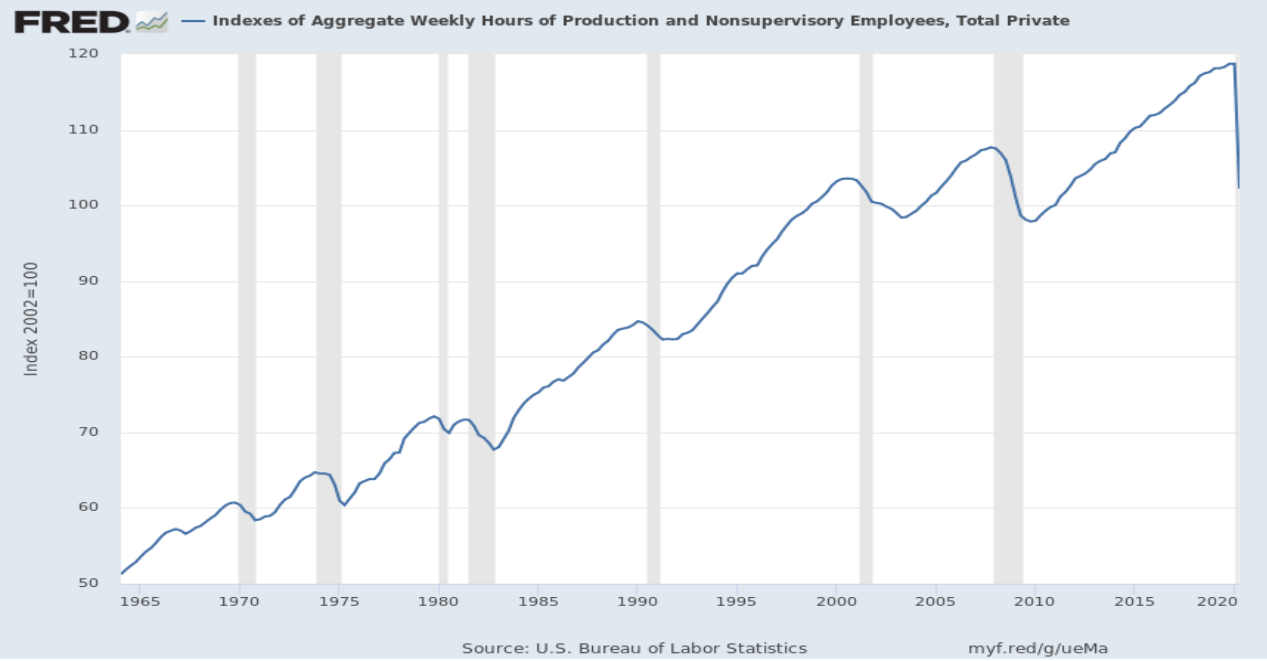
Finally, a fall in the rate of turnover, to begin with, is always associated with the need for additional credit to cover the longer period of production and circulation. This is established by the Graph below. Industrial and commercial loan data is a good proxy for short term credit and the recent spike is most significant. This tends to suggest that turnover in the 2nd quarter seized up. Time will tell.

Graph 4.



It is worth looking at the contraction in hours worked, which at -16.1% exceeds the fall in GDP in the 2nd quarter by almost 50%, but that is to be expected because of duplicated sales. The fall in hours wiped out most of the increase in hours since the depths of the crisis in 2009. However, this fall seems to be understated compared to the recent release by the BLS which shows a 43% fall in hours compared to a 39% fall in output for non-farm industry, and, a 37% fall in hours and a 47% fall in output for manufacturing. (https://www.bls.gov/lpc/) or double the fall presented in the graph.

Graph 5.



China mirrors the USA.

The same patterns of decelerating rates of turnover and of profit are evident in China. I have attached the 2019 release of profitability by the National Bureau of Statistics of China, titled "China Industrial Profits 2019". For the whole of 2019 the complex rate of return for China was 5.2% and the rate of turnover was 5.17. For the first half of 2020 that had fallen to 4.2% and 4.76 respectively. When we consider that in recent years the rates in China were around 7% and over 6, these falls represent a significant weakening of the Chinese economy. This trade and technological war is being fought between two boxers with glass jaws, whose vulnerabilities should keep them out of the ring.

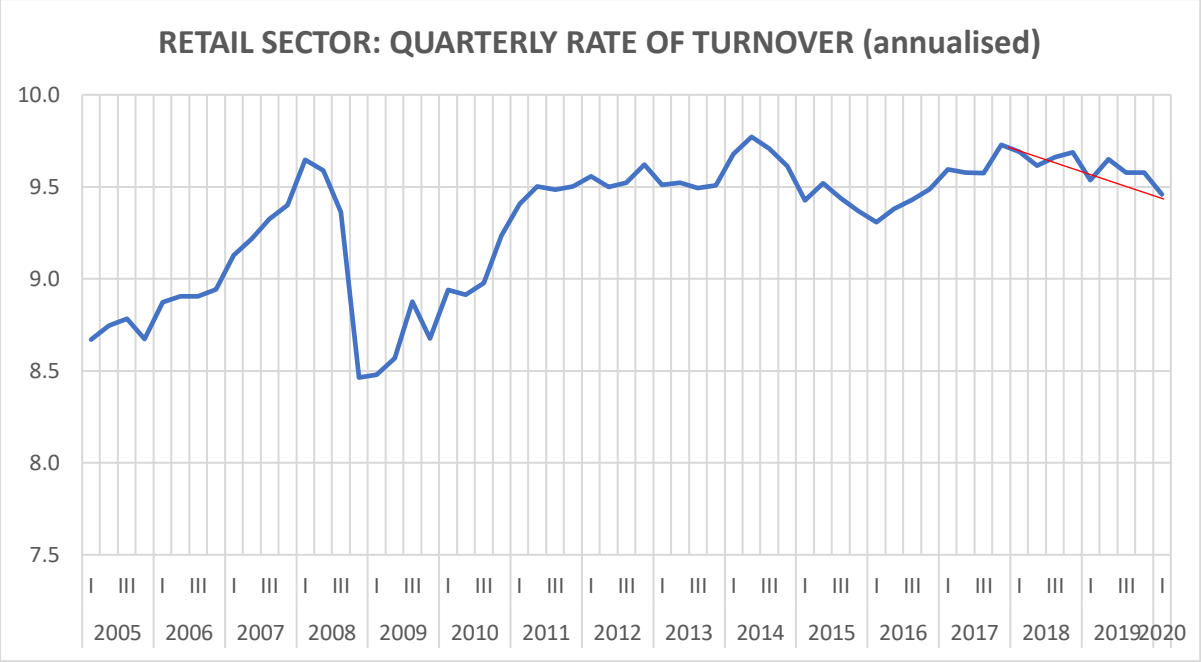
With regard to the USA the following profit data is in. Corporate profits as a whole will only be issued at the end of August by the BEA. Preliminary data according to David Kostin of Goldman's based on FactSet's analysis of 89% of S&P companies having reported, is that overall annual S&P profits fell by 34%, FAANG profits only rose 2%, and, without FAANG the S&P would have fallen by 38%. The fall in the Russell 2000 small caps was 97%. Thus, it is looking as though corporate profits fell 40% and the fall would have been much worse had it not been for the fictitious gains made on Wall Street. Interestingly the FAANG, which now make up over 20% of the S&P market cap, only altered the profit balance by 10% (decelerating the fall from 38% to 34%).

The rate of profit for the USA in Q2 remains on track to fall to its lowest point since the War.

A final look at retail sales.

Before proceeding to examine the data on production and sales which were released this week, it is worth reminding ourselves again of Marx's following observation; *that it is only in the retail sphere that commodities circulate against cash*. In all other spheres they circulate against credit. This is brought out by the turnover formula. In the graph below we note that annual turnovers are above 9. Yet adjusted inventory turnover is just 8 (or as the capitalists measure it, 1.5 months, 12 months/1.5 = 8). Inventory turnover, like the speed of light, is the limiting factor inhibiting the turnover of capital. Capital cannot turn over faster than the commodities being bought or sold. Or can it?

Graph 6.



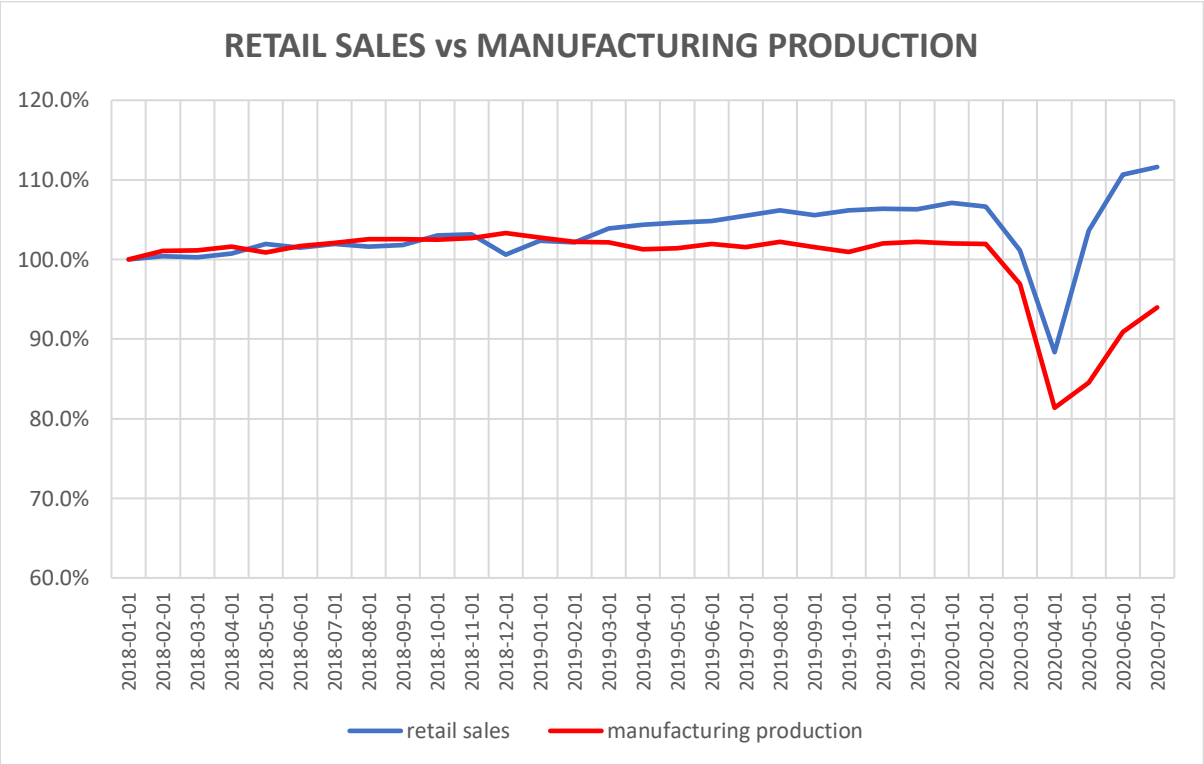
There is nothing wrong with the formula. Indeed, it validates Marx's circuit of capital:

$M.C....P....C^{+}.M^{+}$

What is occurring is the following. On the closing side of the circuit (right side) commodities are being sold for cash. It does not matter if debit or credit cards are being used alongside cash. By the morning the card providers will have credited the retailer. On the opening side (left side) of the circuit retailers take credit from suppliers. With the centralisation of retail in the hands of large retailers including Amazon, extended terms have been forced on suppliers. Often 45 days of credit are taken during which time 45 days of cash are received from sales. Thus, the amount of working capital is reduced by credit being taken on the one side and cash being received on the other. It is this reduction in working capital that elevates, correctly, the rate of turnover found in the graph below. The faster the turnover of capital relative to revenue, the lower the requirement of working capital because fewer days of cash are needed. This is the only sector where this occurs.

Returning to the graph, we note that there has been a fall in turnover since 2017. The trend is down. This is not consistent with the strength of sales as reported by the Census Bureau and another proof that sales data has been inflated recently. The graph below compares the data released this week on sales and production to once again determine the veracity of retail sales.

Graph 7.



(Sources: FRED Tables RSXFS for retail and IPMAN for production.)

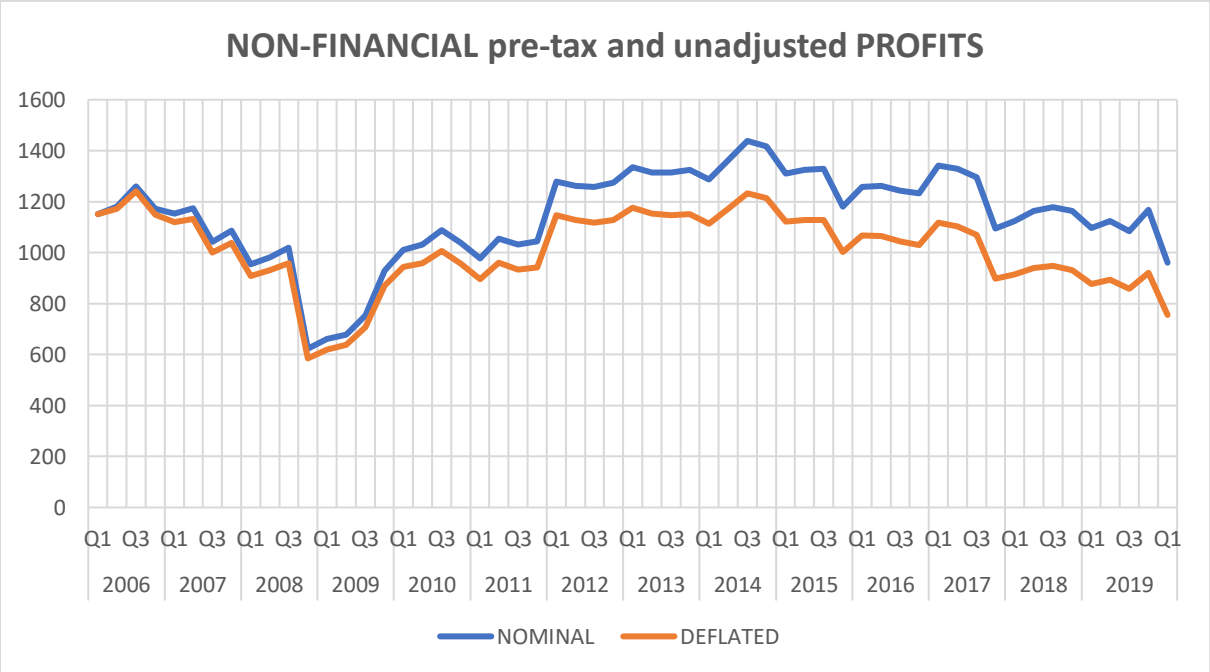
In July the increase in manufacturing production exceeded that of retail sales. However, the gap remains more than double the size that can be attributed to inventory movements in both manufacturing and retail. The June to July gap has reduced from 21.8% to 18.7%.

July reports from ports on the US West Coast indicates a significant rise in container traffic. Whether this is driven by actual retail sales or building up stocks in preparation for lockdowns this Autumn cannot be determined, but 15% of the volume of trade is Personal Protection Equipment and other Covid related items.

Conclusion.

By any measure both the USA and China entered the pandemic with their economies weakening. In China, industrial profits fell by 3% in 2019 while the complex rate of return fell from 5.6% to 5.2%. Underlying this fall, the rate of turnover also decelerated. In the USA, the estimated rate of profit in Q1 was down 39% compared to its previous peak in 2014. (This graph will be updated to include the estimates for Q2 at the end of August.) Thus, the driving economic force in both countries, that of profitability, continued to ebb. Contrary to the bombast of political leaders including Trump, economies entering the pandemic were far from robust and resilient.

Graph 8.



In the meantime, the FED continues to turn investors in Zombies with their fingers congealed around the buy button. The tension with China escalates both financially and militarily while the virus lurks. This mediocre virus has shown over and over again how capitalism has outlived its purpose, leaving behind a fundamentally sick and malnourished society vulnerable to disease, a terrible bequest for any future society.

Postscript.

More analysis of the economy and its recovery will be undertaken in the next article analysing the US rate of profit in Q2, which will enable additional estimates as to the depth of the recession.

Brian Green, 15th August 2020.