

WHERE HAVE ALL THOSE PROFITS GONE?

For corporate America – and its shareholders – the apparent lack of pricing power in cyclical sectors comes at a critical time.

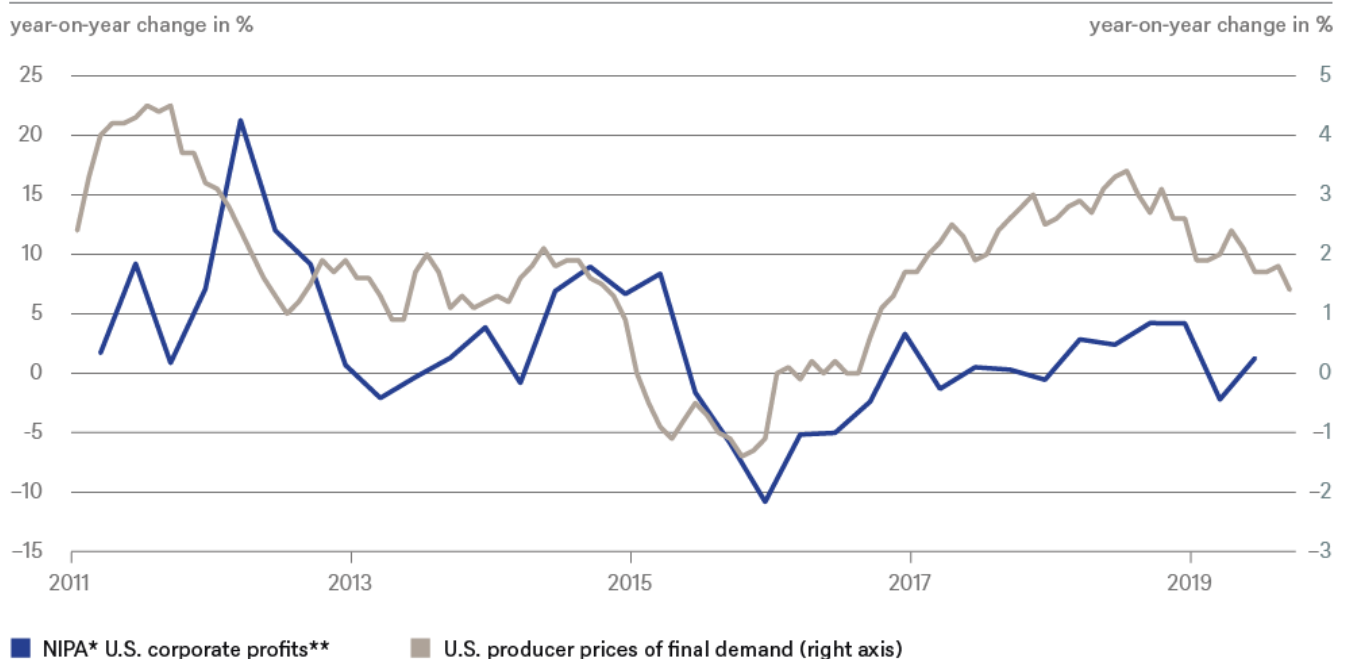
One of the more interesting recent U.S. economic statistics has been the September reading for producer prices. Growth in the core measure, which strips out volatile food and energy prices, fell to 1.4% year-on-year for finished goods and services. That's down from a running rate of well above 2% at the end of 2018. It is only one reading, but still a fairly rattling one. Especially considering the sources of weakness.

Commentators have gotten used to seeing plenty of signs of weakness in U.S. manufacturing. Instead, the main source of the miss was actually in services, where prices fell by 0.2% (month-over-month change), compared to a 0.3% increase in August. A major source of weakness was in the prices received by wholesalers and retailers. As the U.S. Bureau of Labor Statistics helpfully points out, nearly half the decline in prices for final goods and services, was in machinery and vehicle wholesaling, which fell by 2.7%.¹ Other cyclical goods and services also saw price declines,

including light trucks and various chemical products, as well as transportation and warehousing services.

For corporate America – and its shareholders – the apparent lack of pricing power in cyclical sectors comes at a critical time. "In the longer term, it could mean lower margins and ultimately lower profit growth," points out Christian Scherrmann, U.S. economist at DWS. Moreover, various sectors tend to follow each other, usually with some time lag. For example, goods producers already suffering from the trade war might eventually cut back on certain services. Conversely, car wholesalers who just had to markdown their existing stock, might order fewer cars next month, eventually spreading the pain to freight transportation and carmakers alike. Moreover, corporate profits, as measured by national income statistics have already been running out of steam for several years, as our "Chart of the Week" shows. "If core producer prices now start to get squeezed too, that is certainly not a positive sign for profitability," explains Christian Scherrmann.

¹ <https://www.bls.gov/news.release/pdf/ppi.pdf>



* National Income and Product Account

** Corporate profits before tax with inventory valuation and capital consumption adjustments

Sources: Haver Analytics, U.S. Bureau of Labor Statistics, Bureau of Economic Analysis as of 10/16/19

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GLOSSARY

U.S. Bureau of Labor Statistics (BLS)

The **U.S. Bureau of Labor Statistics** is part of the U.S. Department of Labor and is responsible for measuring labor-market activity, working conditions and price changes in the economy.

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