EZY ECONOMICS

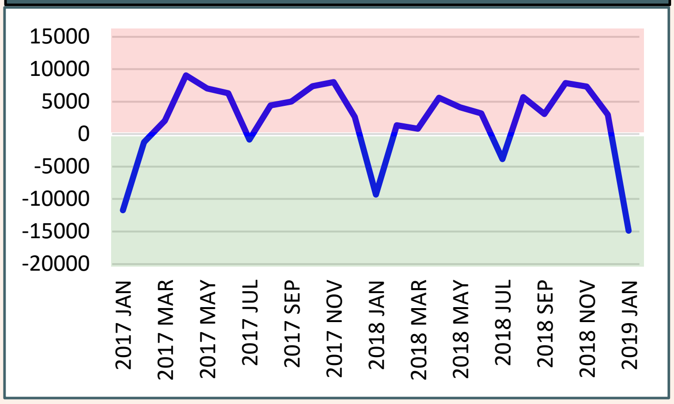
THE WEEKLY 5

**01/03/19**

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

## Bumper Budget

**Public Sector Net Borrowing (£m)**




The treasury received a welcome boost to public finances last week. The UK's budget surplus during the month of January was at its highest monthly level since 1993.

Income from tax receipts exceeded the government's public spending commitments by £14.9bn. This was £5.6bn ahead of last year's figure for January and much higher than had been forecast by independent economists and think tanks.

In economics, we can statistically measure the budget position by looking at the Public Sector Net Borrowing. If this is positive it means the government is borrowing during that month to facilitate the spending commitments in light of a shortfall in tax receipts. However, if the figure is negative, this indicates that the government is no longer borrowing and can actually use the money to pay off past debts or re-invest back into the economy.

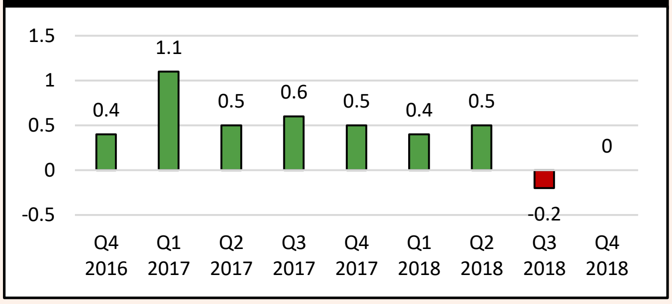
If we scale these figures up and look at borrowing in the current financial year to January, the figure stands at £21.2bn. This is the lowest year-to-date figure in almost two decades.

Explain why the level of Public Sector Net Borrowing affects consumer and business confidence.

Evaluate the impact of the government using these borrowing figures to justify an increase in government spending.

## Germany's Economic Slowdown

**Germany's Quarterly GDP Growth Rate (%)**




The German economy has often led the way when it comes to economic growth across the Eurozone, but maybe things are starting to change.

Countless references over the years have been made in relation to the German's manufacturing efficiency and pedigree. German cars, machinery and capital goods are the envy of the world, making Germany the largest capital exporter in the world. The country also has the largest current account surplus of any country in the world – 8% of German GDP.

Despite all of this though, the Germans most recently avoided the unwanted recession tag because they managed to squeak a neutral growth figure for the fourth quarter of 2018. Some commentators have even speculated that this figure was only neutral because of the fact that there were more days in the fourth quarter compared to the third quarter!

Why this quick economic turnaround? An industrial slowdown appears to be stimulated by a sharp downturn in the confidence and spending commitments of some of the country's biggest trading partners – US, China and the UK.

Discuss whether you agree with the view that a country should stick to its core economic competencies ahead of further economic diversification.

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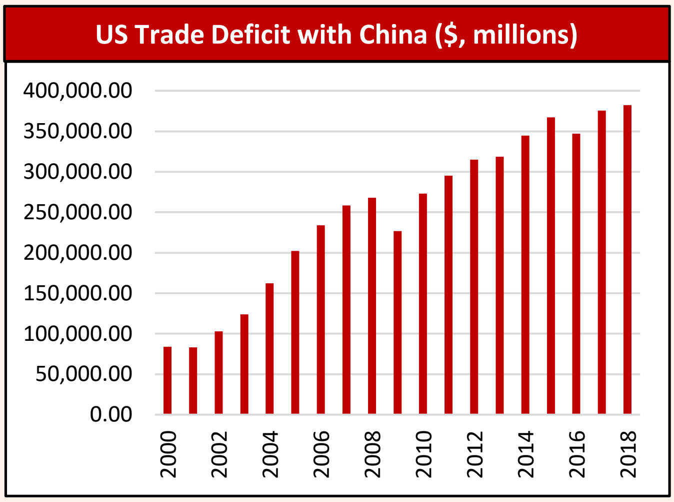
## Top Trumps




This week, the former chair of the Federal Reserve (US Central Bank) accused the current President, Donald Trump, of lacking the required economic knowledge around monetary policy to pass comments about recent US interest rate changes.

To put this into context, Trump has been characteristically bombastic when it comes to calling out the Fed in relation to decisions in recent times to gradually raise US interest rates. On one particular occasion he has claimed that the US central bank are “crazy” and represent the “only problem” in the US economic system.

Janet Yellen, former chair, has defended the Fed’s move to raise interest rates by claiming that Trump does not understand “the Fed’s goals are maximum employment and price stability”. The US unemployment rate stands at 4% and inflation rate is close to 2%.

She also raised an interesting point regarding his determined focus to renegotiate much of the US’s trading relationship with China. She argues that focusing on bilateral trade deficits when setting your own economic policy agenda is not appropriate.

The US is currently locked in a trade battle with China. Negotiations are currently taking place to prevent further tariffs being applied on Chinese goods. The US’s trade deficit with China in goods has grown to almost $400bn under Donald Trump’s administration.

Explain why it is important that central banks raise rates when the levels of employment and inflation are high.

To what extent do you agree with the view that trade deficits are always undesirable for an economy.

In reference to the J-Curve Effect, discuss why measures to reduce a trade deficit may not always be effective in the short-run.

## Rail Franchising Model

The franchising model has worked effectively for firms in the fast food industry like McDonald’s and Subway, but has it worked as well for the firms operating train services in the UK rail industry? The answer to that question is no, if you go by the initial findings of the man in charge of conducting a thorough review of the effectiveness and efficiency of the UK’s rail industry.

Rail franchising works on the basis that the Government owns the infrastructure such as the railways, signalling equipment and stations, whilst the services on those routes are contracted out to private companies that run the services on a fixed-term franchise. These companies are sometimes referred to as Train Operating Companies (TOCs).

Many see the franchising model as an inefficient system in which stifles competition and innovation, resulting in higher fares and falling punctuality. This year saw a 3.5% increase in ticket prices, whilst railway punctuality slumped to a 13-year low – one in every seven trains were delayed by at least 5 minutes.

The Rail Review will begin to publish its findings in 2020 on the appropriate measures that are expected to be taken to upgrade the UK’s franchising system.

Explain why the UK rail industry is a natural monopoly.

Discuss how introducing more competition within routes can generate economic and social benefits.

Imagine you are part of the team in charge of submitting the rail review to the government, what would be the three policy recommendations that you would put forward. Justify your recommendations.

## Liquidity Assistance

The Bank of England this week has provided reassurances to the UK financial system of the ability to access funds if needed in regards to a disorderly no-deal Brexit.

The Bank has publicised a series of measures that will be extended to commercial lenders if the effects of Brexit trigger a financial crisis or credit crunch. You can expect that these measures will mirror some of the liquidity measures that the Bank took immediately after the result of the referendum to stabilise the banking system.

Define and explain the term liquidity within the banking sector.

Discuss how and why a liquidity crisis can take place in a commercial bank.

What banking regulations have been put in place to prevent liquidity crises?