EZY ECONOMICS

THE WEEKLY 5

08/02/19

Here are the five economic stories which have caught our eye this week:

Economic Doom and Gloom

2019 GROWTH FORECASTS				
SPAIN	FRANCE	UK	GER.	ITALY
2.1%	1.3%	1.2%	1.1%	0.2%

All figures correspond to forecasts estimated by the European Commission apart from the UK's Bank of England forecast.

Thursday saw the release of the Bank of England's first quarterly inflation report in 2019, just two months shy of the UK's scheduled departure from the European Union. This report is produced by staff within the central bank alongside the guidance and assistance of the Monetary Policy Committee (MPC). In essence, the report is produced to provide a framework which supports and encourages a forward-thinking attitude towards implementing monetary policy decisions such as interest rate changes.

This report seemed to mirror the concerned tones of editions in 2018 and was rather sobering for anyone looking for some trace of optimism about the projected health of the UK economy. The bank downgraded its outlook for the UK's 2019 growth rate from 1.7% to 1.2%. This is significant because an annual growth rate of 1.2%, if this prophecy does become true, would be the weakest growth rate since the devastating effects of the financial crisis and recession in 2009.

Amidst the backdrop of tumbling growth and significant uncertainty the bank also sent signals to markets that now is not the time to continue to push for higher interest rates. The expected anaemic growth rate of the economy will not be able to cope with an environment of higher borrowing costs and, if anything, the bank is more likely to cut interest rates below their current 0.75% level than raise them at this stage.

This seems to be consistent with the Bank's continued efforts to allow inflation to slightly overshoot its two percent inflation target in order to provide the economy with the adequate breathing space required to trudge along even in the most disruptive of Brexit scenarios.

The bank also focused on the outlook for business investment and has forecast that levels of corporate investment look set to tumble by 2.75% by the time the year is out. This worrying trend is spreading towards the housing and construction sectors and is projected to hit the long-term potential of the economy and restrict real wages increases.

However, the Bank has acknowledged some of the underlying issues of the models used to forecast different Brexit scenarios. This meant the Bank responded by publishing a series of alternative forecasts to complement the ones published last year. The main technical difference between these forecasted scenarios was the inclusion of Brexit scenarios in which the cloud of uncertainty shrouding the UK appeared to dissolve at a quicker rate than previously modelled because of a "fluid" political system. This provided an optimistic undercurrent of over 2% growth 2020-21.

Assess the costs and benefits of a central bank providing forward guidance to markets about the future course of direction for interest rates.

Eurozone Debt Crisis 2.0?

Italy has never been used as a high-profile example of economic resilience, instead it has been continually suffered with growth figures that appear shoddy in comparison to some of its geographical neighbours. Last week Italy officially tipped into recession after recording two consecutive quarters of negative growth. The latest quarterly growth figure was -0.2% and the economic fortunes of the country seem consistent with the sluggish economic numbers published across the entire eurozone. Growth across the eurozone was at just 0.2% and the average across the expanded EU was just 0.3%.

Why do the numbers surrounding the Italian economy gain so much traction amongst commentators? This is because Italy's economy has been fuelled by debt ever since the financial crisis. The Italian economy is valued at a level below that of its pre-crisis level in 2007 so clearly economic growth has been hard to come by. The level of government debt belonging to Italy stands at £2tn and this equates to a debt-to-GDP ratio of 132%. To put this into perspective, Italy is the 23rd most populous country in the world, but it has the fourth largest debt pile in the world. The worry for investors and countries is the exposure that they have to this rising level of debt if Italy continue to run into economic problems.

Economic fears around Italy are exacerbated by that fact that, despite these economic headwinds, the country's recently elected populist coalition continues to harbour the ambitions of an expansionary budget. Even though the government have been forced to reign in these proposals, there is no doubt that the government will try to force through further expansionary budgets to deliver on their election pledges.

If the Italian economy continues to be anchored down by the disappointing performance of the agricultural, fishing and export sectors then an even bigger financial blackhole will need to be plugged. Lower levels of economic growth contribute to a decline in government tax receipts and further the need for future borrowing. This could spark more fears about the stability of the eurozone as whole. Many investors will wake up in cold sweats remembering the financial pain of the Greek debt crisis and hope for a different outcome this time round.

Using a diagram, assess the implications for Italy's economy if the country had the ability to devalue its own currency to boost competitiveness.

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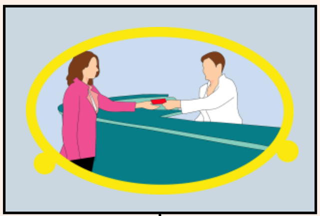
The Economics of Booking a Room



This week a ruling by the Competition and Markets Authority (CMA), the UK's leading competition watchdog, outlined to hotel booking sites that more clarity needs to be introduced on their websites surrounding the "special deals" that are offered when customers search for a room reservation in a hotel.

The firms themselves specialise in connecting customers with available rooms and suites in hotels around the world to meet the specific customer needs. However, the firms, including Expedia and Booking.com, have been accused of using "misleading tactics" to pressurise and encourage customers to make a booking. One of the concerns outlined by the watchdog was the act of sites claiming rooms were more popular than they actually were. This creates a highly-pressurised environment for customers when booking a room and can lead people to make bad and irrational choices and decisions.

The CMA is due to regulate the entire sector to ensure that these practices are not as widespread as first feared and has demanded that any firm in this sector, whether they are under investigation or not, quickly implement the following:

- To improve transparency around the ratings system used to rank hotels on their websites.
- To improve the transparency around a hotel's popularity and the level of demand that it faces.
- To improve the transparency around promotions and discounts applied to certain bookings.
- To improve the clarity of the signposting of additional hotel information such as taxes and bookings fees.

In relation to some of terms you may have come across in behavioural economics, assess the cognitive biases that come into play when firm's use these types of "misleading tactics".

Define the term 'imperfect information' and explain why it is important for competitive markets to function.

Project After

As the clock ticks down to the 29th March – the UK's official departure date from the EU – minds are beginning to focus with greater intent on the true repercussions of a no-deal Brexit.

The civil service (the team of public servants behind the politicians) have begun to draw up plans for economic policies that can be instigated in the event of a disruptive Brexit scenario. Some may say this type of plan is long overdue, but this project dubbed 'Project After' attempts to outline the policy roadmap for the UK to enact in the case people's worst fears become a reality.

The policies put forward in this proposal represent a blend of traditional policies such as supply side reforms, as well as more progressive policies such as tax and tariff reforms.

Explain why the decision to leave the European Union is more likely to have a greater supply side impact than the demand side effects.

With the aid of a diagram, assess the economic implications of the government implementing a series of demand side stimulus policies to deal with a negative supply side event like Brexit.

Let The Race Begin!

THE WORLD BANK

This week, the US President, Donald Trump put forward former Bern Sterns Chief Economist, David Malpass as his candidate recommendation to take over the top job at the World Bank.

The World Bank is an international institution that was formed in 1945 to help grease the wheels of the international financial system so that financial assistance can be directed towards developing countries. The group has traditionally focused on providing aid to countries for the purpose of constructing large capital investment projects. The group's mission objective is to continue to reduce the rate of poverty across the world to create a fairer and more equal system.

The funding for the World Bank comes from the group's shareholders like any other business. However, in the case of the group, its shareholders are countries instead of people. The US is the largest shareholder of the World Bank and therefore leads the group on issues such as Presidency selection. The group is composed of 189 countries and therefore shareholders.

Trump's recommendation is steeped with controversy because of his past advisory roles to the President, as well as his views towards the effectiveness of the World Bank as an international financial institution. Malpass has had high-powered city roles acting as an economic advisor to some of the largest banks on Wallstreet, but got caught up in the sticky financial web weaved by sub-prime mortgages. Most recently, he served as a senior economic advisor to Donald Trump.

Over the years the 62 year-old has criticised some of the actions taken by institutions such as the World Bank. His main area of concern is the direction in which funding has been allocated to certain countries. He believes that too much funding has been given to countries such as China and India and not enough has been distributed to some of the other poorest countries.

Assess the role that institutions such as the World Bank and IMF have in supporting the growth rate of developing economies since 1940.