EZY ECONOMICS

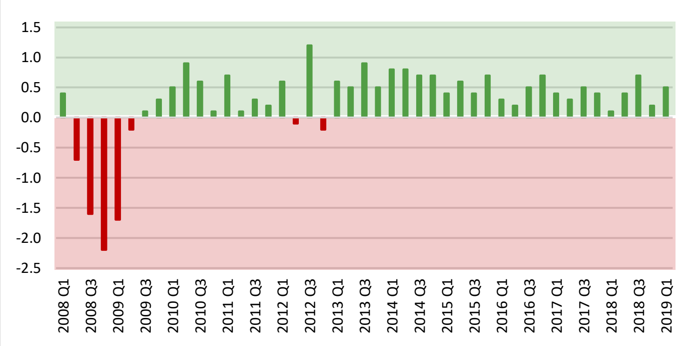
THE WEEKLY 5

17/05/19

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

Stock 'em High

UK Quarterly GDP Growth Rate (%)



This week, the ONS released the latest quarterly growth figures for the UK economy. The headline growth figure for the first quarter of the year (Jan-Mar) stood at 0.5%. This represents a slight improvement on 2018's fourth quarter growth figure of 0.2%. This may not seem significant, but if we compare the GDP value in this quarter to the equivalent quarter in 2018, GDP grew by 1.8%.

The gradual pick up in economic growth has been driven by some general improvements in the value of the UK's traditional AD components. Household spending grew by 0.7%, to reflect the strong employment conditions in the UK labour market. Government spending has also increased by 1.4%, to reflect the government's increased commitment to Brexit planning and central government functions.

Perhaps the most interesting trend of all though, extends to the latest business investment figures. Until this quarter, business investment has steadily fallen in each and every quarter in 2018. Many attach the blame to the uncertainty surrounding the UK's future trading relationship with the EU. However, in the first quarter of 2019, business investment increased by 0.5%. Overall, business sentiment towards investment projects remains relatively weak, but if we delve deeper into these numbers, it suggests that firms are accelerating investment decisions to build up the amount of stock they hold in reserve.

Stockpiling is the term used when businesses scramble to hold as much stock (finished goods, raw materials or intermediate goods) as possible to insulate themselves against potential post-Brexit supply chain disruption. The inventories being stockpiled by UK firms has significantly increased by £5bn. This activity has contributed considerably to the quarterly growth rate of the economy.

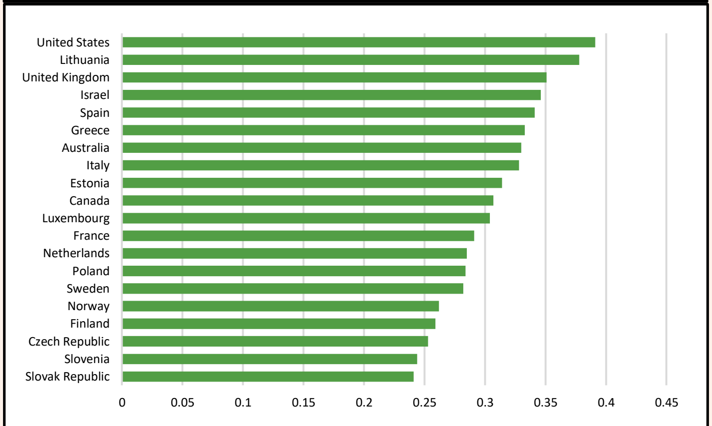
You might think that this provides some positive imagery of a shock-proof UK economy. However, many components and supplies are acquired from abroad. This is reflected in the UK's latest trade figures. The UK's Import volumes increased by 6.8% contributing to the country's widest trade deficit with the rest of the world in half a century (3.4%). This has eroded away some of the gains made across the other AD components during this quarter.

Discuss the differences that exist in calculating the GDP of a country using the income, expenditure and output approach.

With the aid of a diagram, assess the impact that a fall in the value of the pound and trade tariffs will have on a manufacturing firm that buys and sells from the European Union.

Review of Inequality in the UK

2016 Gini Coefficient of Selected Countries



Income inequality is a politically sensitive discussion point for economists, politicians and policy makers to navigate around. The UK, like many developed nations, has not performed particularly well in this performance area if traditional inequality indicators are anything to go by. The UK has seen little improvement in its Gini Coefficient in the last two decades, and now only lags behind the US and Lithuania in this measure according to the OECD.

This week the Institute for Fiscal Studies (IFS) published a comprehensive five-year review into the level of inequality within the UK. The report attempted to assess the consequences (positive and negative) of the growing divides that exist in the income, wealth, health and consumption outcomes of different income holders in society. To do this, the review shines a light on the main indicators driving the growing divide that exists between the highest and lowest earners.

One area the report reflects on is the growth in the average salary of company bosses relative to that of the "average worker". The review suggests that since 1998, the average CEO salary of the top 100 UK companies has increased from 47 to 145 times the average salary since the late 1990s.

What are some of the reasons for this? The IFS have classified the causation factors into two categories – domestic and international factors. Domestic factors relate to the weakening positions of power of low income groups in society. The correlation of this with declining trade union membership cannot be casually dismissed. The international factors discussed relate to the impact that globalisation and technology have had on the market power of firms.

Show how the Lorenz curve and Gini coefficient can be used to illustrate increased income inequality in the UK.

With the aid of a diagram, explain how the presence of trade unions can help reduce inequality.

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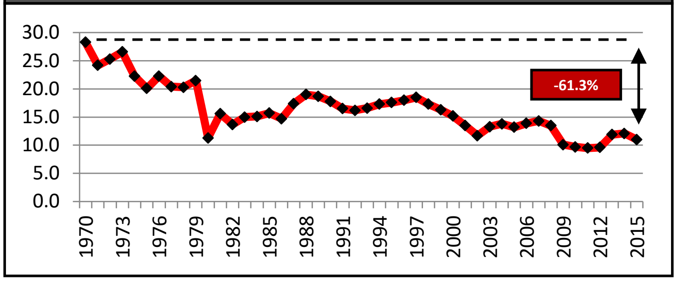
Plight of British Steel

British Steel formed from a takeover of Tata Steel in 2016	
Employees	4,000
Main steel production site is in Scunthorpe	
Seeking £75m cash injection	

UK Steel Production (millions of tonnes), 1970-2015



In 2016, the UK steel industry received a critical hammer blow from India's Tata Steel, who at the time, employed approximately 15,000 steel workers in the UK. An announcement was made to sell its loss-making UK steel plants in light of 'rapidly deteriorating' operating conditions. These traditional steel assets were sold to a private company for the small nominal price of just £1, with further financial assistance of £400m granted since then.

One of the main reasons for the steel crisis was the emergence of China as an economic superpower. China has been averaging a growth rate of 10% in the three decades running up to 2010. A major contributor to this growth has been the Chinese steel industry. The increase in capacity of this industry reflects the strong steel demand forged from a domestic investment boom. China spends approximately 45% of GDP on investment, with government spending to accelerate infrastructure construction a major component. China now produces half of the world's crude steel (822 million metric tonnes), a 722% increase in steel production compared to 20 years ago, and has become the world's largest producer of steel.

This week, British Steel announced that it would be seeking financial assistance from the government to ensure that it can maintain its existing trading position. The company cites "Brexit uncertainties" as the main cause of the problem. The company has faced weaker demand from the European market due to disruption caused by the Brexit negotiations.

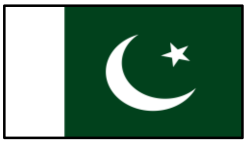
The company is seeking a financial package of £75m to sure up its cash flow position and provide the safeguards needed to protect British Steel workers. The company currently employs 4,000 workers and also contributes to significant business activity in the wider supply chain.

The dilemma for the government is whether it is politically and financially sensible to provide the company with the lifeline it needs to help stay afloat in weak market conditions. If the cash will just be used to plug a short-term financial hole, will the firm run into similar problems later on down the line?

On the other hand, If the firm is allowed to run itself into the ground, this could be a bad political move, but also introduce wider supply chain disruption during a time when business confidence and sentiment is already incredibly weak. This is why some have advocated a temporary takeover deal by the government to nurse the cash strapped firm back to health.

To what extent do you agree with the view that the government should intervene to save British Steel?

Pakistan's IMF Lifeline



2018 Growth Rate	5.2%
2019 Growth Rate Forecast	3.9%
Pakistan Debt-to-GDP Ratio	72.1%

This week the IMF agreed to provide a $6bn financial package to Pakistan to help ease the economic pressures facing the country and its recently elected PM, Imran Khan. The loan payments will be dispersed over a three-year cycle and this will be the 12th international bailout agreement that Pakistan has received from the institution since 1980.

In economic terms, Pakistan has experienced many turbulent growth phases due to the mismanagement of public funds and the failure of economic proposals. The boom-bust cycle that is traditionally witnessed in emerging economies has contributed to an unstable economic picture.

The country is facing an extremely difficult headwind of economic events with growth predicted to drop-off sharply and inflation spiralling higher. This has raised concerns that the country's debt pile will become fiscally unsustainable over time and the impact on living standards could be harsh and unforgiving.

The country has also had to manage a growing current account deficit of close to 6% of GDP. So far, the country has turned to domestic mechanisms to manage this crisis by using its foreign currency reserves to fund critical import spending. However, time and money is running out for the country as foreign currency reserves now stand at just $8bn and additional support is required to manage the crisis.

Like all IMF support packages, a series of strict lending requirements have been enforced on the recipient nation to ensure that standards are instilled to avoid repeat episodes in the future. The structural reforms negotiated by the IMF will include bringing the country's budget deficit back towards sustainable levels, encouraging private sector enterprise and exchange rate liberalisation (a market determined exchange rate).

In groups, research and discuss the role of international institutions such as the IMF in encouraging economic and financial stability across the global economy.

Explain how a market determined exchange rate can act as an automatic stabiliser to help promote a sustainable growth path.

Evaluate the macroeconomic consequences of a government recording a budget surplus. In your view, should this be a desirable policy objective for a government?

Corbyn's Minimum Wage Pledge

The leader of the Labour Party Jeremy Corbyn, pledged this week that a future Labour government would introduce a higher minimum wage rate for the 1.3 million 16 to 17 year olds that are working in the UK. The current rate of £4.35 for workers under-18 would be abolished and replaced with a higher rate of £10 an hour.

"Equal pay for equal work" was how the Leader of the Opposition described this policy, which would mark an end to different minimum wage rates being paid out to workers of different age groups. The policy proposal is suggested to increase the under-18s take-home salary by approximately £2,500 a year. The argument for this type of proposal is that younger workers are being unfairly exploited by companies and this is discouraging those from working in the first place.

The arguments against this type of proposal conform to traditional labour market theory in economics. There are lots of factors which contribute to the value of an individual worker from an employer's perspective, age and the accompanying experience that comes with that, is likely to contribute significantly to the worker's marginal revenue product. A higher minimum wage rate imposed on companies may "price out" younger workers in favour of older and more experienced workers.

With the aid of a diagram, explain how a higher minimum wage applied to under-18s can "price out" out the employment of this age group across the economy.