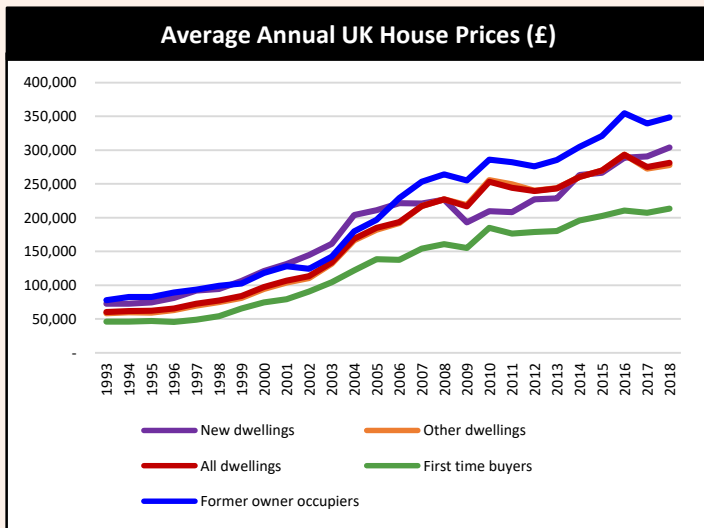


05/04/19

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

Slump in the UK Property Market



House prices in England have taken their first annual tumble since 2012 according to data released by the building society Nationwide. However, the data has shown that when this price index is calculated and applied to all UK homes, average property prices have still risen in value from a year ago.

In 2018, the average home in the UK was valued at £281,000 compared to £156,236 in 2005. In real terms, UK house prices have increased by 161% since 1996. However for the first three months of 2019, property prices in England fell by 0.7%. This is a marginal fall but a significant one in the context of improving social mobility and intergenerational inequality amongst individuals in the UK. Only 37% of 25 to 34 year-olds own their own properties compared to 67% twenty years ago. By contrast, home ownership has increased among older age groups.

So why the fall in house prices? The UK housing market is particularly sensitive to the strength of the UK economy. A change in house prices affects the value of household wealth, creating a positive or negative wealth effect for economic agents. House prices reflect both demand and supply, and, as in all markets, the equilibrium price of a house will occur at the price that matches current demand to available supply.

Many consumer and business surveys indicate a growing sense of caution taking over the buying and selling instincts of players in the property market. Many fear that the subdued sentiment in the housing market is likely to drag on due to ongoing political uncertainty.

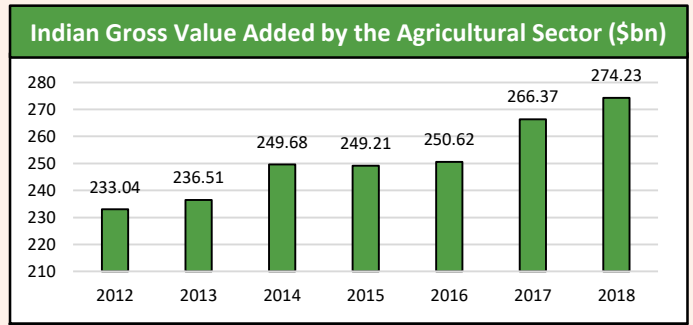
To 1 decimal place, calculate the percentage change in the average house price in the UK between 2005 and 2018.

With the aid of a diagram, explain two reasons why the supply curve for UK homes is relatively inelastic in the short-run.

To what extent do you agree with the view that consumer sentiment is the most influential factor behind house price growth in the UK.



India's Agrarian Roots



Next week the Indian national elections get underway and the incumbent PM, Narendra Modi, has made a series of political and economic pledges to keep India at the top of the economic growth charts.

As in any election or referendum campaign there are a series of themes which dominate the debate bandwidth and ultimately prove decisive in the end result. One of those contested areas in India is the income and welfare levels of Indian farmers. Despite the fact that the Indian economy recorded the fastest GDP growth of any country last year (7.3%), the country and its citizens still rely heavily on the agricultural sector.

The agricultural sector is the driving force behind the incomes of 58% of the population. As the economy begins to open up new trading and investment routes with the rest of the world, this increases the country's contribution to world food trade every year. The agricultural sector in India is efficient, cost-effective and generates high yields.

Many local farmers feel that they are being short-changed by the expansive economic plans of the PM and lament the increasing pressures being placed on them financially and psychologically. This means that this sector is a politically sensitive one for the government and PM. The government has pledged that by 2022, farmer incomes will double from the equivalent of \$1,505 to \$3,420 a year. Increased levels of investment into the sector will also drive improvements in irrigation and storage facilities, as well as further the growth in GM crop development.

There are sceptical voices being raised in regards to the delivery of these pledges. Farmers' incomes have increased by 40% in the three years to 2016, but crucially have only grown by 2% since 2017.

With the aid of a diagram, assess the impact on agricultural prices if farmers experience a good harvest.

Evaluate the impact of the government maintaining a minimum purchase price for Indian agricultural products.

Rate Rigging



This week saw two former Barclays traders prosecuted each with 5-year jail terms with conspiracy to defraud European financial markets. This case centres around the “rate rigging” scandal of the mid-2000s.

One aspect of the monetary policy transmission mechanism is that a change in the bank rate (the rate at which central banks charge private sector banks for loans) influences other interest rates across the economy. One of those interest rates is defined as the ‘benchmark borrowing rate’. This is the rate that banks charge each other to borrow from one another (interbank lending). This form of lending is more popular than you think, as it is cheap, relatively risk-free and quick and easy to source. The benchmark rate in London (LIBOR) underpins trillions of dollars’ worth of financial transactions.

The two men were charged on the basis of artificially influencing the main European benchmark rate so that they could generate huge profits off the back of their own trades. How does it work? A representative trader from each of the city’s banks would jot down an estimate for their expected borrowing costs from other banks i.e. How much would we be expected to pay in interest if we borrowed from Bank X today?

This was meant to be an honest and routine assessment of what the bank has been trading at the previous day. All the votes would then be submitted to an independent banking federation and an industry average would be taken. This average would represent, for that day only, the interest charge attached to loans between banks.

However, during the 2000s, some city traders decided to take advantage of this system and make tiny adjustments to the rate in order to profit from their own trades. Some traders had a position in the market that would benefit from higher rates, others had a position in the market where they would benefit from lower rates. There have been many stories produced over the years of traders colluding in online chat rooms to decide upon a collective strategy. Without the help from their colleagues, individual submission anomalies would be removed due to the process of taking an average.

Many traders that were involved in this process have defended any submission strategy that they had at the time. They argued that submitting a range of estimates was a sensible approach during uncertain trading environments.

Explain how interbank lending help maintain liquidity in the UK financial sector.

Assess two benefits and two consequences to the real economy of greater lending restrictions placed on banks operating within the financial sector.

To what extent do you agree with the view that financial institutions should only acquire emergency funds from the central bank?

Services Slowdown

This week the publication of a series of business surveys added to the jittery nerves of stakeholders in the UK economy. The surveys aim to monitor the general health levels of an economic system by surveying a diverse spread of different businesses and fielding them questions about how confident they feel about operating within the local business environment.

The results indicated a contraction in confidence – the first time this has been the case since the result of the EU referendum result. Why does this matter? If businesses and their headline investors are feeling uncertain about the future, it is unlikely that they will invest an even greater stake in the economy. The services sector comprises 80% of UK GDP, a retrenchment in this sector will have significant consequences for the UK economy as a whole.

The publication of these surveys are sometimes scoffed at by some in academic fields because of the unscientific approach taken to predict confidence levels. The reality is that these surveys may be imperfect but they help guide the institutions of influence about the likelihood of oncoming economic shocks.

Economic shocks are unexpected events that disrupt the very foundations of any economic system. How is it possible to predict an economic shock? Well an economic shock is often caused by two distinguishing factors. These factors are defined as exogenous and endogenous. Endogenous factors are built into economic models and theories and therefore economies can protect themselves from those sorts of disruptions due to the forecasting nature of their models.

However, exogenous factors are the ones that can render the results of an economic model inaccurate. These are factors which cannot be easily predicted using these models, but they affect the overall outcome of the model itself. The classic case of demand and supply provides an application of this issue. The demand and supply model is used to show what happens to the equilibrium price and quantity in a market, but these equilibria are heavily influenced by exogenous factors such as consumer tastes and confidence. It is very difficult for economists and forecasters to integrate an accurate measure of consumer sentiment into an economic model.

Explain why in many advanced economies, the services sector has become more influential whilst traditional industries have declined.

To what extent do you agree with the view that it is the government’s responsibility to prepare an economy for any economic shocks?

National Price Hike Week

	Mobile Phone Contract Prices	2.5%
	NHS Dental Check-Ups	5%
	Air Passenger Duty	10%
	UK TV License	5%

The first of April represents the start of the financial year for businesses and therefore represents the day in which consumers have to fork out just a little bit more to consume some of the everyday essentials.

It is estimated that the average household will have to find an extra £250 to cope with the price changes over the next 12 months as businesses re-adjust their prices to respond to changes in the base level of inflation.

Consumers may not like having to pay these extra charges but in the context of rising real incomes it would appear that the squeeze on living standards in the UK is smaller this year round than it has been for many years.

Define and explain how the price elasticity of demand (PED) of a good is calculated.

With the use of a diagram, show how a business’s total revenue depends on the PED value of a good.