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EZY

THE WEEKLY 5

EZY

HERE IS OUR WEEKLY NEWSLETTER ROUNDING UP THE KEY STORIES, FACTS AND FIGURES FROM THE WORLD OF BUSINESS AND ECONOMICS.

Shinzo Abe (Japanese PM, pictured above) cautiously hopes that this delayed fiscal initiative will generate the funds required to help Japan fight off future strands of deflation.

Japan's Sales Tax Plans

THE JAPANESE GOVERNMENT IS TO PERSEVERE WITH A TWICE-DELAYED SALES TAX HIKE TO HELP THE COUNTRY WRESTLE BACK CONTROL OF ITS PUBLIC DEBT CRISIS.

Since the turn of the century, the Japanese economy has been caught up in a devastating deflationary spiral. This represents longstanding issues in the underlying health of the Japanese economy and reflects wider demographic and social issues across the country. Despite positioning itself as the third largest economy in the world (according to IMF figures), it has slowly gained the unwanted reputation of being one of the slowest growing economies of the G7 (the collection of the largest seven economies in the world). Last year, Japan recorded an annual growth rate of just 0.8% in real GDP. Rather surprisingly, this just hovers above the average annual growth rate of 0.75% since 2009.

Now if you apply the theory of AD-AS analysis to the Japanese economy, you should quickly identify the link between weak growth and low inflation. Since 2000, the average annual rise in prices on everyday household essentials stands at 0.08%. This sustained lid on inflation might seem an attractive proposition at first glance, but it hurts the economy in several subtle ways. First of which is the impact that the sustained pressure of low prices has on the mentality of shoppers across the economy. Falling prices pose an agonising dilemma to shoppers over whether to buy now or buy later, in the hope of holding out to get more for each of their Japanese Yen. Purchase delays and stagnation in the retail sector directly undermine the bottom-line profitability of the private sector and in the long run damage the tax take of the government.

It is the central bank's remit in a developed country to ensure price stability through setting an inflation target that the monetary policy agenda should be committed to achieving. Japanese interest rates have been perilously close to the zero-interest trap door since the mid-1990s. This means the conventional route out of an ensuing cycle of weak economic and price growth is closed off. Other alternative instruments such as quantitative easing have been used, but as well as economic stagnation, there is no escaping the pressure that demographic changes in Asia's second largest economy is having.

Japan has a rapidly ageing population, with a median age of 46 currently, and forecasts up to 2040 suggest that for every child under 16 there will be three adults over 65. A shift to a more inactive population is likely to make the challenge of arresting deflation in the economy far more challenging. However, a shrinking population is also hampering growth prospects with the population predicted to shrink from 126 million to just 86 million by 2040. These demographic trends are arising due to a combination of high life expectancies (83.7 years) and low fertility rates (1.45). The IMF predict that the impact of ageing could potentially drag down Japan's average annual GDP growth by 1 percentage point over the next three decades. The fiscal burden of an ageing population, as well as the financial cost of preparing to host the 2020 Olympic Games means the government need to find ways of rebalancing the economy.

This explains why the Japense government this week have reluctantly pushed through a planned sales tax increase that was originally devised to come into play in 2014. The policy initiative will push the tax applied to basic household items from 8% to 10%. However, this is a tax change with a technical twist. The Japense government has haunting memories of previous increases of the main sales tax rate in recent history. In the 90s a rise from 3% to 5% triggered an election and the imminent downfall of the then incumbent government. In 2014, yet more backlash was felt from Japanese shoppers and voters around the increase from 5% to 8%.

To insulate consumers from the risk of this tax rise, the government have indicated that support will be on hand for those that need it, but the policy will still be pursued in order to help raise inflation. One of those support packages will come in the form of a 5% refund when purchasing a good with an electronic payment. This will more than offset the effects of a tax increase on consumers and encourage consumers to adopt means of payments other than cash.

The influential figure behind restoring Tesco's dominant position as the largest grocery retailer in the UK has resigned, leaving investors and markets pondering the future of the 100-year-old firm.

Tesco's Turnaround Plan Complete

THIS WEEK THE MAN NICKNAMED 'DRASTIC DAVE' ANNOUNCED THAT HE WILL STEP DOWN FROM HIS ROLE AS THE CEO OF TESCO AFTER FIVE YEARS AT THE HELM. HE IS CREDITED WITH TURNING AROUND THE FORTUNES OF TESCO AFTER A DAMAGING ACCOUNTING SCANDAL.

The year 2014 was a landmark year for a whole host of different reasons. It marked the year of the Scottish Independence referendum, witnessed the release of the hotly anticipated finale of the Hobbit cinematic series and saw Ed Sheeran top the charts with his second album titled X.

Meanwhile in the business world, Tesco, the UK's largest supermarket chain was swept up in the eye of a financial storm. The chain had just announced an accounting slip which concealed a £250m blackhole in its finances. The group's accountants booked payments before they were due in and overstated the firm's profit position. Temporarily this elevated the company's share price and valuation on the stock market and for a brief time elevated the company to new funding heights.

Upon the discovery of this financial window-dressing, the backlash against the company was fierce and unforgiving. The company was forced to issue three separate profit warnings across the trading year, part of which was down to the accounting fiasco and partly due to Tesco's retail business model being undermined by discount chains, Aldi and Lidl.

The company recognised the need for fresh leadership, a leadership style that would turn a blind eye to any misconduct and put an end to the suspected culture of comfort at the very top. That man was Dave Lewis, a man seasoned in experience of high-pressured jobs at the top of some of the biggest companies in the world such as wholesaler Unilever. This would be his most challenging venture - turn around the bottom-line profitability of the business by taking the fight to discounters, as well as cleaning up the conduct of the executive board to restore confidence in one of Britain's most recognised brands.

He began with a complete clean-up of the company's corporate governance structure. Immediately sacking any executive responsible for the accounting scandal, with professional external auditors drafted in from the City to instantly instill credibility in the company's finances.

On the business side of things, he began to take a brutal cost-cutting approach to the company's activities. His approach was that the company's costs had spiralled out of control in a trading environment full of increasingly cash concious consumers. Rather than grow their way out of these problems, he placed the spotlight on sourcing efficient savings and focusing on the company's core compentencies, a form of lean production. A series of ambitious new store openings were shelved and the format of Tesco's stores was simplified to put the focus back on grocery shopping and away from 'store experience' features that were costly and caused the firm to lose focus. The overall cost of this plan amonted to cost savings of £1.5bn and the restructuring resulted in 10,000 middle managerial positions being closed.

With costs stabilised, the company could begin to re-focus its effforts to arrest the slide in market share, revenue and profits to new entrants into the market. The traditional four pillars of the UK supermarket industry had turned a somewhat competitive industry into a market that showed all the hallmarks of being an oligopoly. However, since the financial crisis, consumers began to focus on price ahead of quality and this opened up the market for low-cost chains to capitalise on. The historically dominant firms had to respond quickly and Tesco immediately began pursuing price cuts across a range of products, opening new discount store formats and launched a takeover bid of a strategically important convenience wholesaler Booker. All of this helped turn the profit fortunes of the company from its biggest ever loss into a respectable operating profit margin of 3%.

The pressure of being a business CEO is intense therefore it should come as no surprise that Dave Lewis announced this week that he has decided to step down at the end of 2019 to give a new face a chance to capitalise on the sound foundations that he helped put in place. One would suspect that the challenge of maintaining the profitability figures under Dave Lewis' tenure might be an even greater challenge than what 'Drastic Dave' faced himself five years ago.

TESCO	2015	2016	2017	2018	2019
Total Sales	£49,583m	£47,859m	£49,867m	£50,993m	£56,883m
Total Revenue	£56,925m	£53,933m	£55,917m	£57,493m	£63,911m
Profit/Loss For The Year	-£5,766m	£129m	-£54m	£1,210m	£1,320m
Full-Time Employees	362,370	351,289	342,770	327,916	321,490
Market Share	29%	28.4%	28.1%	27.9%	27.7%

THE SCALE OF THE TURNAROUND: Financial Data for Tesco Group (2015-19), Data from Tesco Plc. Financial Accounts

WTO Ruling

The World Trade Organisation (WTO) has ruled that the united states may proceed with imposing tariffs on goods imported from countries in the European Union (EU)

A lot of focus has been placed on the simmering trade tension that exists between the US and China, but there has been little coverage on the longstanding trade issues between the US and the EU. The escalation between the two regions emerged after a row over state subsidies provided to their region's biggest plane manufacturers.

The whole dispute centers around the concept of fair competition and whether it is in the interest of the authorities in those regions to provide grants to their own companies to help them undercut domestic rivals when being sold in international markets.

The World Trade Organisation (WTO) is the ruling trade body that oversees any disputes between nations that are not bound by a trade agreement. Each case is referred to the WTO and a general tariff schedule is applied based on the case in question. As long as ***trade reciprocity*** is maintained (each country gets fair and equal treatment) the WTO will facilitate any trade decision a country wishes to impose on another.

In this case, US plane manufacturers accused the EU of granting loans at a discount rate to European plane manufacturer Airbus. The US argued the case that this provided Airbus with the secure funding to absorb losses and undercut US rivals such as Boeing when firms were bidding for contracts. The WTO has ruled in favor of the US and cited unfavorable state aid as the reasons for this. The US has been granted permission by the WTO to impose a series of import tariffs on a selection of different of EU goods. It is argued that the money collected by this tariff schedule can be used to provide additional support to those industries that have been undercut by the EU throughout this time period. The tariff schedule totals £6bn and includes a headline tariff rate of 10% on imported aircrafts from companies like Airbus.

This ruling is likely to see a trade retaliation from the EU and hurt a lot of individuals stakeholders in both the US, EU and global economy.

US-EU TRADE SPAT: The WTO ruling means that the US can proceed with placing import tariffs of £6bn on EU imported goods.

SUBSIDY DISPUTE: American plane manufacturer Boeing accuse the EU of subsidising the production of Airbus planes to undercut Boeing planes in international markets.

UK Economy at a Glance

HERE IS A SUMMARY OF SOME OF THE LATEST FIGURES FOR THE UK ECONOMY

-0.27% | Q2 GDP GROWTH

The UK experienced its first quarterly contraction in GDP since 2013 in the second quarter of 2019. This has prompted fears that the UK may fall into a technical recession (two successive quarters of negative growth).

3.8% | UNEMPLOYMENT RATE

The UK unemployment rate (% of adult working population in a job) is at a four-decade low with the growth in the self-employed and part time workers responsible for this sustained increase. The employment stands at a record high (76.1%).

1.7% | INFLATION RATE (CPI)

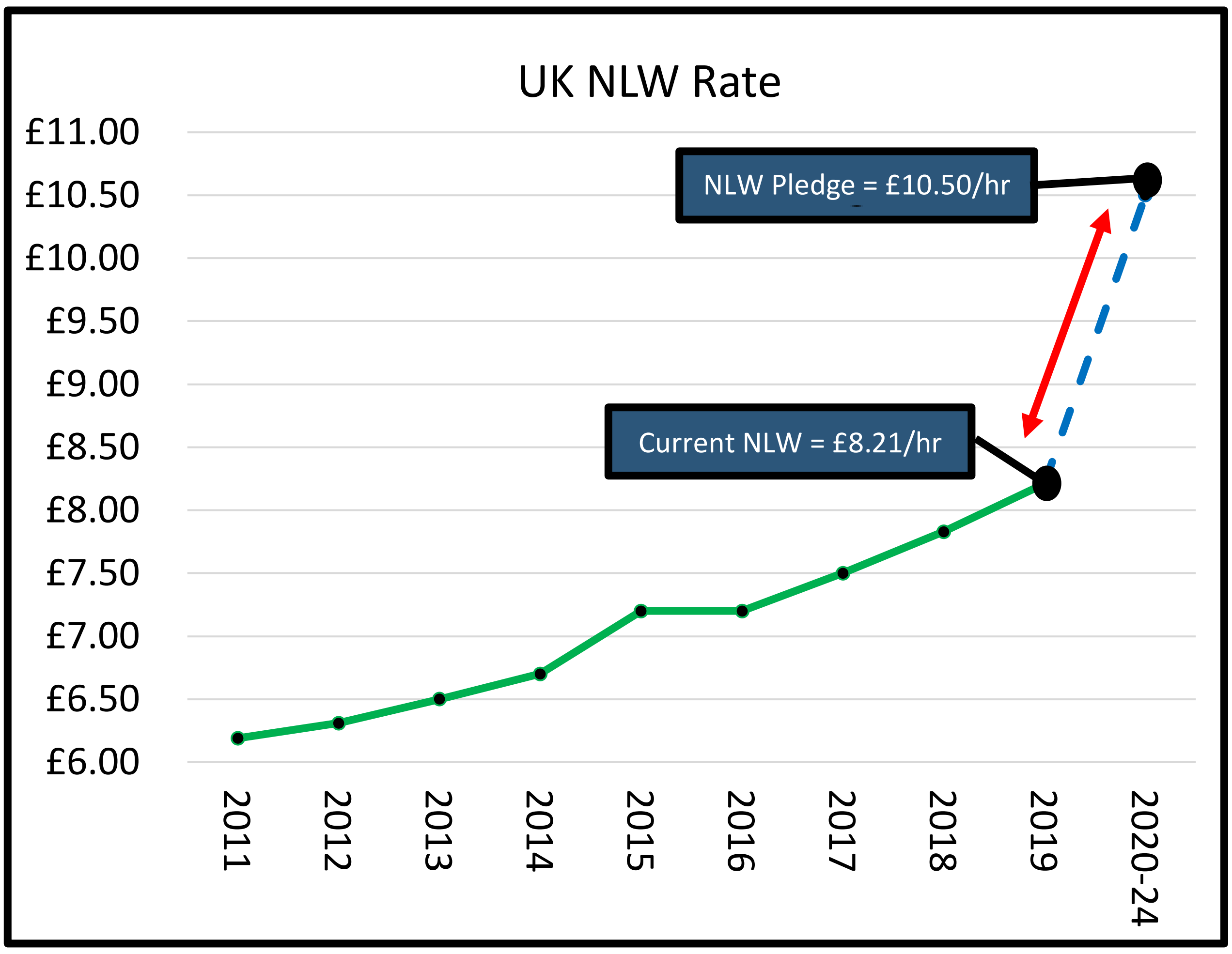
The monthly CPI inflation rate for August stood at 1.7% (30 basis points below the official inflation target) as higher oil prices and the fall in the value of the pound have fed through to the headline figure.

3.8% | WAGE GROWTH

Regular weekly earnings in the three months to July grew by 3.8%. If we take the inflation rate into account over this period, this indicates that real wages in the UK are on the rise.

0.75% | INTEREST RATES

The Bank of England has kept interest rates unchanged at 0.75%. The MPC have indicated that further interest rate movements will take place after the Brexit uncertainty has cleared. However, the decision of whether it will be a rate cut or a rate rise depends on the Brexit outcome.



UK National Living Wage

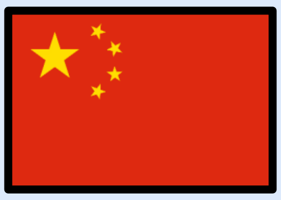
THE CHANCELLOR SAJID JAVID ANNOUNCED THAT THE CONSERVATIVE PARTY WOULD INCREASE THE NATIONAL LIVING WAGE RATE TO £10.50 AN HOUR BY 2024 TO BOOST LOW EARNINGS.

Party Conference season is always a moment for political parties to announce a series of headline-grabbing policies to energize their voters. This week was the turn of the Conservative Party and alongside a host of big-ticket infrastructure projects valued at £25bn, the Chancellor of the Exchequer announced a planned rise of the National Living Wage under the watch of a future Conservative government.

The National Living Wage (NLW) is a slightly different rate than compared to the National Minimum Wage (NMW) but has gained traction as a labour market policy tool since the Financial Crisis. Both rates bound employers by a set of rules to sufficiently compensate their employees with a wage that reflects the value of their work and effort. The NMW is a piece of national employment legislation that forces employers to pay their workers at least a fixed rate per hour of work based on their age group, whilst the NLW is a regional wage rate set on the basis of the basic cost of living in different areas. Therefore, London has a higher NLW rate than compared to other areas in the country.

This week, the Chancellor committed the Conservative Party to raising the NLW to £10.50 an hour. By doing so, the rate would be set at a level of 60% of median earnings. This is significant because the 60% income threshold is used to determine whether someone is defined as living in relative poverty. Even though we are still waiting for official costings on this policy, it is estimated to boost the pay of 4 million workers who are on an hourly pay grade below that. Many businesses will worry that they will have to absorb the extra cost of this policy pledge in future which may cause financial issues.

CHINESE ECONOMY IN THE SPOTLIGHT



THIS WEEK MARKED THE 70TH ANNIVERSARY OF THE FOUNDING OF THE PEOPLE'S REPUBLIC OF CHINA BY THE COMMUNIST PARTY. WE TAKE A LOOK AT THE IMPRESSIVE GROWTH AND DEVELOPMENT STORY OF THE WORLD'S SECOND LARGEST ECONOMY.

On the 1st of October 1949, the Communist Party of China made a historic declaration that would change the political and economic landscape of the global economy. The then Communist Party Leader, Chairman Mao, announced the creation of the People's Republic of China after a bitter civil war between communists and followers of the National Party. This would bring together rival factions within the large geographical space of the country and look to reform and develop the economy.

In the beginning, China was an isolated and closed economy that had to rely upon its own developed self-sufficiency to survive. Poverty rates were extremely high, life expectancy stood at just 35, the adult illiteracy rate stood at 80% of the population, trade with the rest of the world was shut off and political coordination with other countries was non-existent. The need for reform was evident and the country began its metamorphic transformation into an industrialised economy in the 1950s.

Firstly, a large social and economic campaign called 'The Great Leap Forward' was announced, with an aim to industrialise large sections of country and move away from the country's agrarian roots. The plan was to boost industrial output by developing industries such as steel, as well as ploughing significant investment into large state infrastructure projects. These industries were concentrated in some of the country's largest towns and cities and the urban population in these cities swelled beyond control.

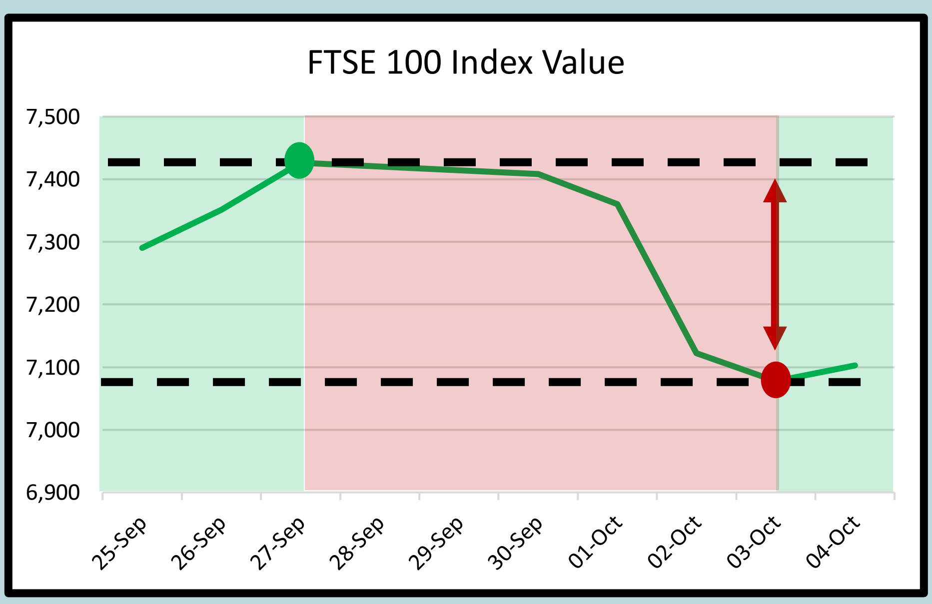
This demographic change put huge strain on an inward-looking economy and resulted in severe food shortages due to underdeveloped agricultural sectors. A rationing system was brought in to control food supplies in these urban regions, but this had devastating effects for those priced out by this system and resulted in up to 40 million people dying over the course of a 10 year period. The effects of this policy disaster haunted the country and created social tension and a breakdown in trust amongst communities ravaged by poverty. It was not until the 1970s that China began to recover and realised its powerful potential on the world stage. In 1979, the US and China ended a period of diplomatic silence between the two nations and paved the way for external assistance to fund China's internal development.

Foreign investment swamped the big cities of China, as US companies began to use the country as a production facility due to lower labour and land costs. For example, the average worker in China gets paid 87% less than the average UK worker. More and more Western companies saw this as an opportunity to boost their own competitiveness and China was the happy recipient of this inward investment. The money allowed China to improve and develop its own human capital and develop stronger infrastructure. The product of this uplift in economic activity was that China was recording growth figures that even countries like US were deeply envious of. The economy averaged an annual growth rate of 10% over the course of each of the last three decades (80s, 90s, 2000s). This culminated in the Chinese economy being valued at close to $20tn, which made China the world's second largest economy, behind only the USA.

A big part of China's success stemmed from embracing its position as a net exporter of goods to the rest of the world. In the 1980's, China's share of world trade stood at just below 1% of global GDP, the country now exports over $4tn worth of goods every single year and is the world's largest goods exporter in the world.

The growth in trade and economic performance has brought through a significant number of cultural and social changes in the country. The Human Development Index for China has increased from 0.423 in 1980 to 0.727 in 2018, suggesting an improvement in living standards. It is estimated that 850 million Chinese citizens have been lifted out of the $1.90 poverty threshold and education standards have risen sharply with almost a third of the Chinese population now owning a university degree.

However, in recent years, growth in China has begun to tail off. Last year was the slowest annual growth rate that the economy had recorded since 1990. China's economy is over-reliant on export growth and trade figures are beginning to subdue due to several different factors. Consumer demand in China is weak and does little to replace lost momentum in the country's exporting performance. Economic policymakers in China have stressed that this is a natural transition period for China. After years of double-digit growth, the economy is moving into its settled stage of development. We should expect to see growth figures in China to remain relatively passive, but the focus should be on the quality of this growth and whether it is being directed into the right areas and not just on the raw numbers.



DATA: Chart that shows how the FTSE 100 Index Value has fallen over the course of the past week to record its worst weekly performance since 2016.

CHART OF THE WEEK

The FTSE 100 has recorded one of its worst weekly performances since 2016 due to Brexit concerns and rising geopolitical uncertainty.

The FTSE 100 is a stock market index that attempts to track the performance of the largest 100 companies listed on the London Stock Exchange (LSE) based on market capitalisation (Share Price x Shares Issued).

It is used a barometer of the strength of the UK economy as these firms represent firms that are responsible for a significant proportion of economic activity in the system. If the index rises it is a general sign that the UK economy is getting stronger, if it falls it is a sign of weakness in the UK economy.

This week has seen a dramatic drop-off in the valuation of FTSE 100 companies as a result of rising uncertainty over just a short space of days. If investors are unsure about the future trading environment for these firms, they will decide to park their money in safer assets rather than in stocks and shares. This sell-off will be reflected in lower company valuations and a lower FTSE 100 index value.

This is a great application of how index values are used to assess general trends. In this case, the specific index value is of little relevance, but it is the movement in this index value over time which provides economists, investors and commentators with a valuable tracker of performance. You need to be comfortable handling and interpreting index numbers across your studies.

Saudi Arabia's 2030 Vision

THE MIDDLE EASTERN COUNTRY HOPES TO MAKE VISITING THE KINGDOM EASIER AND MORE ATTRACTIVE FOR INTERNATIONAL TOURISTS TO VISIT TO HELP BOOST TOURISM TRADE AND DIVERSIFY THE ECONOMY AWAY FROM OIL.

The economic power of countries in the Middle East has often centered around the oil trade. If you take a look at a snapshot of the largest oil exporters in the world, 3 out of the top 6 are based in the Middle East. In fact, the largest oil exporter is the Kingdom of Saudi Arabia with 8.3 million barrels of oil exported to the rest of the world every single day.

Middle eastern countries are optimally located on grounds that are rich in oil and natural resource reserves, and given the valued nature of these commodities, it provides many of those countries with a significant bulk of their revenues. The estimated value of the Kingdom's natural resources is estimated to be close to $35tn.

The Kingdom generates just under 50% of its GDP through the oil industry and 90% of its export earnings through petroleum related sales. However, with global oil prices having already fallen significantly in the last five years, the Kingdom has begun to accelerate plans to end the reliance on the oil sector and to put reforms in place to focus on a post-petroleum fueled era.

This reform-based project is titled 'Vision 2030' and this week the Kingdom announced plans to open their markets up to foreign visitors. A new travel visa will be launched to encourage tourists to the region. It is hoped that this will encourage visitors, as well as help foster development in domestically based businesses through investment and commercialisation. It is hoped that the policies of this project will boost the country's tourist sector to 10% of GDP.

VISION 2030: Saudi Arabia hope to encourage international visitors to the area to boost the country's tourist sector.

THE WEEKLY 5

ECONOMIC CONCEPT OF THE WEEK

Trade Tariffs

TARIFFS REPRESENT A FORM OF TRADE PROTECTION. IT ENSURES THAT DOMESTIC INDUSTRIES ARE PROTECTED FROM FOREIGN COMPETITION BY IMPOSING A TAX (TARIFF) ON A SELECTED GOOD/SERVICE BEING IMPORTED INTO A COUNTRY. TRADE TARIFFS ARE ONE OF THE MAIN FORMS OF PROTECTIONISM THAT YOU NEED TO BE COMFORTABLE WITH DISCUSSING AND EVALUATING.

It involves imposing a specific tax on all selected final goods that are imported into a country. By doing so, this raises the final price of the good being imported into that country (Original Price + Tariff).

Domestic consumers and businesses are likely to reduce their consumption of this imported good as a result of the final price being higher (law of demand). If the reasons for imposing the tariff were to protect domestic industries (sunset or infant), domestic consumers are likely to turn to the cheapest domestic alternative of that good, restoring demand and activity in that protected sector. Another benefit of imposing a tariff on a good is that it can raise revenue for the government which can be re-distributed to suit domestic purposes and policies.

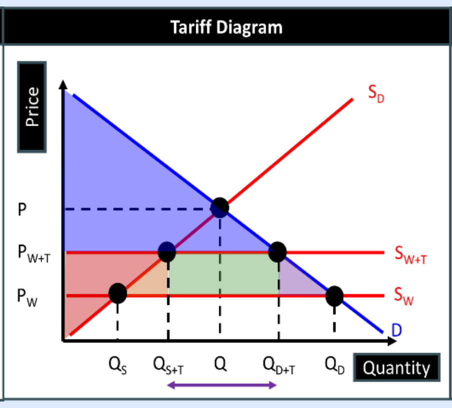
The imposition of trade tariffs moves out of line with the increased integration of the world's major economies (globalisation) through free trade agreements and trade blocs. It also goes against the theory of comparative advantage by protected less efficient domestic industries ahead of cheaper consumption alternatives for consumers.

You might argue that in some industries keeping alive a failing industry using tariffs may have its strategic advantages when it comes to trade negotiations, and war and conflicts between nations.

You are likely to be required to represent the impact that the imposition of a tariff is likely to have on a market using a diagram. It is important to take time to familiarise yourself with this diagram and how to notate the effects of it on different economic agents.

Tariff Impact	
Price of Imported Good	Increases
Domestic Demand	Falls
Domestic Supply	Rises
Quantity of Imports	Decreases
Government Tax Revenue	Increases

Tariff Diagram



Tariff Effects

- Post-Tariff Producer Surplus
- Government Tax Revenue
- DWL – Inefficient Production
- DWL – Lower Consumption
- Post-Tariff Consumer Surplus

Enjoyed what you have read so far? Why not challenge yourself with a few teaser questions based on the material found in this week's edition of the Weekly 5.

Calculate the percentage increase in the proposed National Living Wage Rate in four years' time to the rate set in 2013. Round your answer to 1 decimal place.

Explain three reasons why a country may impose trade tariffs on another country's goods or services. You may wish to use a diagram to aid your explanation.

Investigate and research the Japense economy and discuss two effective policies that would help stimulate growth and raise the inflation rate.

To what extent do you agree with the view that a firm should focus on reducing their costs through retrenchment strategies to improve performance ahead of trying to pursue higher levels of revenue by expansion.

In reference to a developing economy of your choice, explain the link between economic growth and development and discuss the impact that tourism and diversification can have on the growth prospects of that country.