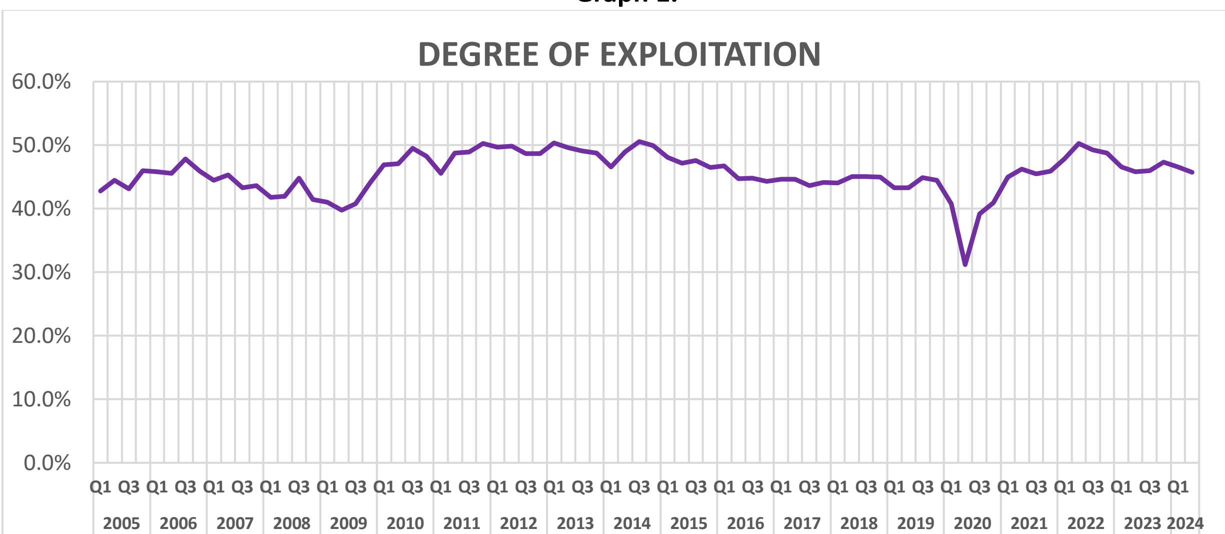
DESPITE A WEAKENING ECONOMY THE US RATE OF PROFIT HOLDS UP.

On Thursday the BEA released NIPA Table 1.14 and with it corporate profits. Profits held up supported once again by a lower interest paid burden. This rise in profits seems inconsistent with the weakening economy until we realize how much these profits are impacted by the TECH 6 and Health Sector.

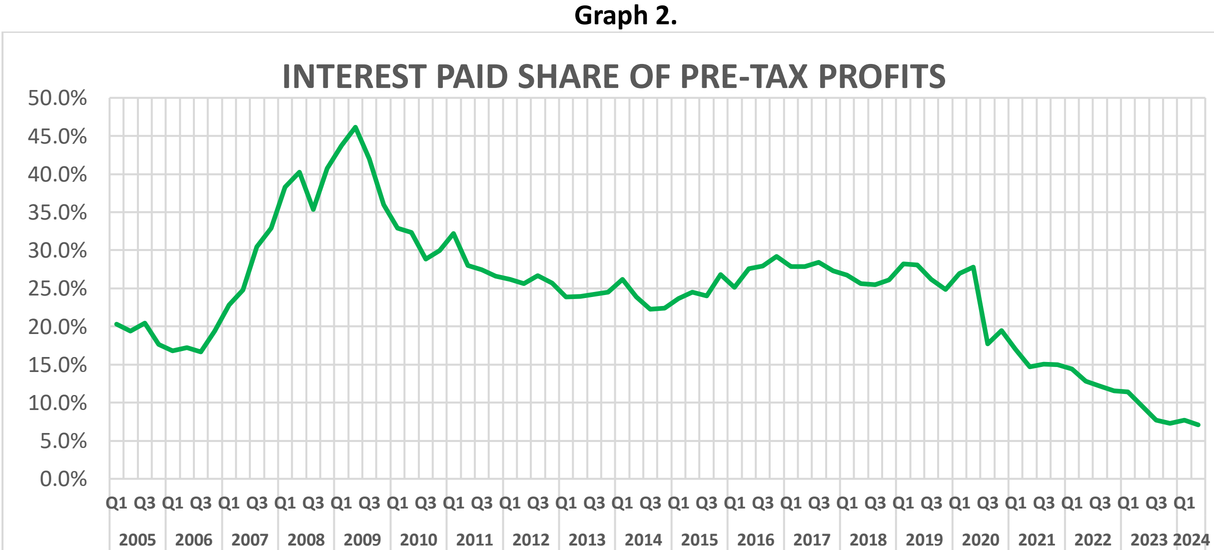
I have raised the issue that in a period when wages are outpacing prices we should see falling profits not rising profits. And for the first time there is a glimpse of this. The first graph registers the trend in the degree of exploitation. Over the last two quarters, or six months, there has been a fall in exploitation of 3.5%. The degree of exploitation, however, remains higher than pre-pandemic but only marginally so. It remains well down from the five year period ending 2014 when profits were elevated the last time round. (All data and calculations can be found in the accompanying spreadsheet Table 1.14 quarterly Q2 2024.)

Graph 1.



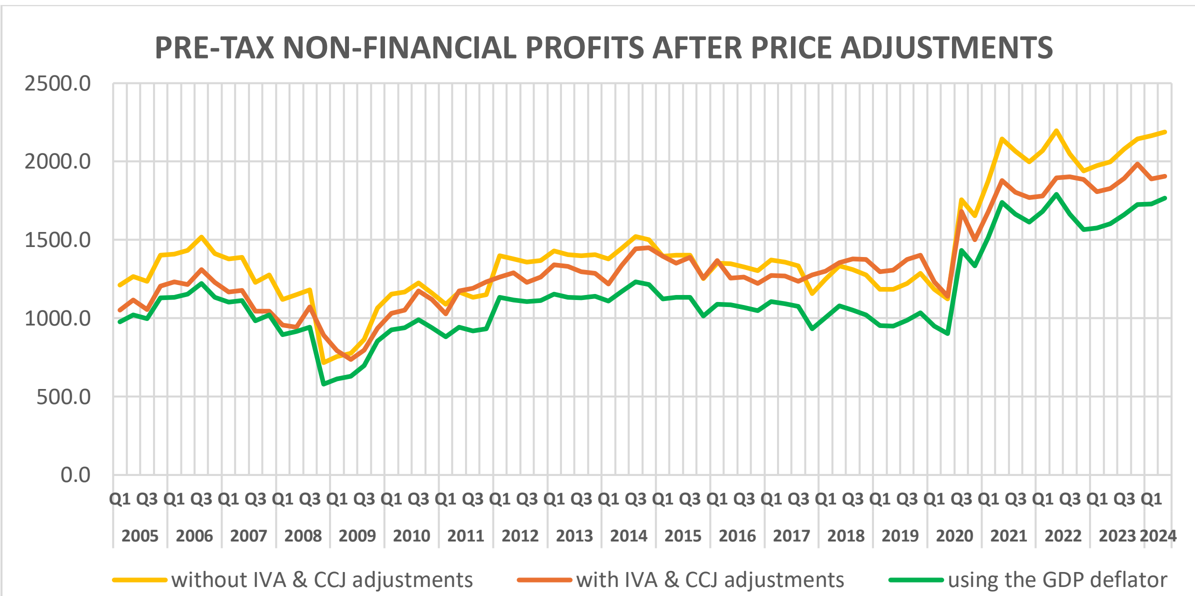
Once again the reduction in interest paid reversed some of the fall in profits due to a decline in the degree of exploitation.

Graph 2.

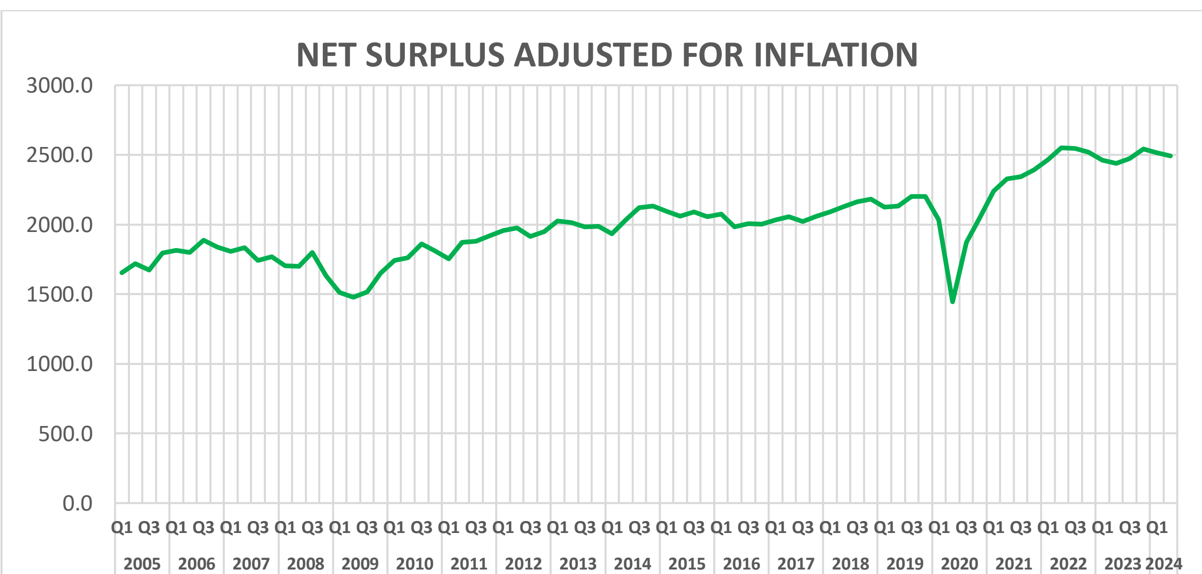


This fall in interest paid is entirely due to the infusion of Covid funds which have been harboured in these corporations either earning interest or obviating the need to borrow and pay interest. The effect on the mass of profits and the net surplus is clear to see. Whereas pre-tax profits (without IVA & CCJ adjustments) went up 96%, the net surplus which is unaffected by interest paid, rose only by 13%. One more example where the enduring effects of Covid Funds can be seen, an effect which has been highly supportive of the economy especially at a time of elevated debt levels and deteriorating market conditions.

Graph 3.

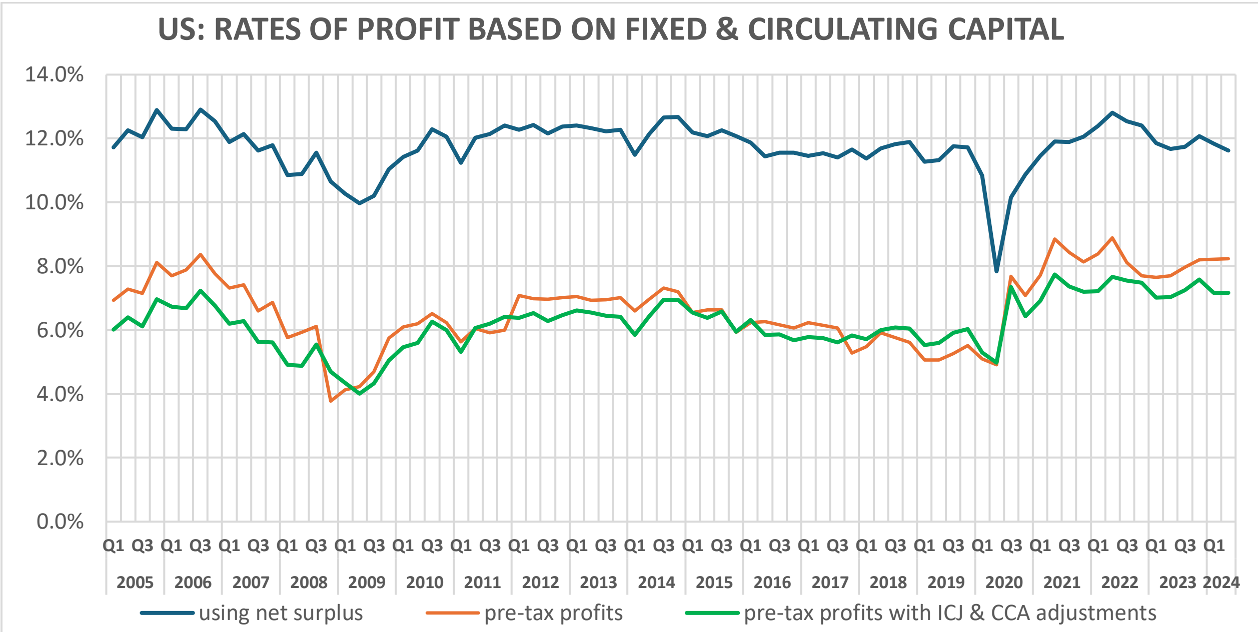


Graph 4.



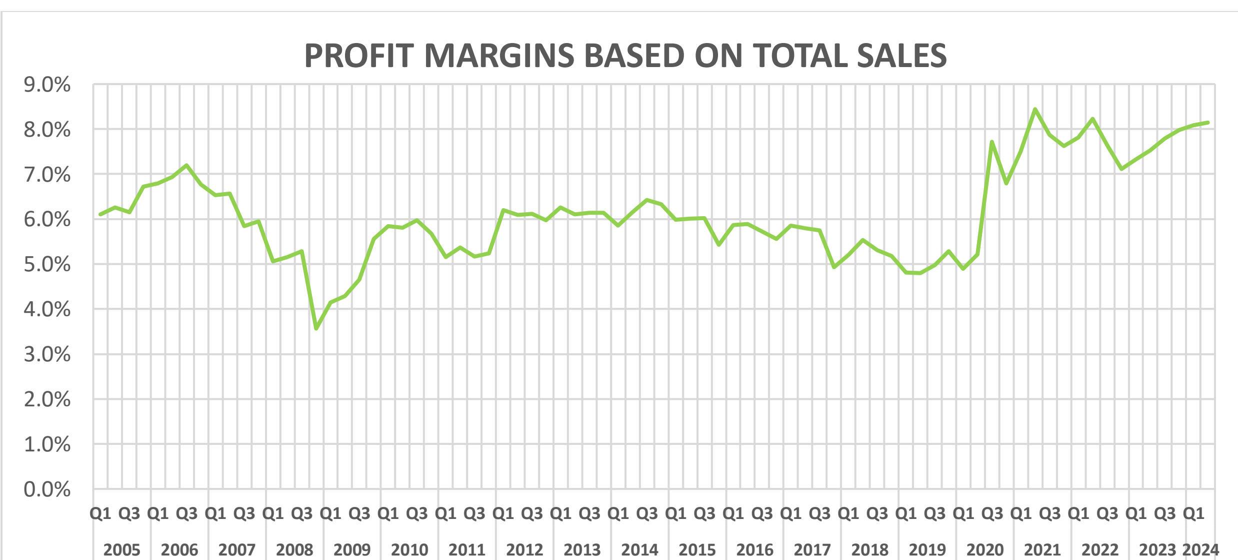
Having obtained the profit data we can proceed to obtain the more important rate of profit. Once again as fixed assets for the quarter have not been released I have estimated them by using the capital consumption data provided in Table 1.14 and as GDP by Industry data for Q2 have not been released I used the Q1 turnover rate to solve for Gross Output.

Graph 5.



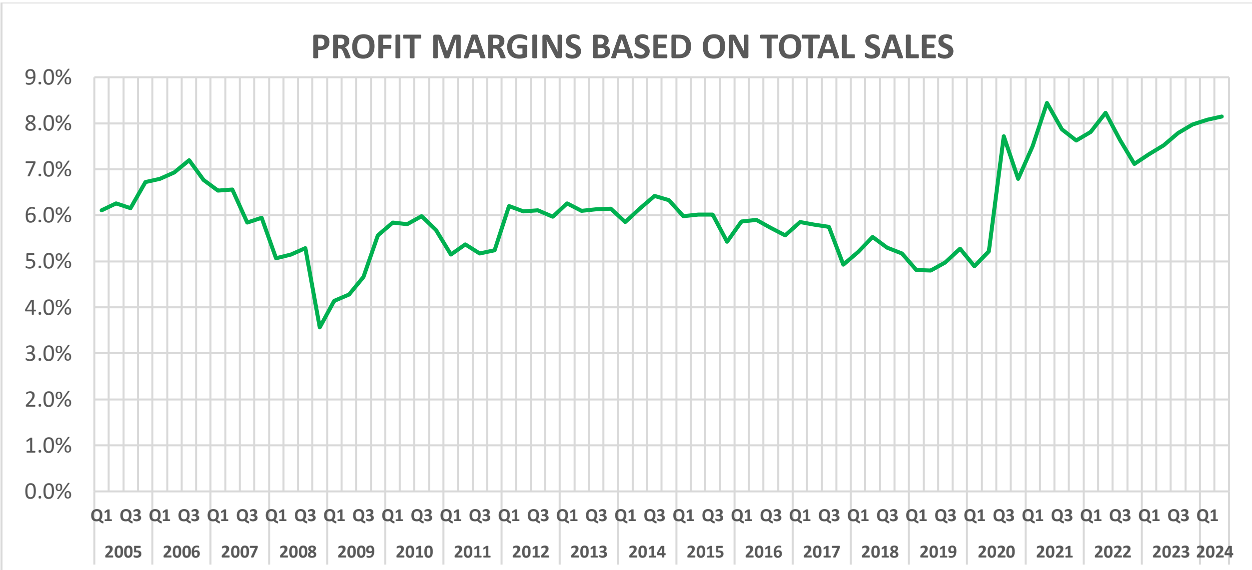
In contrast to the pre-tax rates of profit, the rate of profit measured by the net surplus is no higher than pre-pandemic, a period of weakness for the US economy. Nevertheless the active rate and headlines are based on profits rather than EBIT data which corresponds to the net surplus figure. In every way, the enterprise rate of profit, or the pre-tax rate of profit, is the more important when it comes to investigating the incentive to invest. It goes without saying that much of this rise in the rate of profit is not widespread but concentrated in the Big 6 Tech and Big Pharma.

Graph 6.



Like the rate of profit, the profit margin remains elevated and remains above the pre-financial crash levels.

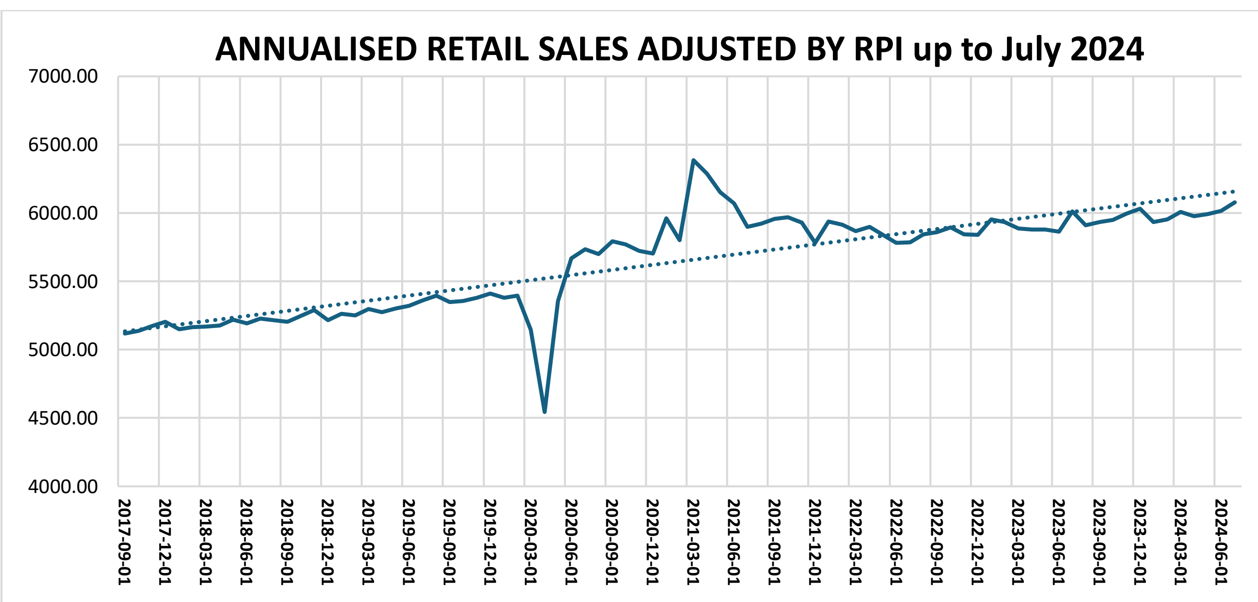
Graph 7.



Retail Sales.

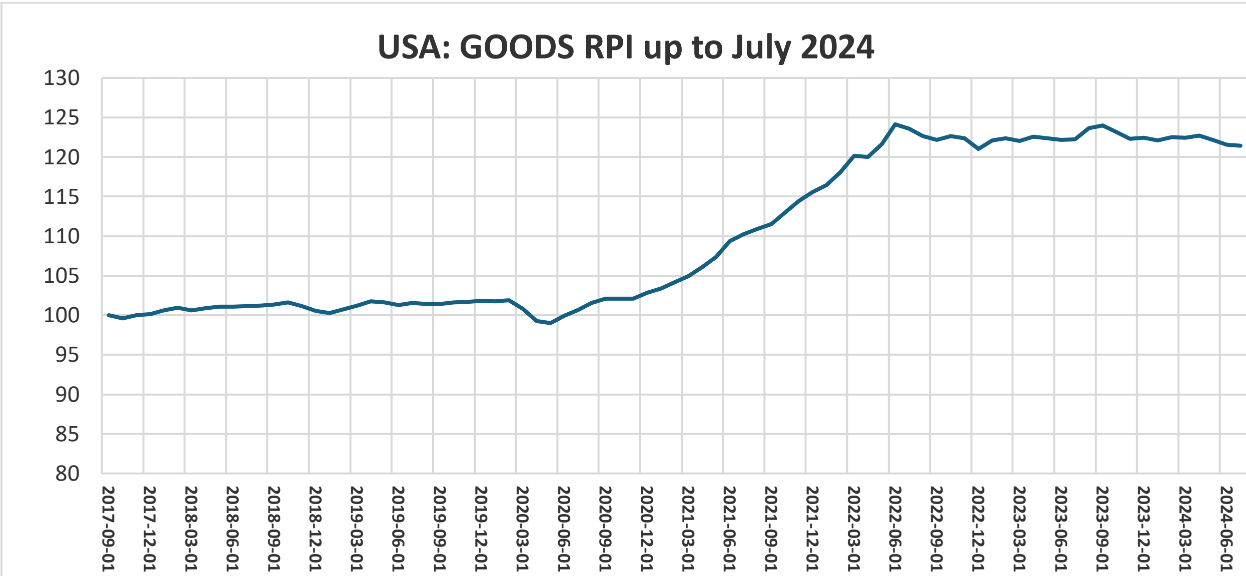
As I explained in my previous post on US GDP when adjusted retail sales are equal in size to service sales. For more on this follow this link: http://theplanningmotive.com/2024/07/28/us-data-in-the-past-revisionism-was-a-political-term-now-it-is-economic/ On the point of revising figures it is worth including the subsequent and significant downward revision to the employment data of over 800,000. I have no doubt retail sales and personal consumption will be revised downwards as well. In the meantime retail sales for the quarter rose by 1.9% in nominal terms and by 2.2% in volume terms due to goods deflation.

Graph 8.

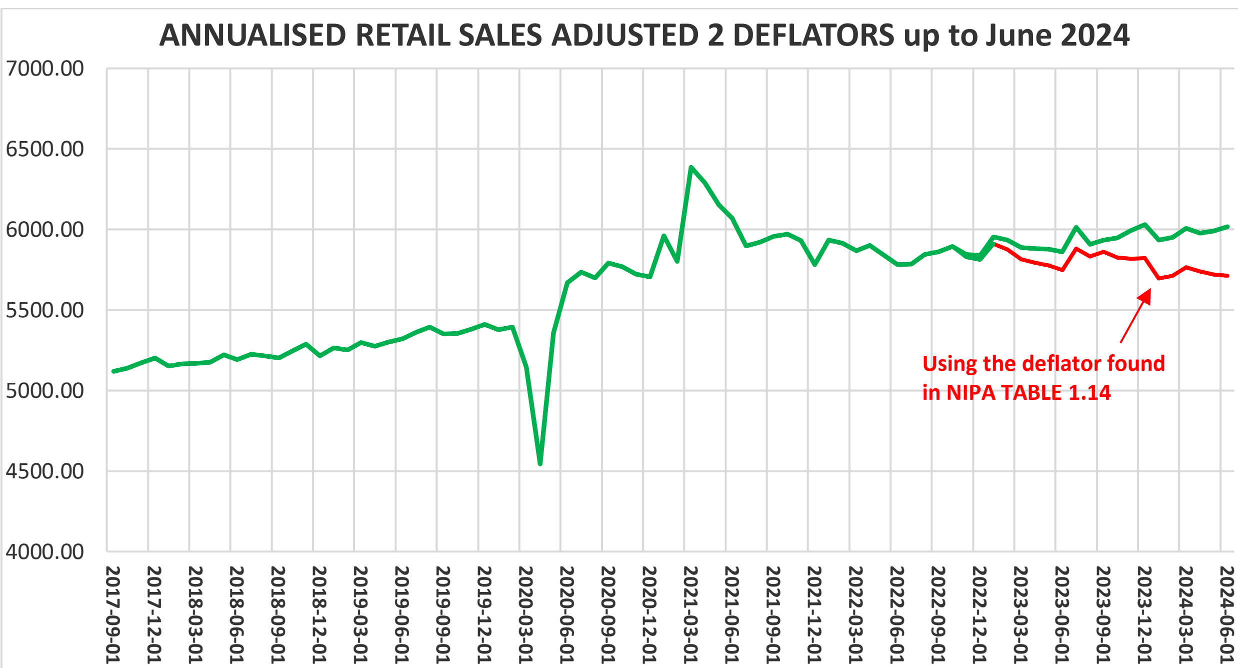


Prices for goods are flat to trending down. I produce my own RPI (Retail Price Index) as the BLS only provides a CPI which blends in service and goods inflation.

Graph 9.



Graph 10.



I have also supplied the sales data using the corporate deflator as found in Table 1.14. It shows a more rapid recent fall in the volume of sales. I suspect the real figure lies closer to the red graph. This tends to be supported by tangential evidence. Table 3.3.3 issued by the BEA giving the volume of personal goods consumption expenditures provides a rise of 22.7% from Q2 2020 to Q2 2024. Retail sales volumes on the other hand over the same period exceed 30%. Both cannot be right. It is likely retail sales are inflated.

I find the July retail figure somewhat surprising given the high temperatures found in the USA and consequently higher energy bills which always impacts retail spending especially on discretionary items. However, the July figure was inflated by large volumes of auto sales registering 15.8 million SAAR due to computer issues in June, but predictions for September are down to 15.2 million SAAR, back to the June level. (For the quarter as a whole, auto sale volumes were down 0.5%). In addition, store closures this year at 3,200 already exceed last year's entire total. *Dollar General's* shares have plunged and one of the oldest chains, Big Lots with over 1,400 stores, is on the verge of bankruptcy. Only a handful of the largest retailers managed revenue growth of over 4% in their north American segment over the quarter – Amazon, Costco, Walmart and in clothing TJ Maxx.

Again this weakness in retail is supported by facts on the ground. Volumes in packaging were flat to rising, while freight movements were flat to falling. Amcor one of the largest US packaging groups saw volumes improves 1% though there was segmental softness: "*Volumes returned to growth in the June quarter, up approximately 1% compared with the prior year which represents a sequential improvement of 5 percentage points. As expected, volumes remained soft in healthcare categories and in the North America beverage business through the June quarter, unfavorably impacting overall volumes by approximately 2%."* Berry Global also saw modest volume growth in the US market of 2% "***Consumer Packaging – North America** Net sales increased 4% to $831 million primarily driven by 2% organic volume growth and higher selling prices as a result of improved product mix. The volume growth was led by our food, beverage, personal care, home care and industrial markets while foodservice markets saw modest declines."* International Paper showed similar North American volume growth. It should be pointed out this return to volumes was not only due to final demand but also that destocking by customers had ended and they were now restocking. UPS reported a 0.7% volume growth in Q2 for its North American Segment. Pitney Bowes reported a slight volume growth. On the industrial side JD Hunt saw volumes shrink across the board. The CASS Freight Index fell by 5.3%. Railroads were stronger than trucking. CSX railroads saw a 2% volume growth. Union Pacific Railways only 0.5%.

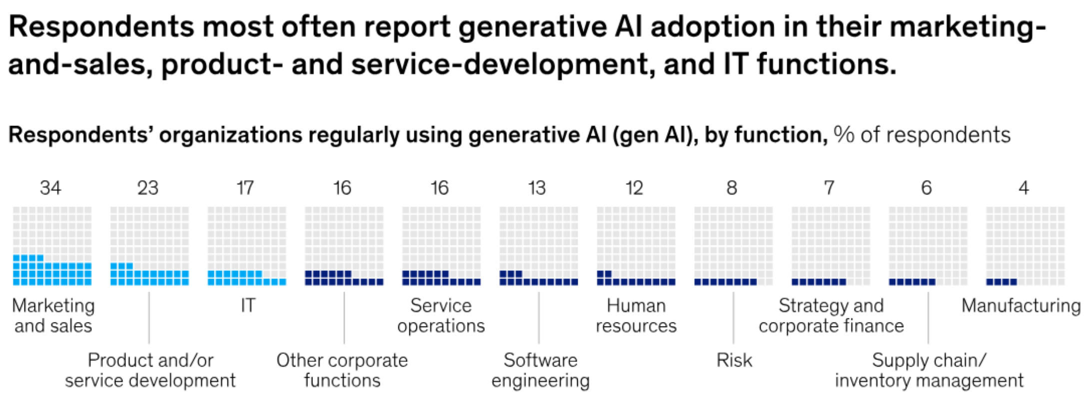
A.I. remains Altogether Interesting.

There has not been the much heralded mass layoff yets. Layoffs seem confined to the Tech industry itself where workers have been fired to pay for A.I. Research & Development using overpriced Nvidia chips. "*In the tech world alone, there have been nearly 100,000 layoffs in 2024, according to Layoffs.fyi, a site that tracks job cuts in the tech industry."* Nor has there been a blockbuster application found for gen A.I. "*The report, titled "Gen AI: too much spend, too little benefit?" notes that mega tech firms, corporations, and utilities are set to spend around $1 trillion on capital expenditures in the coming years to support AI".* This is confirmed by this report in the Washington Post which concludes the producers of gen A.I. have to still turn a profit. Given the expansion in Nvidia's revenue this quarter, that Trillion expenditure is not far off. "*Record quarterly Data Center revenue of $26.3 billion, up 16% from Q1 and up 154% from a year ago."*

But as I have said before, most critics of gen A.I. are looking in the wrong direction. It won't be the upstream producers of A.I. such as Microsoft, Google and OPENAI who will reap the benefit but the downstream users of these systems. Already contained in the quarterly reports, a number of key companies have been extolling the benefits of employing these systems. One of them was Walmart who claimed that without these systems they would have had to employ thousands of additional workers to build out their eCommerce base. At a guess, it is likely we are now moving from the phase of verification to the phase of roll out of theses systems, but concentrated in particular sectors. Workers beware.

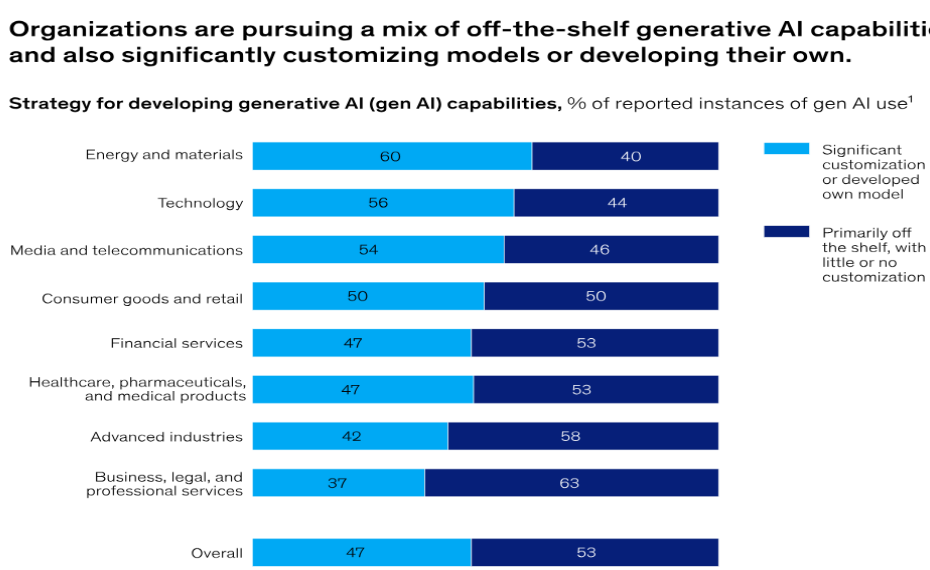
At least this is the gist of McKinsey's analysis. McKinsey's 2024 report makes insightful reading**."** ***If 2023*** *was the year the world discovered generative AI (gen AI), 2024 is the year organizations truly began using—and deriving business value from—this new technology. In the latest McKinsey Global Survey on AI, 65 percent of respondents report that their organizations are regularly using gen AI, nearly double the percentage from our previous survey just ten months ago. "Organizations are already seeing material benefits from gen AI use, reporting both cost decreases and revenue jumps in the business units deploying the technology." "The average organization using gen AI is doing so in two functions, most often in marketing and sales and in product and service development—two functions in which previous research determined that gen AI adoption could generate the most value—as well as in IT."*

Table 1.



So far its use in manufacturing is limited. **Companies are still spending more on analytical A.I.** than on generative A.I. One reason is concern over inaccuracy. Already 44% of respondents have had one serious incidence with gen A.I. that has impacted their business. The majority of corporate users are employing off the shelf versions rather than producing their own dedicated algorithms from scratch as shown below.

Table 2.



Finally the report finds that it is exceptional for companies to turn a profit from these systems though they help with revenue growth.

In contrast the rest of US industry is in dire straights. Of course it is important not to minimize the importance of the US domination of the information technology age, and to this we may add life sciences as well, but two swallows do not make a summer. *The New Atlas* on YouTube is one of the more instructive podcasts on the state of US industry. It has revealed that the US's manufacturing industry is so hollowed out that the US Navy is having trouble keeping its aircraft carriers at sea: **China's Naval Power Surpasses US - US Geopolitical Reach Exceeds its Industrial Grasp.** Its not only Boeing that is failing, but whole sections of industry are also failing to ramp up. In the end it is not so much silicone that wins wars but steel, as the war in Ukraine has revealed. This war has exposed the US as more of a cyber-tiger than a real one, showing that it is not technical dominance but industrial dominance what wins wars.

Conclusion.

Profitability continues to hold up though no doubt this is concentrated in fewer and fewer corporations. As for the rest, many corporations continue to struggle as the levels of bankruptcy fillings accelerates. "*Comparing this year's filings to previous years, there is a noticeable increase in all bankruptcy chapters. Chapter 7 filings have risen by 14.06% year-over-year, from 4,970 in 2023 to 5,669 in 2024. Chapter 13 filings have grown by 3.47%, and Chapter 11 filings have surged by 46.98%." Given that* 2024 and 2025 are the years when refinancing peaks, we can expect filings to continue to accelerate.

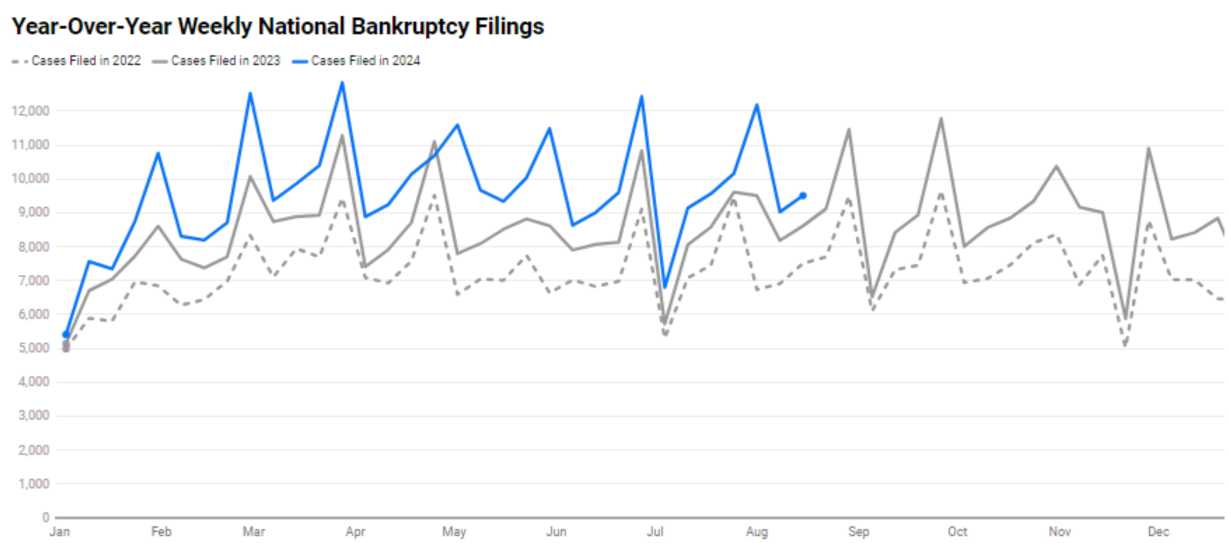


Chart: Ryan Stone, BankruptcyWatch • Source: BankruptcyWatch • Get the data • Created with Datawrapper

The markets are convinced that an interest rate cut is due in September. They are unanimous in their concern that the FED is behind the curve once again. But then over-optimistic official data does not help the FED's corner. However, we should not underestimate the support a rapid series of cuts can bring provided the Dollar can sustain these cuts. For the time being the US economy is doing what it does best, moving sideways softly.

Brian Green, 30th August 2024.