EZY ECONOMICS

THE WEEKLY 5

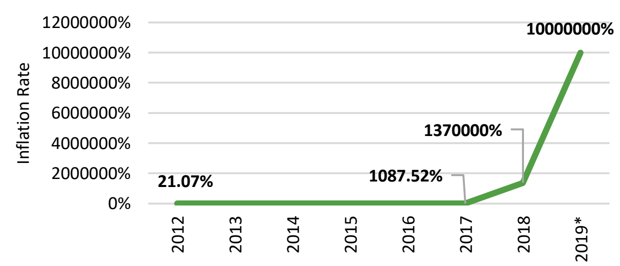
01/02/19

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

Venezuelan Crisis:

The economic and political crisis that has engulfed the South American country of Venezuela has seemingly deepened even further this week. The country which is situated on the north coast of South America is famous for its natural wonders, diverse culture and vibrant people, but in recent times these iconic features have been replaced with images of civil unrest, violent protests, rising crime, starving families and political skirmishes.

These images have been underpinned by a weakening domestic economic picture, that many locals believe is a result of a series of political and economic mistakes made by the past administration. Systemic levels of corruption that have shrouded past presidencies has resulted in the mismanagement of public funds. This has created unaffordable living conditions with inflation creeping towards 2,000,000%.



Some of the biggest problems have come from the economy's heavy reliance on oil revenues to sustain the country's fiscal position and plans. The Venezuelan economy has always been in a precarious position because of its extreme reliance on producing and selling oil to generate 90% of its revenues.

Heavy borrowing during the oil boom of the early 2000s has left Venezuela's national debt high. The debt levels were justified based on the revenue that was expected to arise from oil production. However, in 2014 the price of oil fell dramatically because of the rise of US shale fracking, the removal of Iran export sanctions and increased Russian oil production.

This economic strain has been reflected in the country by the deteriorating health of many of the country's citizens and the decision of up to three million Venezuelans to flee the country to escape the terrible living conditions. There is now a movement by the people and other foreign governments to force the incumbent president out to provide relief to the country's citizens.

Define the term hyperinflation.

Discuss the impact that increasing monetary stimulus has had on the inflation rate in Venezuela.

The Corruption Charts:

Rank	Country	Region	2018 Score	2017 Score
1	Denmark	Europe	88	88
2	NZ	Asia Pacific	87	89
3	Finland	Europe	85	85
11	UK	Europe	80	82

This week the 2018 results of the Corruption Perceptions Index was released by the non-governmental agency, Transparency International. The worrying news for the UK this week is that for the first time in the history of the publication of this index the country has fallen outside the top 10.

This is an index which attempts to rank 180 countries on the level of corruption which exists within the public sector of each nation. It is calculated by using the results of a detailed examination of the individuals that operate in that sector as well as the views of citizens and business people belonging to each nation. Once the results are collected a score between 0 and 100 is assigned to each country so that these scores can be quantitatively examined and interpreted. The higher the score, the cleaner the country.

The importance of measuring the prevalence of corruption in countries is not lost on economists because it is often associated with a breakdown in the democratic system that many of the world's most developed economies are built upon. Corruption can soon become widespread and begin to affect the efficiency and productivity of an economy.

Discuss and evaluate how the level of corruption that persists in an economy can affect a country's HDI score.

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Going For Gold:

Throughout history gold has been the one precious metal that has reshaped and revolutionised the way that monetary systems operate all over the world.

For instance, in the 1940's it was used to facilitate a stable monetary environment for developed nations that were beginning to recover from the physical and financial devastation of the Second World War. This was officially known as the Bretton Woods Agreement, which pegged some of the world's most widely-used currencies to the value of an ounce of gold.

The reason for this? Gold is often perceived to be one of the few safe haven asset classes that investors can turn to – in times of political and economic uncertainty the price of gold holds up. This is because unlike other currencies, gold is an asset that has a value and purpose established outside of the financial system (it is a metal after all!). Therefore many investors turn to gold when faced with days of negative returns and resell when markets have recovered.

However it's not just investors that trade in gold, central banks also take an active interest in this precious metal. Central banks have to hold reserves to in order to arm themselves with the financial firepower required to stabilise their own currency. Wild currency swings can dramatically alter the economic and trading performance of a nation and can contribute to vicious economic and political crises.

This week, data released by the World Gold Council highlighted the growing trend in which central banks are slowly building up their gold reserves. It is estimated that central banks now hold $1.4tn worth of the precious metal and in 2018 the volume of gold bought by these institutions rose by 75% on the previous year. This has contributed to the price of an ounce of gold hitting its highest levels since the beginning of 2017.

The catalyst for this change has been the fact that central banks are attempting to distance themselves from the US Dollar – the traditional foreign currency reserve of choice. The US Dollar has come under intense selling pressure in 2018 as a result of the risk exposure spilling over from global trade tensions. Central banks seem to be taking the approach that it is better to manage this risk by introducing a more balanced allocation of reserves to their balance sheets.

Discuss some of the benefits and costs of a country using a fiat currency to underpin their monetary system.

With the aid of a diagram, explain how central bank reserves can be used to preserve the value of a currency.

Chinese Slowdown:

Ever heard of the phrase "When the US sneezes, the world catches a cold"? Well it would appear that this metaphor is now being applied to China – the second biggest economy in the world.

China has established itself as one of the major economic players in the global economy. Most people are aware of the country's manufacturing penchant, but with a population size of 1.4bn the country has to establish many two-way trading routes with more developed countries to sustain living standards. Economically, China has a role to play in almost 35% of all the goods traded globally and contributes to 20% of the entire global economic activity.

However, in recent times the Asian powerhouse has begun to lose some of its economic momentum – 2018 was the slowest year for growth since 1990. This slowdown has been reflected in recent data publications on consumer sentiment, manufacturing data and retail sales. For many firms that rely on the Chinese market as a source of growth, this is problematic.

Assess the impact of the Chinese slowdown on each of the following :

Profits of a Smartphone Chipmaker	Investment Levels of European Car Manufacturers	Global Price for Commodities such as Iron Ore

Transfer Deadline Day:

FIFA

Thursday brought the curtain down on the January transfer window for European football clubs. This is the one-month period during the season in which clubs can reassess their goals and reinforce their squad with additional recruitments if needed. This window complements the three month summer window that most clubs use to significantly invest in their squad for the season ahead.

The traditional closing day of the football transfer window provides an added element of excitement away from the entertainment on the pitch for fans, media companies and newspaper gossip columns. The sight of clubs, managers and players scrambling to get a last-minute deal over the line never seems to get old, but the economics of this window make fascinating reading too.

In 2018, the total spend in the January window for English clubs amounted to £430m with £150m being spent on the last day. If we look at the top 5 European leagues this figure reaches £817m for just 31 days of trading. The year-on-year increases in spending by clubs is interrelated with the rise in foreign ownership of football clubs and increased investment from TV companies for match rights. This money has to go somewhere and it seemingly has flooded the transfer market, pushing up the signing fees, wages and salaries of all players on the market as well as agents.

It has often been argued that the weekly wages that some of the top football players earn these days is astronomical compared to other jobs in the economy and it looks certain to continue to rise and rise.

Using the concept of marginal revenue product (MRP), explain why professional football players can command higher salaries in their respective industry compared to nurses and doctors.