How to understand the economy and how it affects your customers and clients

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1 Objectives

By the end of this workshop, you will understand how to:

- remain up to date with the key economic issues that will be of concern to your business and to your customers and clients without the need to become an economics expert

- spot the risks which will be of greatest concern to you and your customers and clients

- ask good questions when discussing economic issues with colleagues and with customers and clients

- foresee possible economic scenarios and methods to respond to economic changes.

2.1 The key measures of how the economy is performing

The key measures used to assess how the economy is performing are as follows:

Consumer Spending

Economic Growth

House Prices

Taxation

Government Spending

Bank Lending

Exchange Rates

Imports & Exports

Interest Rates

Inflation

Confidence

Employment and Unemployment

Differing GDP growth, unemployment statistics and interest rates at October 2018 selected countries

	GDP growth Annualised rate	Unemployment Rate %	Interest Rates % 10 year Gov't bonds
United States	+2.9%	3.7%	3.2%
Britain	+1.2%	4.0%	1.6%
Euro Area	+2.2%	8.1%	0.5%
India	+8.2%	6.4%	7.9%
China	+6.7%	3.8%	3.4%
Australia	+3.4%	5.0%	2.7%
Brazil	+1.0%	12.1%	8.4%
Singapore	+2.6%	2.1%	2.6%
Spain	+2.7%	15.2%	1.6%
Greece	+1.8%	19.0%	4.3%
Russia	+1.9%	4.5%	8.7%

Source: The Economist

2.2 Predicting the Economic Future

Interestingly, all of these economic measures are inter-related and arguments rage concerning which measures are most important when attempting to predict how the economy will perform.

Economic prediction has been likened to trying to drive a car in a forward direction with a blackened out windscreen and only the rear view mirror to guide you!

In 2007 the Bank of England proclaimed that “this is not an international financial crisis”. In August 2008, it said its “central projection” was for “broadly flat GDP over the next year or so”. In fact, the economy shrank by over 6%. Oops!

The Bank is currently spending £3.5m overhauling its forecast model because the previous one just didn’t work.

2.3 Economic Causes and Effects –The Economic Levers

Economic causes and effects do exist:

Growth in real wages (i.e. wage increases in excess of the rate of **inflation**) drive the level of **consumer spending** which accounts for a large percentage of activity in the economy. Increases in consumer spending improve sales in the manufacturing and service sectors so increasing **company profits** and hence **share prices**.

Increases in **company profits** allow companies to increase **real wages** and **invest** in new products, marketing campaigns, new technologies and innovation. This investment and resulting increase in consumer spending will increase the level of **activity in the economy** as measured by **GDP (Gross Domestic Product).**

A **growing economy** (increases in GDP) provides companies with the **confidence** and need to **employ more staff** and buy more from suppliers.

Increasing **employment** improves **consumer confidence** so consumers spend more and are prepared to **borrow** more. Some of this additional borrowing will be used to buy houses and can (depending upon the number of houses being purchased and the number for sale) lead to an increase in **house prices** which improves consumer confidence even further.

Of course, there has to be a degree of **confidence** in the economy and the ability of **consumers** to service loans for the **banks to be prepared to lend**. Banks also need confidence in the ability of companies to service loans if they are to **lend to companies** and help finance **investment** in new products, new technologies, etc.

The interest rates that banks are prepared to lend at have an impact on the amount that consumers and companies are willing and able to borrow. The amounts **borrowed** impact the level of **consumer spending** and corporate **investment** and hence the level of **employment/unemployment**, **real wages** and so on.

The value of **imports and exports** is also important to the economy.

The **Balance of Payments** refers to the difference in the value of imports and exports.

If exports exceed imports we have a Balance of Payments **surplus**. If imports exceed exports we have a Balance of Payments **deficit**.

By **exporting** goods and services, businesses increase sales and profits and help create **GDP growth**. They can then recruit **more staff** and **invest** in new products, etc.

How an economy is performing in terms of its economic growth rate has a direct impact on **exchange rates** which then has an impact on the level of **imports and exports**.

2.4 Public Sector and Private Sector

Much is made currently of the need for governments to cut the **Budget Deficit**.

The **Budget Deficit** is the amount that the Government or **Public Sector** has to borrow in order to finance **Government expenditure**.

It is normal for the Government to borrow because typically the amount that the Government receives in **Taxation** (personal taxes on wages, corporate taxes on profits, Value Added Taxes on consumer spending, other taxes such a Petroleum Revenue Tax and Duties on alcohol) does not cover the amount spent on education, health, defence, overseas aid and so on.

However, at present the amount that the Government has to borrow is excessive and costing the taxpayer huge amounts of money just to be able to pay the **interest** required by those organisations who have lent to the Government by investing in Government bonds known as **gilts**.

The **Private Sector** refers to all profit and not for profit organisations which are not part of the Government or Local Authorities.

2.5 Exercise in Groups

What could/should the Government do to create economic growth?

2.6 Economic Growth Drivers and Growth Brakes

Growth Drivers

- Increases in real wages
- More people in employment
- Increased exports
- Increased Government spending
- Reduced tax rates
- Reduction in interest rates
- Increased consumer confidence
- Increased consumer spending
- Increased corporate investment

Growth brakes

- Increases in unemployment
- Reduced Government spending
- Increase in tax rates
- Increased interest rates
- Reduced exports
- Reduced consumer confidence
- Reduced consumer spending
- Reduced corporate investment

3.0 The Key Economic Issues and Risks Faced by Clients

3.1 Exercise in Groups

You are on the Board of Directors of a large business in one of the following industry sectors:

- Airline industry
- Hotel industry.

For the industry sector assigned to your group, decide what you feel are the economic issues that would worry you the most and how you could respond to those economic issues?

Your industry sector………………………………………………………….

Which are the economic issues that would worry you the most?

How could you respond to the above economic issues?

4.0 How to Stay Abreast of Changes in the Economy

There are several useful sources of economic information and opinion to enable you to quickly and easily stay abreast of changes in the economy.

These include:

- The "UK Economic Outlook" report prepared by PricewaterhouseCoopers (PwC) which is available in pdf format from the PwC website
  www.pwc.co.uk/economics

- The Office for National Statistics website
  www.ons.gov.uk

- Reading the business section of a good daily newspaper such as The Daily Telegraph, The Times, The Guardian, The Independent and The Financial Times.