THE US RATE OF PROFIT CONTINUES TO DECLINE IN Q1 2023

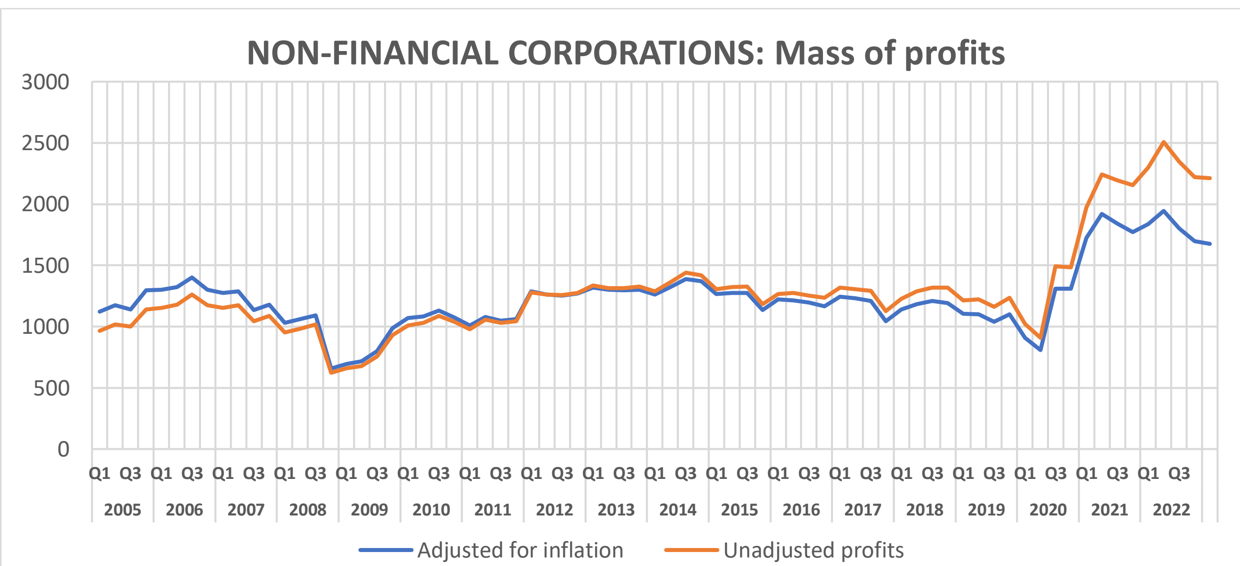
On the 25th of May the BEA released corporate profits in the form of NIPA Table 1.14. This enabled the preparation of a rate of profit estimate as well as associated ratios. Earlier earnings reports issued by the major corporations had already anticipated a fall in the mass and the rate of profit. Also on the 25th the PCB in Holland released its March estimates for global trade and production.

All data and calculations can be found in the accompanying spreadsheet titled 'Table 1.14 first quarter 2023.' There is a deflator found in Table 1.14 (line 41) which can be used to calculate the increase in prices in the non-financial corporate sector year on year. That deflator prepared by the BEA can be found in row 53 on my spreadsheet. It yields an inflation rate of 8.4%. This compares to the official price deflator for final sales of 5.4%. I am of the opinion, as I have stated in previous articles, that 8.4% is closer to the mark. This being so, instead of growing by 1.3% in the last quarter, GDP actually fell by 1.7%. This is closer to the tax data issued by the CBO which shows a fall in tax revenue adjusted for capital gains of 8.5%. Clearly an economy which continuously underestimates inflation is one which always manages to avoid recessions.

In all cases, when the term 'adjusted for inflation' is used, the figure is -8.4%.

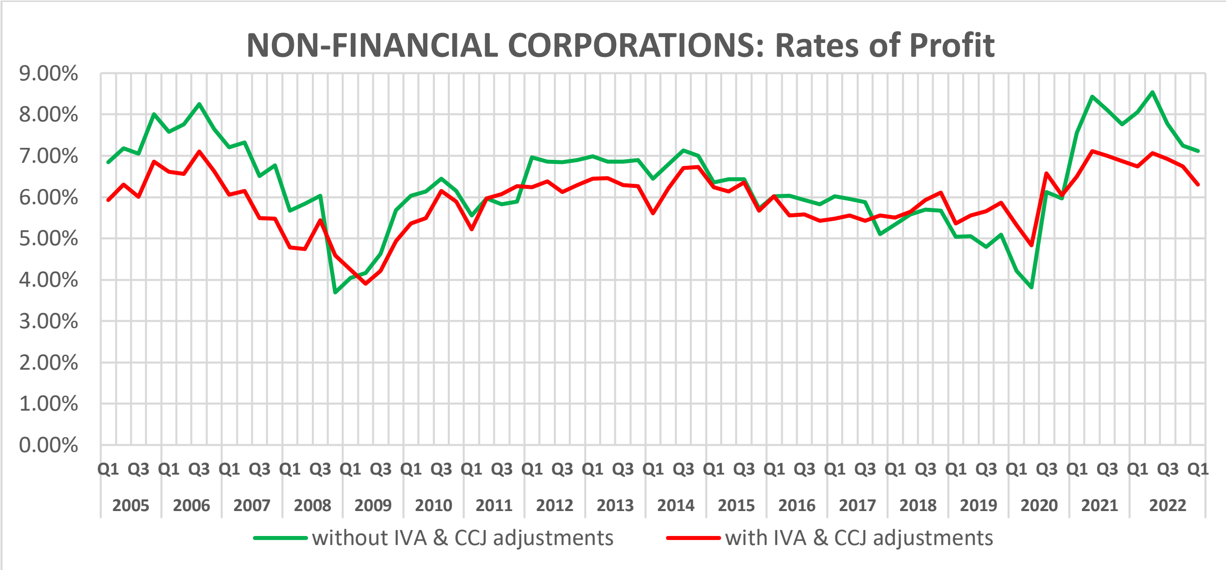
Despite three consecutive quarterly falls amounting to 13.7% in total, the mass of adjusted profits remains elevated 20% above its two previous peaks this century. The fall this quarter was weak, supported by price rises which I believe to be higher than 8.4%. Given the likely fall this coming quarter, I remain of the opinion that by mid-year, the mass of profits will have declined back to their 2019 levels adjusted for GDP..

Graph 1.



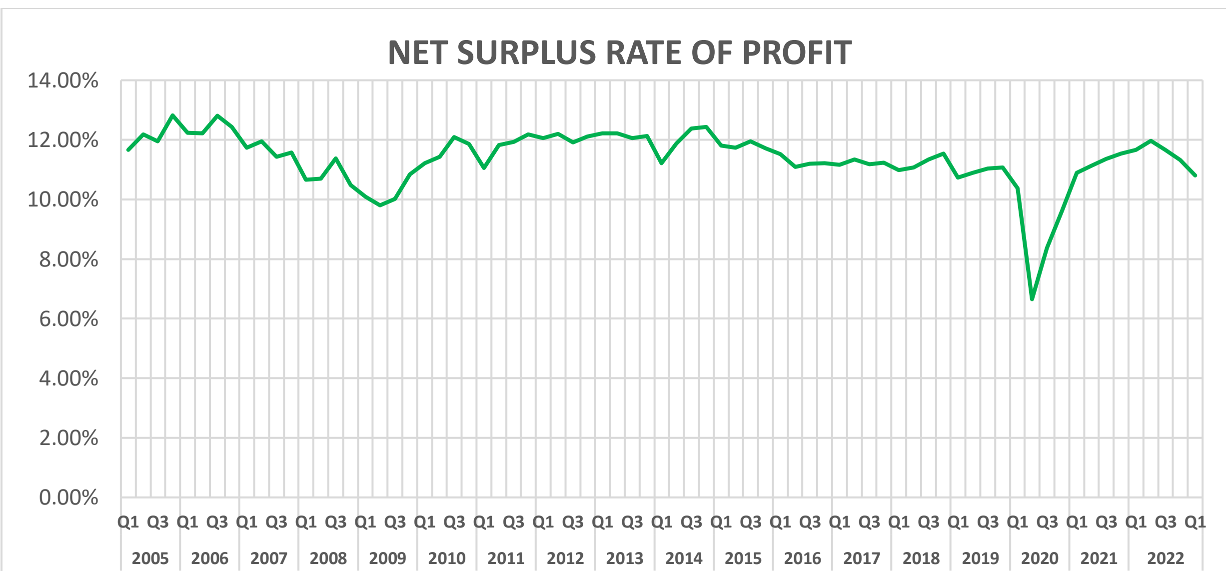
The continued fall in the mass of profits in turn led to a fall in the **absolute rate of profit**. Here the fall was more pronounced particularly in Graph 3 which describes the net surplus rate of profit. In all cases the denominator comprises both fixed and circulating capital. In terms of fixed capital where the data lags, I have used 'capital consumption' data located in line 52 to extrapolate fixed capital from the figure provided in Fixed Capital Table 4.1. at the end of 2021. I have found this to be sufficiently accurate to provide a strong estimate. The rate of turnover used to calculate circulating capital is that for the goods sector.

Graph 2.



The rate of profit in 2021 and 2022 was the highest this century propelled by Covid subsidies and thereafter by profit gouging via inflated prices. As previously predicted, by mid-year the rate of profit should revert back to pre-pandemic levels. It is currently 17% lower than its previous peak in the second quarter of 2022 which places it mid-way between this peak and its pre-pandemic level.

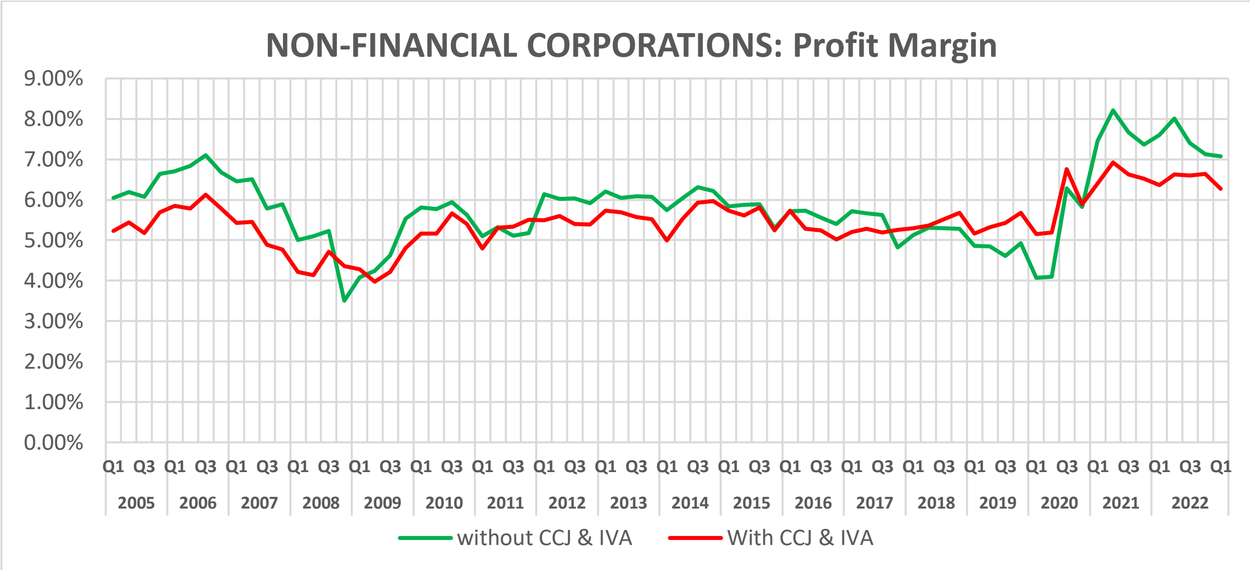
Graph 3.



Despite subsidies the effect on the net-surplus-rate-of-profit was less pronounced. It peaked below the previous 2006 and 2014 peaks. It is currently down 10% from its recent peak having fallen back to levels last seen before the pandemic.

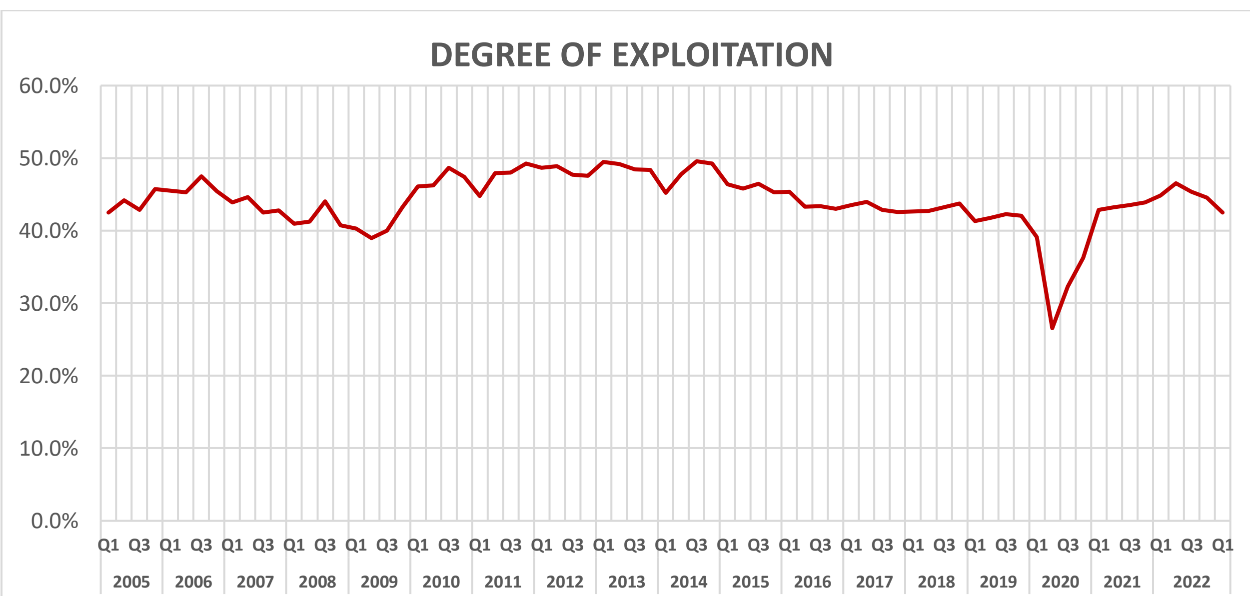
The graph below shows a similar pattern. Profit margins here are correctly measured by gross output or total sales and not simply by final sales or GVA. This takes into account the variations in turnover.

Graph 4.



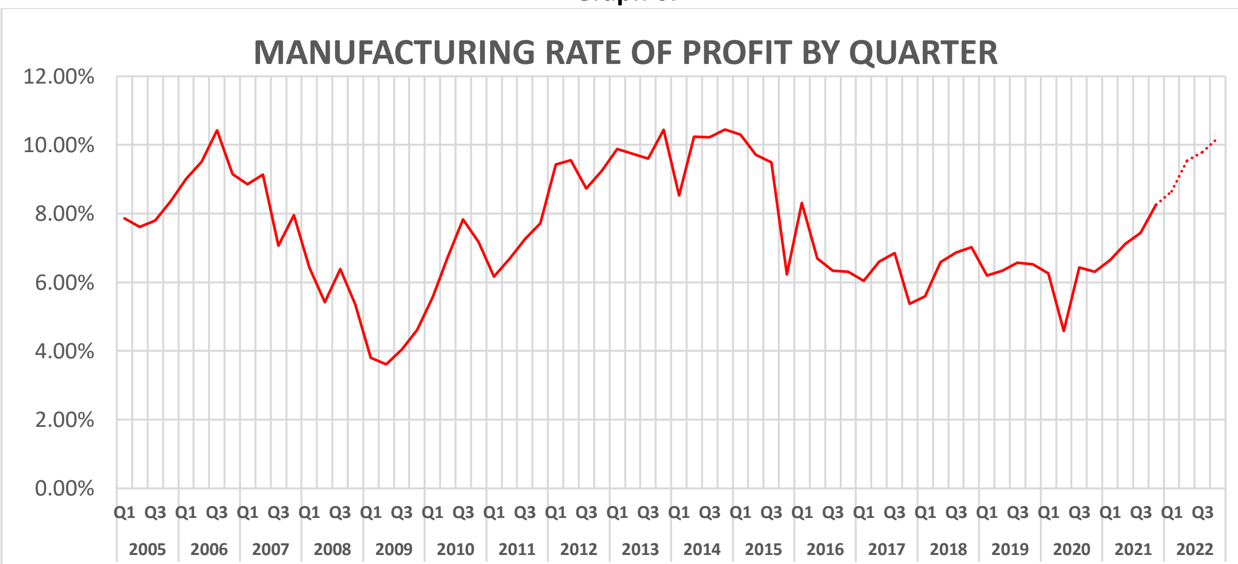
Graph 5 is a most interesting graph. It is not influenced by subsidies. Instead it takes data prior to the adjustment for tax and subsidies in Table 1.14. The degree of exploitation is calculated by dividing the net surplus by the compensation of employees. Here we have confirmation that the recent elevated rate of profit was not a function of a rise in the rate of surplus value. Despite wages falling far behind price rises thereby increasing the degree of exploitation, it still did not reach the levels of exploitation found between 2010 – 2014 at the pinnacle of globalisation. The reason: underlying profitability was far better during this period propped up by significant transfers of value from the Pacific Rim, particularly China. In short it was transfers rather than subsidies which dominated. Now that the former is diminished and the latter absent, US corporations will have to rely more on the brute exploitation of their North American workers.

Graph 5.



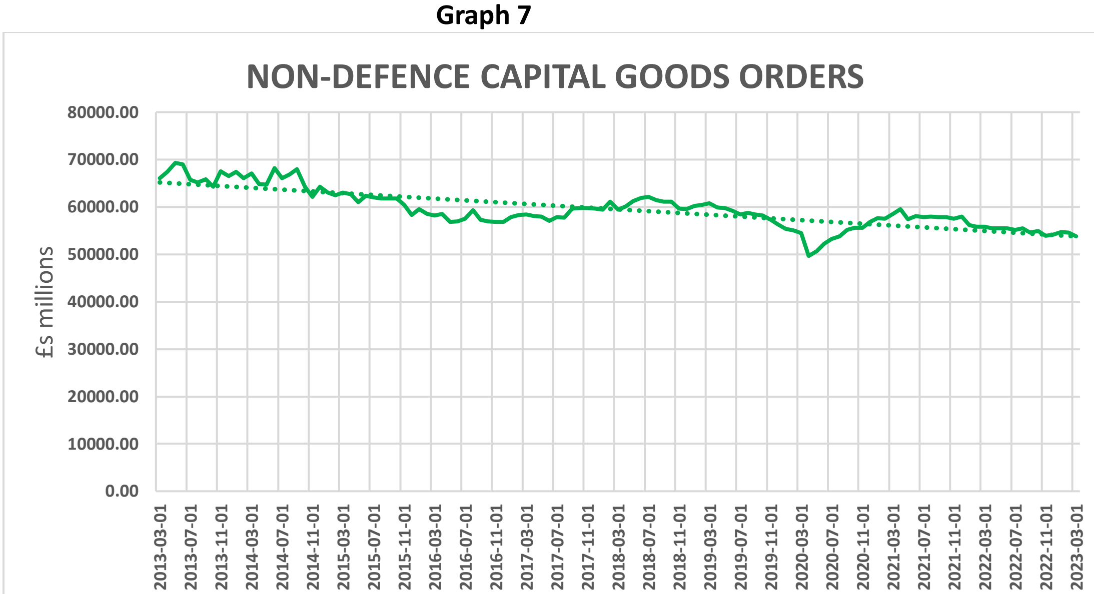
In the case of manufacturing which experienced a near 40% fall in its rate of profit between 2014 and 2019, more than enough to precipitate a recession, the restoration of the rate of profit appears to be ongoing. However, I am not confident of the rate of profit in 2022 as there is little data to calculate fixed investment. But if this estimate is anywhere near proximate it shows the beneficial effects the CHIP Act, The Inflation Reduction Act, the fall in the price of inputs, and oh yes less we forget, arms spending, is having on the fortunes of the manufacturing sector.

Graph 6.

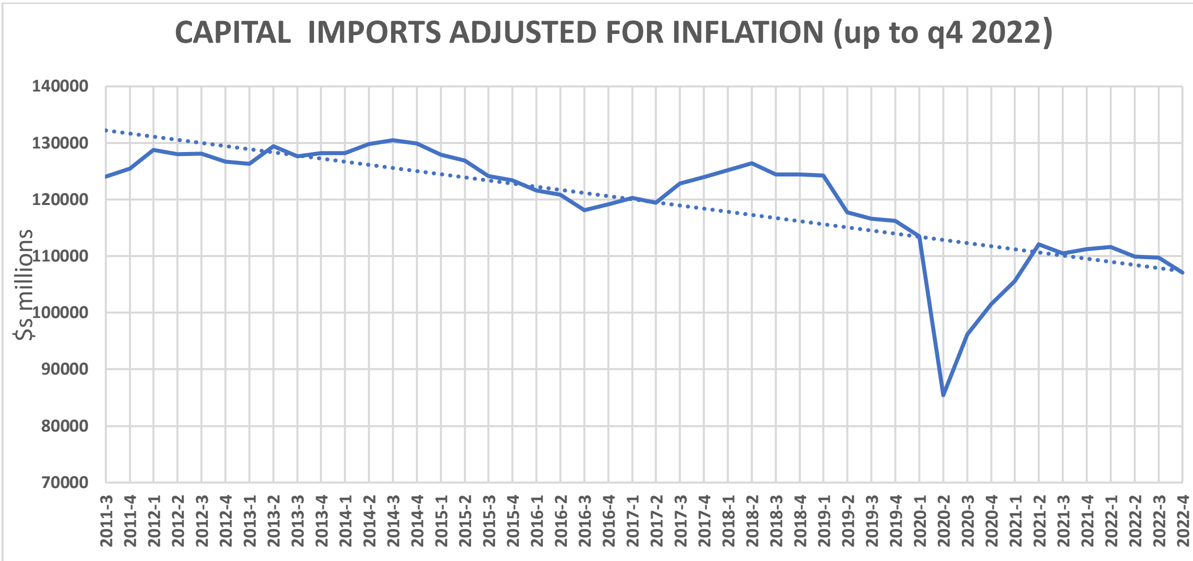


However, despite the improvement in profitability it is clear that the corporations are not confident this will be long-lived, given it was mainly a product of earlier subsidies and now government investment support in the form of the above two Acts. As a result fixed investment orders and imports have not recovered adjusted for inflation. A case of take your money now instead of making your money later. (All orders and imports have been deflated by the [Producer Price Index for Capital Goods](#).)

Graph 7



Graph 8.



The amount of money in the form of seed investment by the Federal Government and by State and Local Governments is eye watering. While this will reduce the capital laid out privately and therefore the capital against which profits will be measured, it will do nothing for the profit side. The costs of fabricating chips for example will be anywhere from 30 to 50% more expensive in the USA than in Asia. So said the founder of TSMC which is bleeding $40 billion into its Arizona plant. He had this to say as well: "*Chang said that costs for manufacturing in the US are simply prohibitive… and it will be hard for the US to compete internationally"* These comments were made in mid-2022 when chip prices were elevated and demand strong. Now they are depressed as the world faces a glut of chips with market prices dictated by the most efficient plants all of which are based in Asia. Well at least Arizona has lots of sand and therefore silicon, maybe the plant can be converted to making designer labelled silicone frisbees.

The banning of Micron chips in strategic Chinese infrastructure is the first retaliatory step in the tech war initiated by the USA. If this is the result of China finally embarking on the mass production of its own 28nm DUV lithography machine, then the balance in this war could be shifting. It is said this machine will cost a fifth of the price of the equivalent ASML Dutch machine. If this machine can be scaled up, and no one has more manufacturing prowess than the Chinese, and if it's work rate is comparable, then it fundamentally alters the cost structure of all chips 7nm and above. The losers of course will be the North American chip companies and ASML as well as the lesser Japanese and South Korean manufacturers. Even Apple will not be safe.

So while the US is focusing on building the world's most expensive chip industry it is about to lose its most lucrative market, China. This seems to be lost on Wall Street even when Micron presented its most recent financial report which was a complete disaster. Year on year quarterly revenue fell by 53% converting an operating profit of $2.55 billion into a thumping loss of $2.3 billion. And yet after this catastrophic report Micron's share price is up 22% compared to its price before the release of those financials capitalising it at nearly $1 trillion. Why? In a word, AI. Weave AI into your press presentation and everyone is a winner because while CHAT Bots can do a lot wrong in the real world they can do no wrong on Wall Street. And who manufactures most of the chips for the planet destroying servers powering AI, its Micron of course.

It seems it is not only Chatbots which can hallucinate. Deep learning is in its infancy and infants learn to walk by stumbling especially if the terrain is bumpy and full of traps, which capitalism is full of. Deep learning is a beast which programmers are always chasing behind trying to repair the damage as and when it is uncovered. Wall Street may salivate at the prospect of proprietary systems culling jobs and costs at workplaces, but it will not be long before Microsoft or Google will be sued for negligence when one of their public or general systems does harm.

Moreover, the holy grail of deep learning, misnamed artificial intelligence, was always the culling of higher paid white-collar workers rather than cheaper blue-collar workers. The perception of the danger to jobs posed by proprietary deep learning programmes tailored to specific industries is now widespread. Predictably it has led to increased job insecurity. The effect of this will restrain consumption by this layer of the working class and professionals as they prepare for the worst. A hint of this appeared in the Financial Times sponsored *Business of Luxury Summit* held in that shithole Monaco filled with floating yachts between the 21 and 23 of May. At this summit there was the hint of what is to come as it became clear that the lower end of the $1.34 trillion luxury market was unravelling leading to $60 billion being wiped off the share values of the luxury producers. Thus before deep learning delivers cost cuts on the supply side it will have impacted the demand side first.

The debt ceiling saga.

Currently fiscal policy and monetary policy are at odds and in conflict. A growing budget deficit which boosts the economy undermines monetary policy, meaning that tightening has to proceed further requiring additional interest rate rises. As the CBO report for April shows, the budget deficit is heading for an unsupportable 7% of GDP deficit, which is large enough to juice inflation.

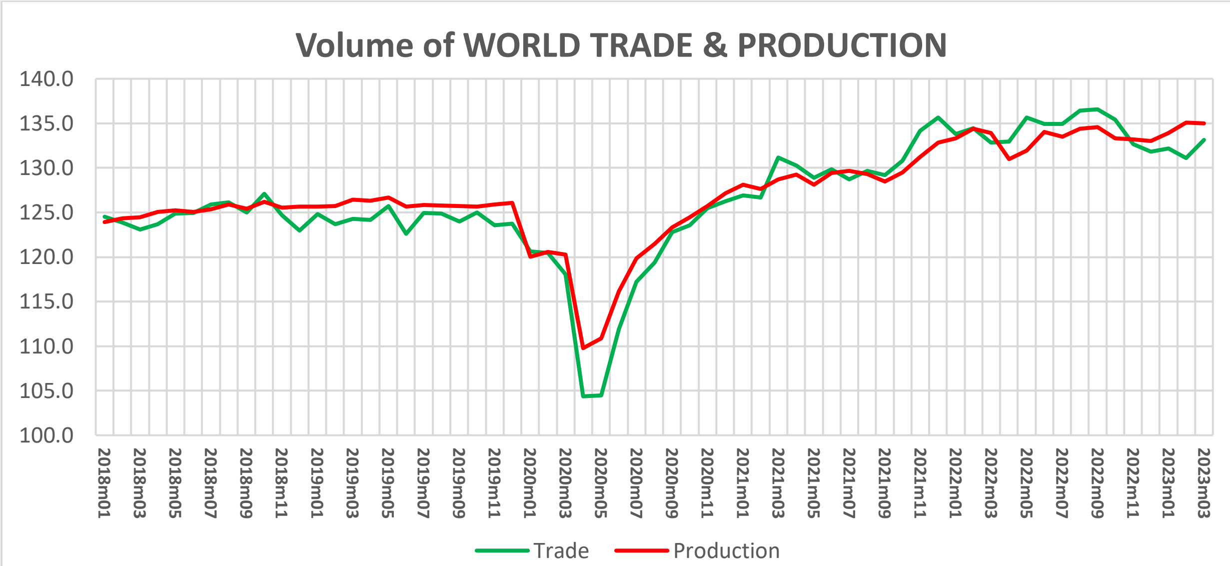
At the time of writing a deal appears to be emerging whereby the Democrats will agree to a two-year freeze on spending except on the military. The GOP intends to harm their prospects in the election next year as the axe is taken to popular programmes. But even if the debt ceiling was not an issue, steps would have had to be taken regardless to reign in the deficit. The problem in the future will be not so much spending but the collapse in the tax take as the economy contracts and the super-rich continue to avoid paying their share of tax, making the deficit intractable and bringing forward the next debt ceiling episode.

Not only are the tightrope debt negotiations spooking Credit Rating Agencies thereby putting the US's AAA Rating at risk, but it is spooking economists such as the Oxford based El-Arian. He tweeted and then followed this up in an interview with Bloomberg TV on Friday, that the standing of the US economy and the Dollar is being put at risk. What the dumbos in Congress tunnel focused on party politics do not appreciate, is that this kind of shenanigan is unaffordable when the status of the Dollar as the world's reserve currency is in the spotlight as never before.

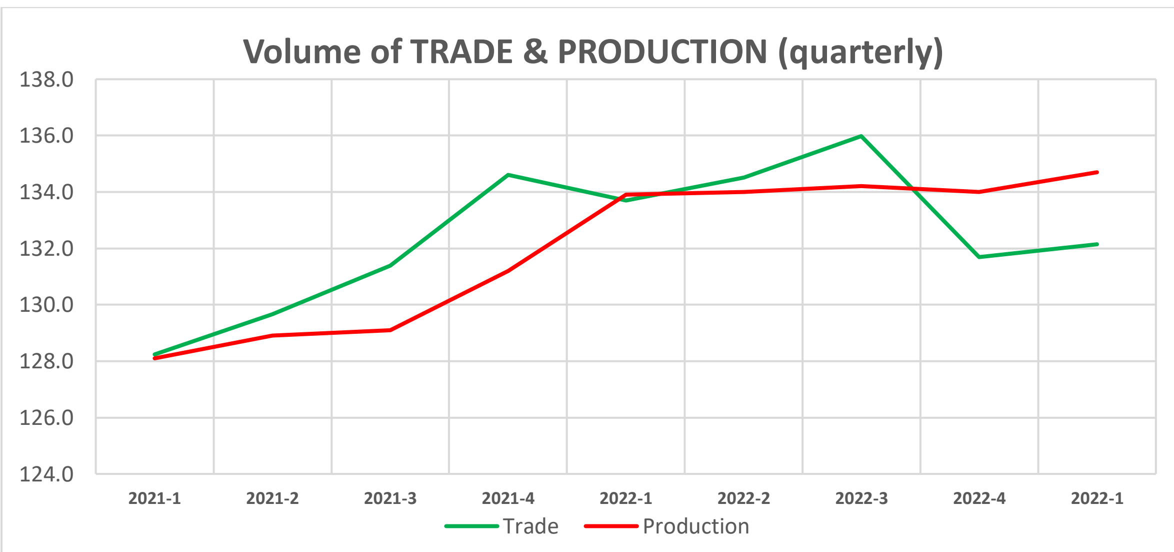
The global economy.

The CPB in Holland released its latest World Trade Monitor. This covered March completing the data for the quarter. The effect of China's reopening can be seen. On balance over the last 6 months global trade is down sharply while production is flat. March over March data is essentially flat. The data is likely to be revised downwards as revised country estimates are released as in Germany.

Graph 9.



Graph 10.



This will be as good as it gets. China's data is disappointing as month-on-month growth in production and trade evaporates. Germany is now in a prolonged recession forcing it to rethink its approach to the war in the Ukraine and its relationship with China. I will have more to say on this once I am able to review profitability in Germany. As for the whole of the European Union, production fell by 4.1% while combined imports and exports fell m.o.m. in March. Singapore's imports and exports fell at a faster rate in April while industrial production fell by 1.9%. Not to be outdone, Taiwan's industrial production fell by a dramatic 23.52% in April adding to the 3% fall in first quarter GDP. In Japan export growth moderated in April while imports fell at a faster rate. Machinery orders in March, instead of rising by 1%, fell by 3.9% making a nonsense of the robust investment intentions reported by the concurrent Tankan survey. (All data from *Econoday*) What all this shows is a fracturing global market hurting economic prospects, China's in particular.

Conclusion.

It could be said that the US's abnormally elevated rate of profit is now normalising. This is an important observation. But it should be recalled that the old normal as found in 2019 was associated with a global economy narrowly avoiding recession thanks to the repression of interest rates..

It is only possible to discuss trends, predictions are out given potential climatic events such as the current 2023 Asian Heatwave where temperatures have risen 2 degrees above average. The trends which this article focused on are now well established; they are falling US profitability and investment. While the fall in the rate of profit decelerated in Q1 due to monopoly pricing power this is unlikely to be repeated in Q2 as volume falls re-accelerate. The fall in volumes can best be gauged by the 70% reduction in the construction of sea going containers as shipping lines and ports become constipated with empty containers. This follows the sharp fall in the production of cardboard and bubble wrap.

It is unlikely that the events which supported Q1 will be repeated. China is disappointing. Fiscal spending is going to be tightened. The trajectory of interest rates is indeterminable. Bank lending is constricted, and bad debts are accumulating. While the Stock Exchange is hallucinating on AI there is little else to support its enthusiasm. As for whether or not the US is in recession, this is not a question for the economists but for the statisticians who compile the deflators.

Brian Green, 26th May 2023.