

Arne Jon Isachsen
28 January 2015

Economic and Political Challenges

- The World Economy
- The European Economy
- Oil prices – Effects on the Global Economy
- More on Exchange Rates

But first, some introductory remarks

President Obama, in his State of the Union Address, on inequality. Concerned about the middle class. And the republicans have to come up with something here too. Also, normalizing relationships with Cuba, through pope Francis. And Obama is changing immigration practices in the US. Latin America likes what they see. Is America taking back (from China) her neighbors in the South?

QE just started in Euroland – although Ms. Merkel did not like it. But Germany is only one country out of 19 and was overruled

Election in Greece – what will that bring? European Debt Conference? Remember, German debt was written down in 1953. Debt forgiveness – an emotional affair

... some introductory remarks...

Income inequality becoming less acceptable politically, thanks, in part, to the French professor Thomas Piketty.

One per ten thousand richest, 0,5 % of total income in 1973, up to 3,3 % in 2010, i.e. almost seven times bigger a share.

Share of income to top ten percent 1910-2010, in USA



Øverste desilandel av USAs nasjonale inntekt falt fra 45-50% i perioden 1910-1920 til mindre enn 35% på 1950-tallet (dette er fallet dokumentert av Kuznets); deretter steg den fra mindre enn 35% på 1970-tallet til 45-50% i perioden 2000-2010. Kilder og data: se piketty.pse.ens.fr/capital21c.

..... some introductory remarks...

Swiss National Bank stops intervening in market for foreign exchange, and the CHF strengthens considerably. Why did SNB change track? Denmark – next in line?

In China, president Xi Jinping keeps fighting corruption, beware Revolutions have a tendency to eat their own

In Russia, Putin feels the heat of economic sanctions and halving of the price of oil, but his popularity is soaring.

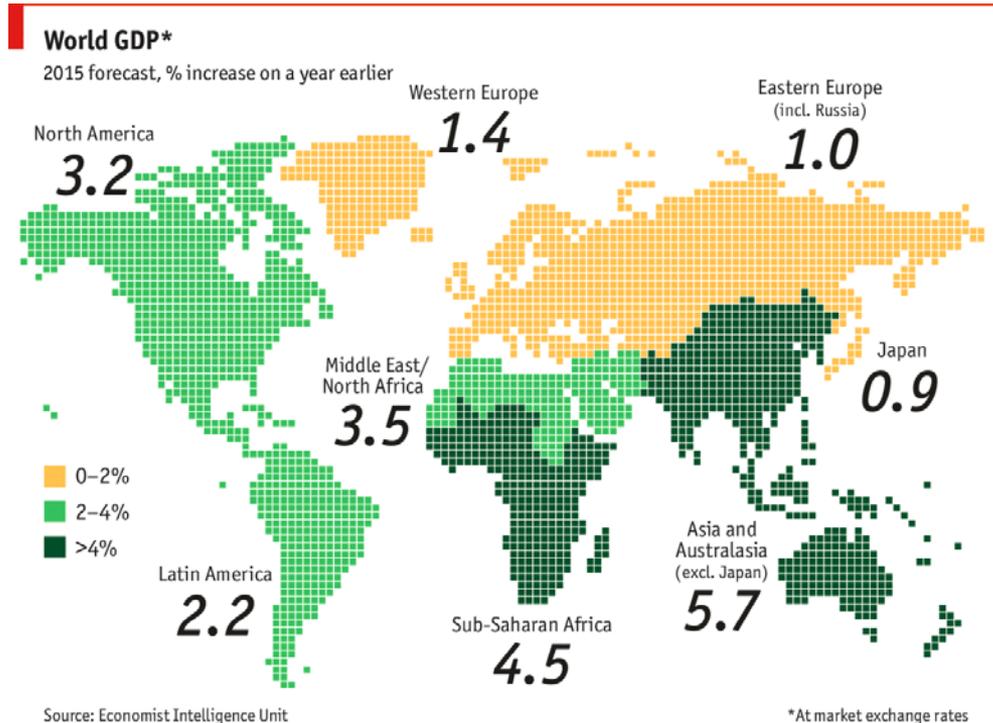
..... some introductory remarks...

In times of stress and upheavals (cf. changes in oil price and volatile exchange rates) it is hard to forecast with simple linear, economic models.

Comparing with earlier historic events can be quite useful, i.e. price of oil halved in 1985, and the price stayed low for a decade and a half.

A final observation – both China and Russia want to establish relations with other countries, without USA being involved. A multipolar world they would like.

The World Economy



Kilde: The Economist

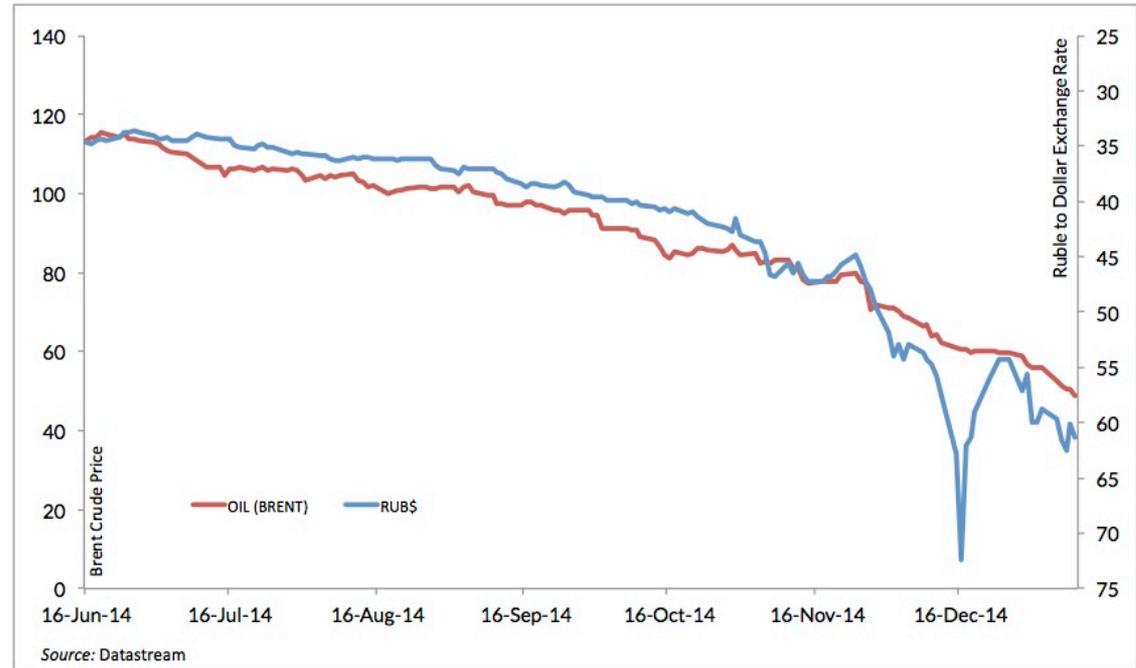
Economist.com/graphicdetail

... the world economy ...

- World economy – single engine growth (USA) for the rich world, more than 3 % growth in 2015, positive sentiments.
- China will grow by about 7 % in 2015, down to 6,8 % in 2016
Mean Reversion, after having grown by about 10 % for more than 30 years
- IMF guesses 3,5 % world growth, whereas the World Bank 3,0 %.
- General problem, Chronic deficient demand (Martin Wolf)

... the world economy ...

Oil prices and the price of the rouble



Kilde: "Russia's Output Will Slump Sharply in 2015",
Anders Åslund, The American Interest, January 15, 2015.

... the world economy ...

- Russia may enter negative terrain next year.

IMF minus 3 %, Anders Åslund minus 6-7 % growth

Putin not used the good years to restructure the economy

About 2/3 of exports was oil last year

And half government expenditures finances by oil

A very modest SWF

Will the middle class stage a return?

Or will Putin put in place even more dramatic measures?



... the world economy ...

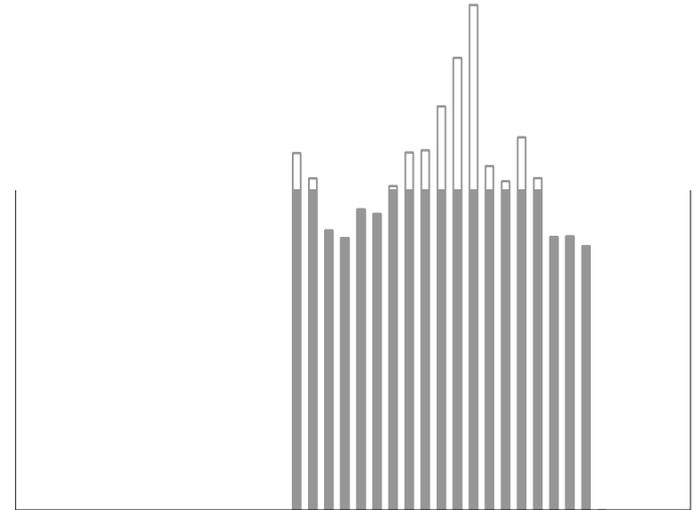
1978 – Deng Xiaoping in charge

1989 – Tiananmen Square, tanks against the students. China came to a standstill.

1992 – Deng's Southern Tour

2001 – Member of WTO

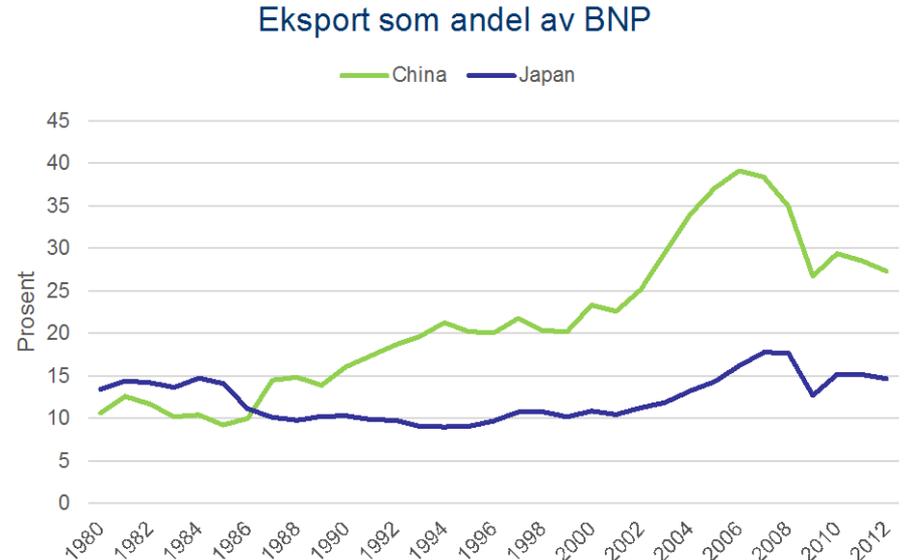
2012 – Xi Jinping takes over



Kilde: Swedbank

... the world economy ...

- Exports no longer contributing to economic growth in China.
- Excessive real investments,
- Private consumption and public expenditures must take over.
Necessitates a redistribution of income.

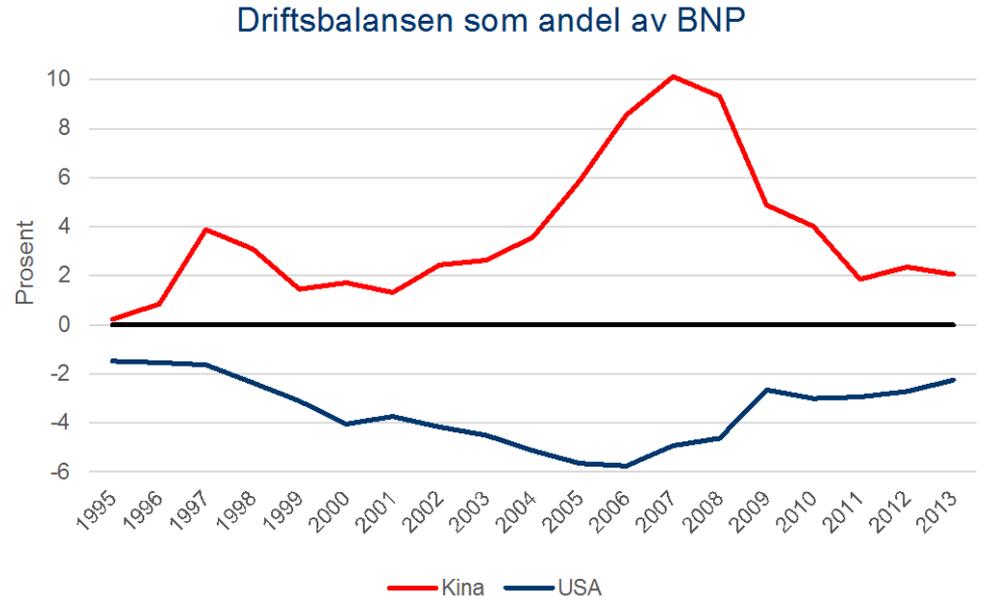


Kilde: WorldBank

... the world economy ...

China and the US – more balanced trade.

China uses her foreign reserves more actively in foreign affairs. Silk road finance, to knit neighboring countries closer to China. Investments in Africa and Latin-America. But meeting increased scepticism many places, e.g. Venezuela and Botswana.

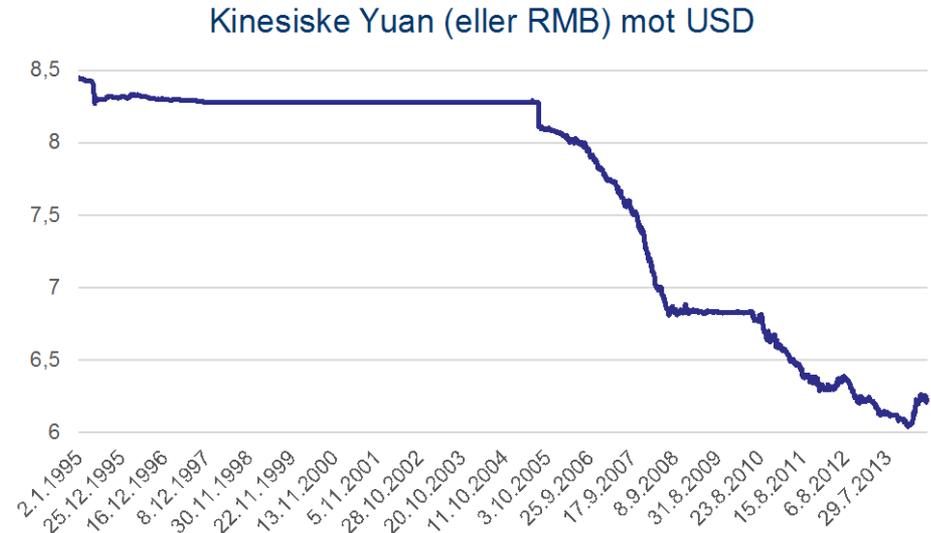


Kilde: WorldBank

... the world economy ...

China keeps a tight rein on the exchange rate. Only gradually and marginally allowing capital to flow freely in and out of China.

But increasingly using RMB for transactions on the trade account – to be free from the dollar.

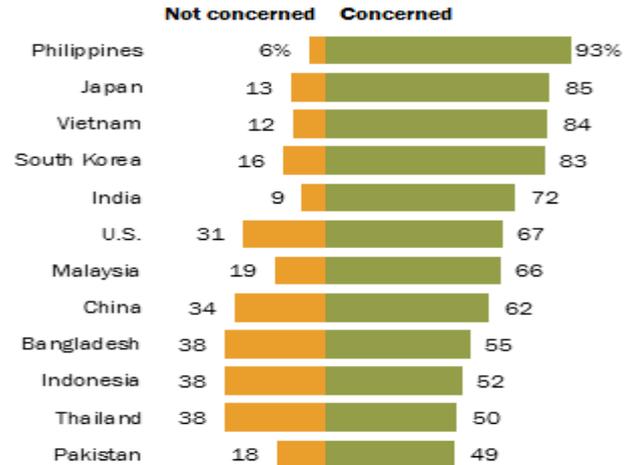


Kilde: Datastream

... the world economy ...

Strong Concerns about Territorial Disputes with China

Concern that territorial disputes between China and neighboring countries could lead to a military conflict

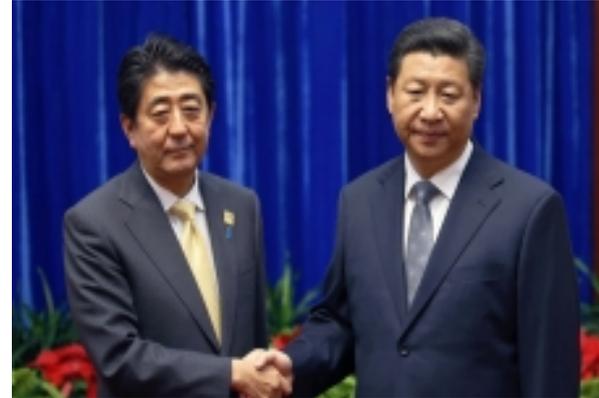


Source: Spring 2014 Global Attitudes survey. Q110.

PEW RESEARCH CENTER

PEW RESEARCH CENTER

China short of soft power.
The friendly couple?



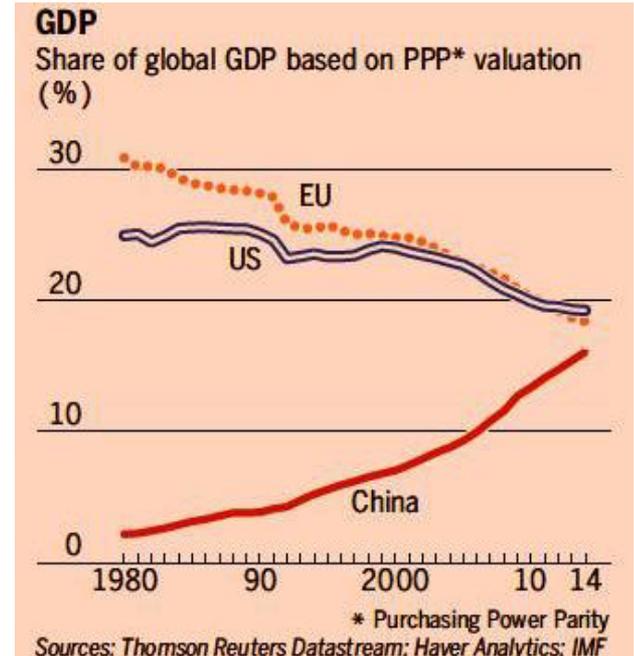
... the world economy ...

EU, USA and China close to equal shares of world GDP

Demography and innovation – USA best. Also, a robust political system, although sometimes one doubts

In China, number of people in working age on the decline. Will China keep growing so fast? Middle Income Trap a danger? From Made in China to Invented in China, does that require a more open society?

Europe also getting older faster than America. The problems with the euro are far from solved. Need a better mechanism for rescheduling debt.

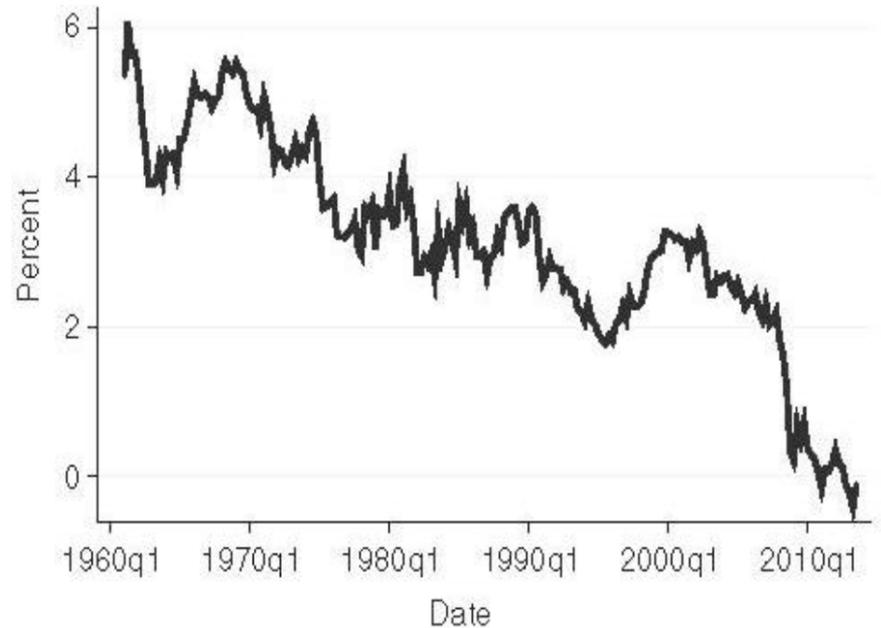


... the world economy ...

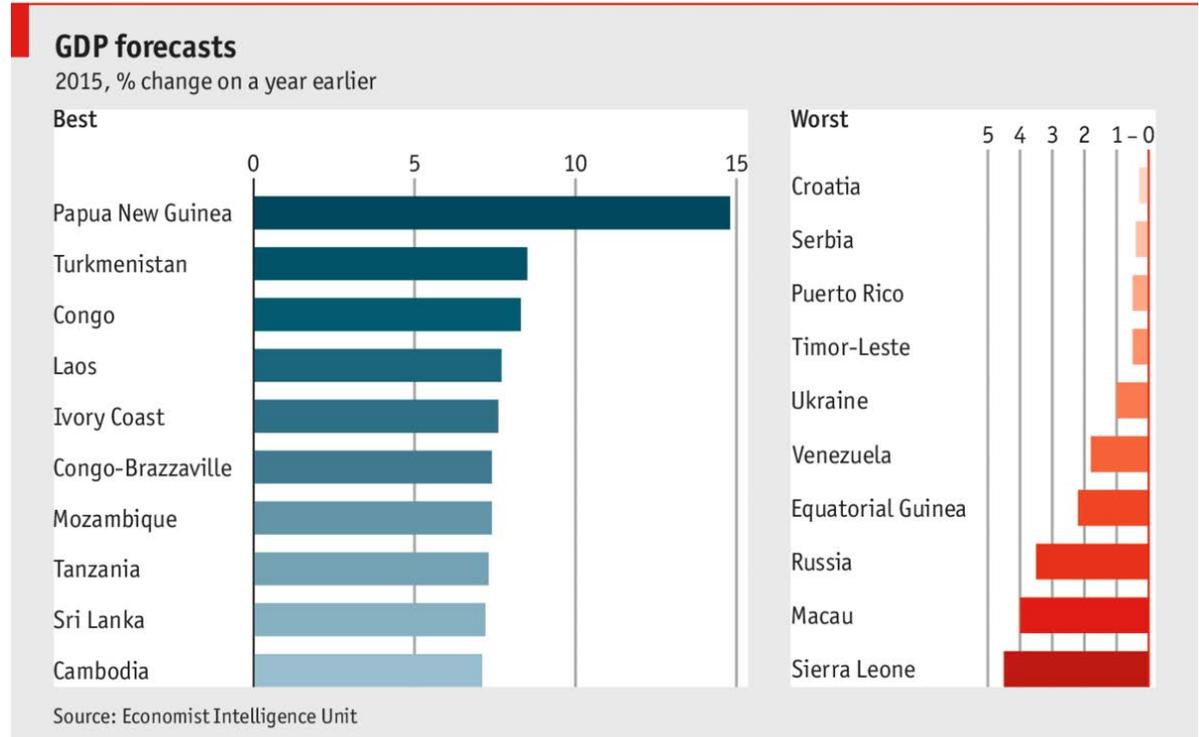
Real rate of interest that equilibrates aggregate demand and supply at full employment declining steeply

- Declining rate of population growth
- Change in income distribution, and savings on the increase
- Modest productivity growth

Natural Real Rate of Interest in USA



The best – and the worst

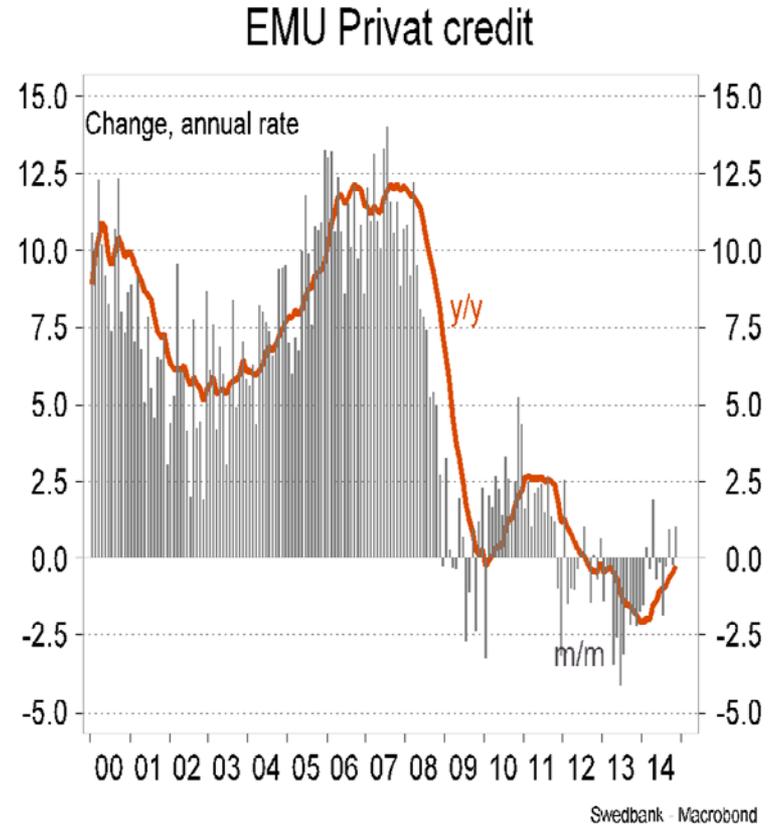


Kilde: The Economist

Economist.com/graphicdetail

The European Economy

- The financial crisis in 2008 and supply of private credit dries up
- Quantitative Easing (QE) and ECB will buy for 60 bn euro a month in government bonds for 19 months.
- Easing of credit to banks, will it be followed by increased bank lending to business? In America, direct finance of corporations, and QE more effective
- General point: QE necessitates and orderly and quick procedure for debt restructuring. Why?



Kilde: Swedbank

... the European economy ...

A trade gap opens up after the financial crisis, i.e. the euro area accumulates big surpluses on the trade balance

... but as we shall see, mainly Germany that benefits from these developments

... the European economy ...

1999-2008 No DEM to appreciate, and trade surpluses with other euro countries (red)

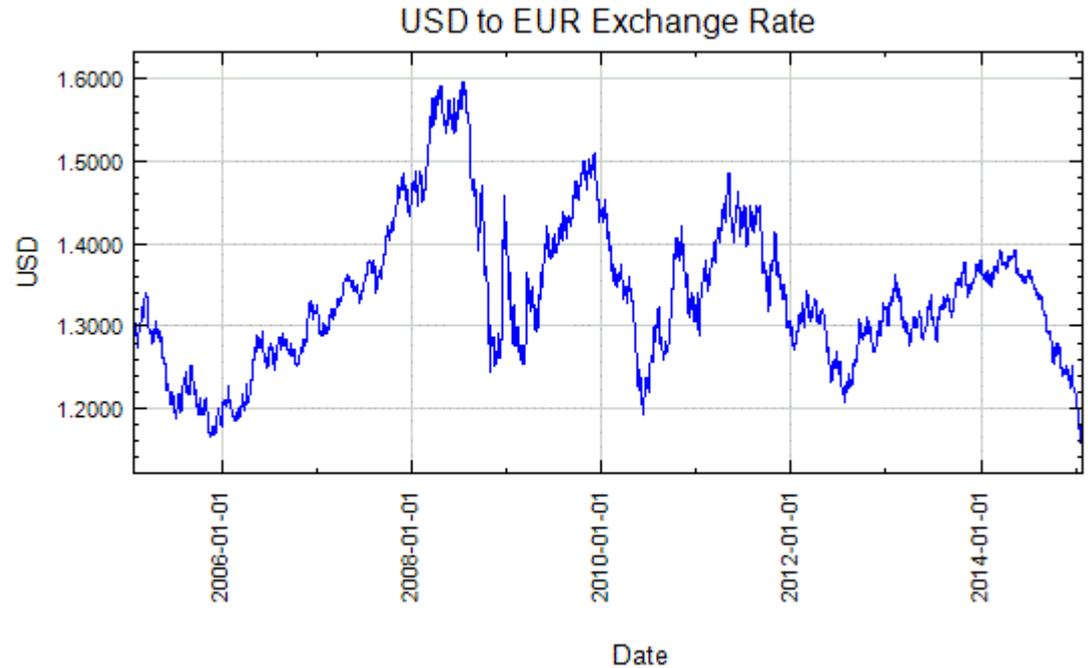
2008 – 2014 Germany's surplus with euro area evaporates. Why?

Merkel: Other euro countries need to improve competitiveness. Would help if Germany inflated a bit more. BUT: A country's competitiveness is not the same as that of company.



... the European economy ...

Jan 1999, 1 euro = 1,18 dollar
Nov 2000, 1 euro = 0,83 dollar
July 2008, 1 euro = 1,60 dollar
These days, 1 euro = 1,10 dollar



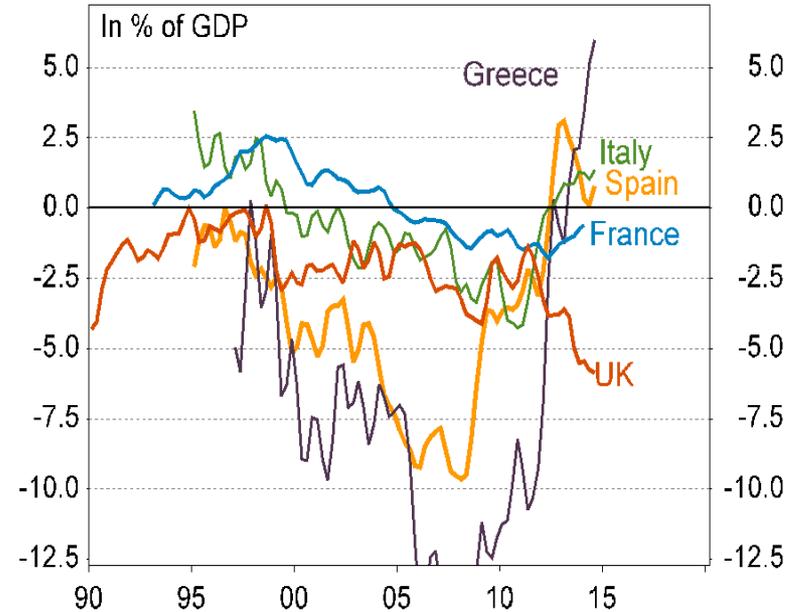
Kilde: Swedbank

... the European economy ...

Finally, Greece is in the black on her current account. Also, Greece has a surplus on primary balance, i.e. public sector can pay all their bills, not including interest on loans, and still have some money left.

Tempting to default?

Current accounts



Source: FraWta, Swedbank

Kilde: Swedbank

... the European economy...

Grexit next?

After a series of defeats from Dunkirk to Singapore, in November 1942 Churchill could tell the House of Commons that Alexander and Montgomery had turned back Rommel's forces at El Alamein.

"Now this is not the end. It is not even the *beginning of the end*. But it is, perhaps, the end of the beginning."

2008, financial crisis and the end of the beginning for euro?

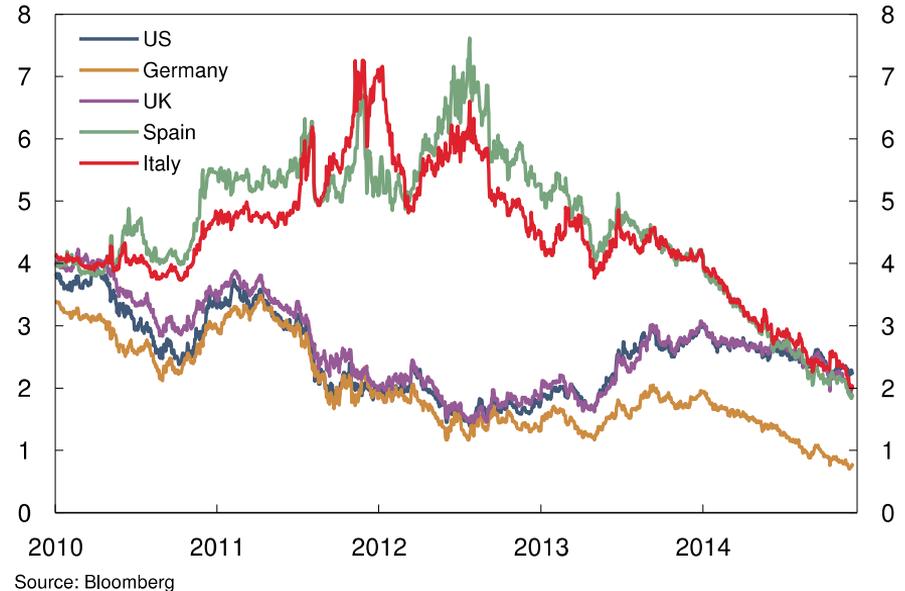
2015, and Grexit, initiating the beginning of the end of euro?



... the European economy ...

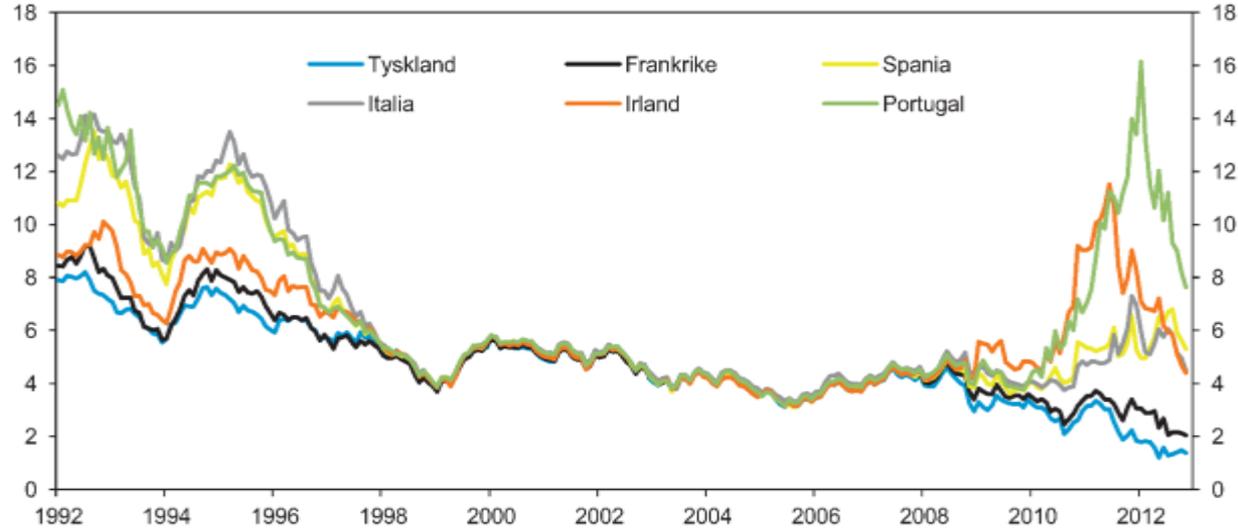
- Quantitative Easing and the spreads towards Germany keep narrowing
- Common currency and exchange rate risks is replaced by credit risk. But the market does not take notice until 2008

Ten years government bonds 2010 - 2014



... the European economy ...

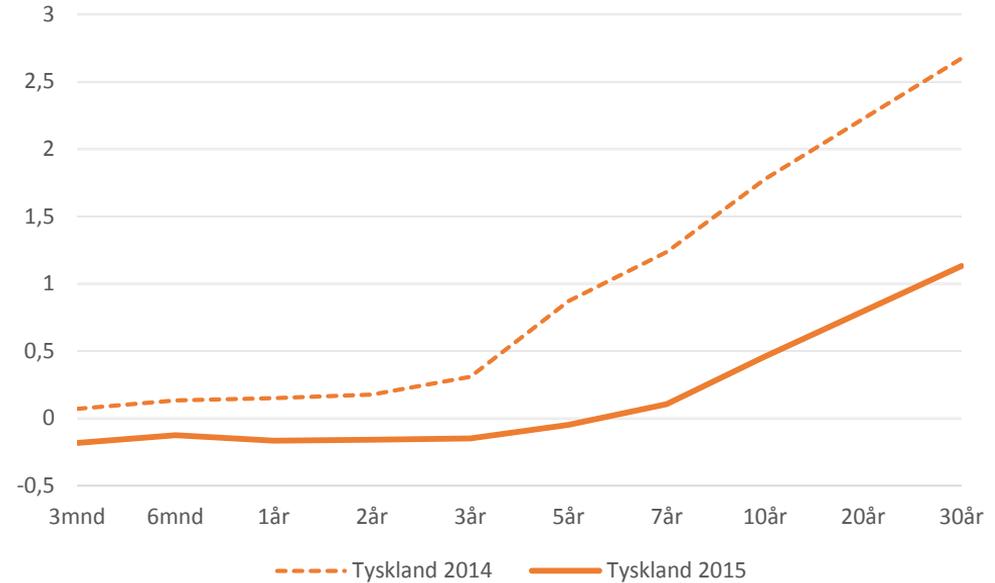
Ten years government bonds



... the European economy ...

- Expected some increase in the rate of interest in Germany a year ago.
- What materialized? A reduction down to unbelievably low levels

Yield Curves, 16 January Germany



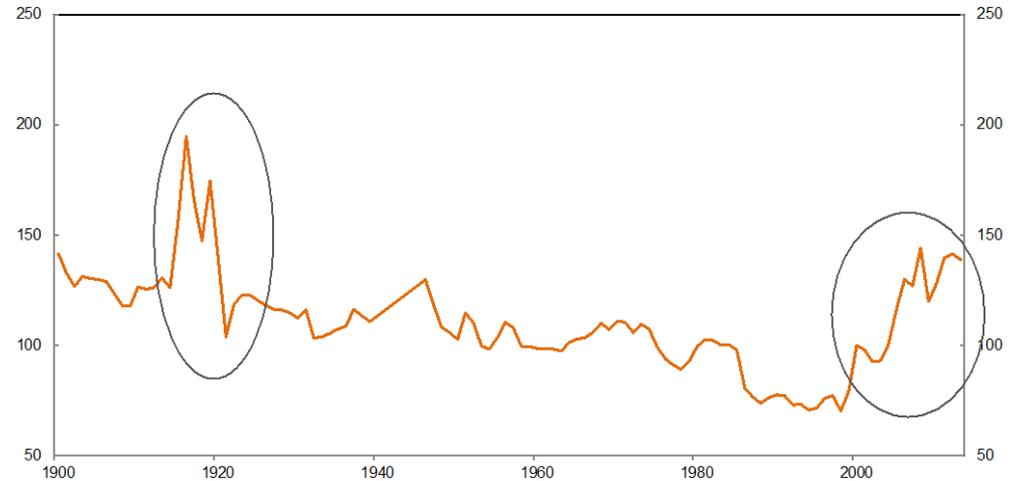
Kilde: Datastream

... the European economy ...

Norway – solid challenges ahead.
Terms of trade working against us.

Tools: Incomes policy, a weaker
krone, and fiscal policies

Bytteforhold (eksportpriser delt på importpriser).
1900-2013. Indeks 2000=100

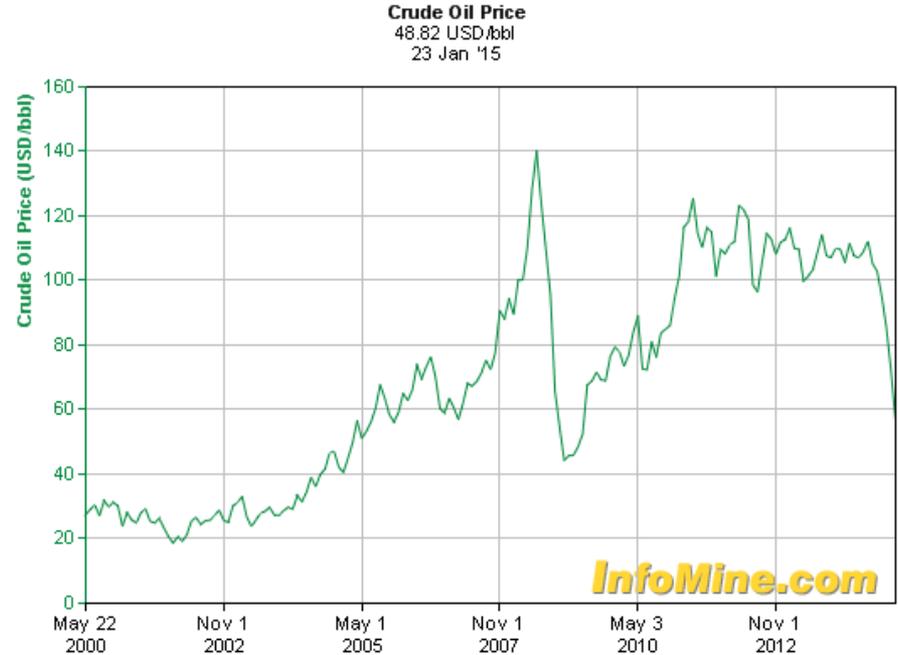


Kilde: SSB og finansdepartementet

Oil prices – Effects on the Global Economy

Price of oil down 30 %, and world GDP increases by ½ % first year. Why?

- Cheaper inputs
- Income redistributed and aggregate demand increases



..... oil prices ...

Improve public finances by taking away domestic subsidies on fuel (India), or raising tax on gasoline (only 5 cents per liter, since 1993, in USA), i.e. let the price at the pump decrease a bit less than the price of crude oil. But seems not to happen.

Oil intensity of world GDP about halved since 1970s.

Supply shock basically behind current price decline. Need more expansionary monetary policies, cf. QE in by ECB, to reach inflation target.

Lower oil prices, good for growth (in importing countries).

..... oil prices...

OPEC did not agree on new quotas in November 2014 – and was kept at 30 mb/d.
Saudi-Arabia wants to maintain market shares – can live with much lower prices.

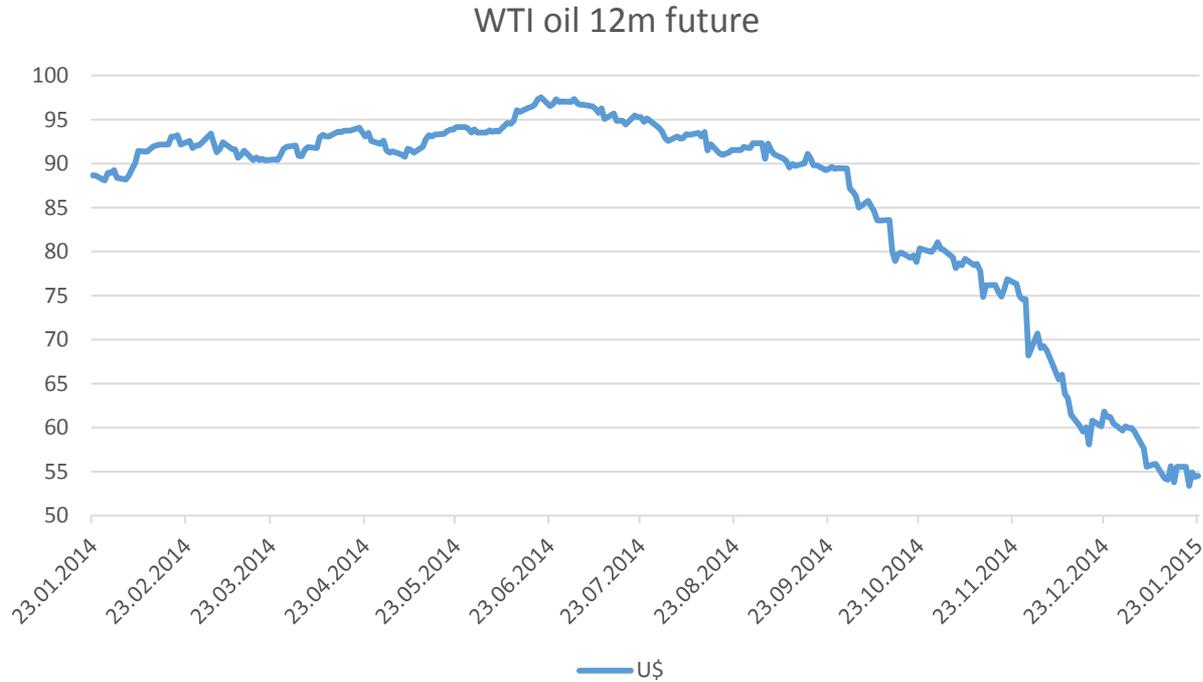
Shale production based on fracking, costs about 50 dollars per barrel. Sort of marginal global costs. Small scale production. Price on oil futures, 90 dollar in 2020.

Saudi-Arabia wants the world to believe that their optimal price in the long run is significantly lower than 60 dollar. Must keep the price below 60 dollar for some time. 1985-86 experience, and the price stayed down for almost 15 years

Hard to calculate an equilibrium price for a cartel.

... oil prices...

Oil futures prices



More on Exchange Rates

Danmark

	16-jan-15	01-apr-15	01-jul-15	01-okt-15
EUR/ DKK	7.43	7.45	7.45	7.45
USD/ DKK	6.39	6.36	6.47	6.59
CHF/ DKK	7.36	7.52	7.45	7.37
GBP/ DKK	9.71	9.54	9.67	9.67
SEK/ DKK	0.79	0.78	0.79	0.80
NOK/ DKK	0.84	0.80	0.83	0.85

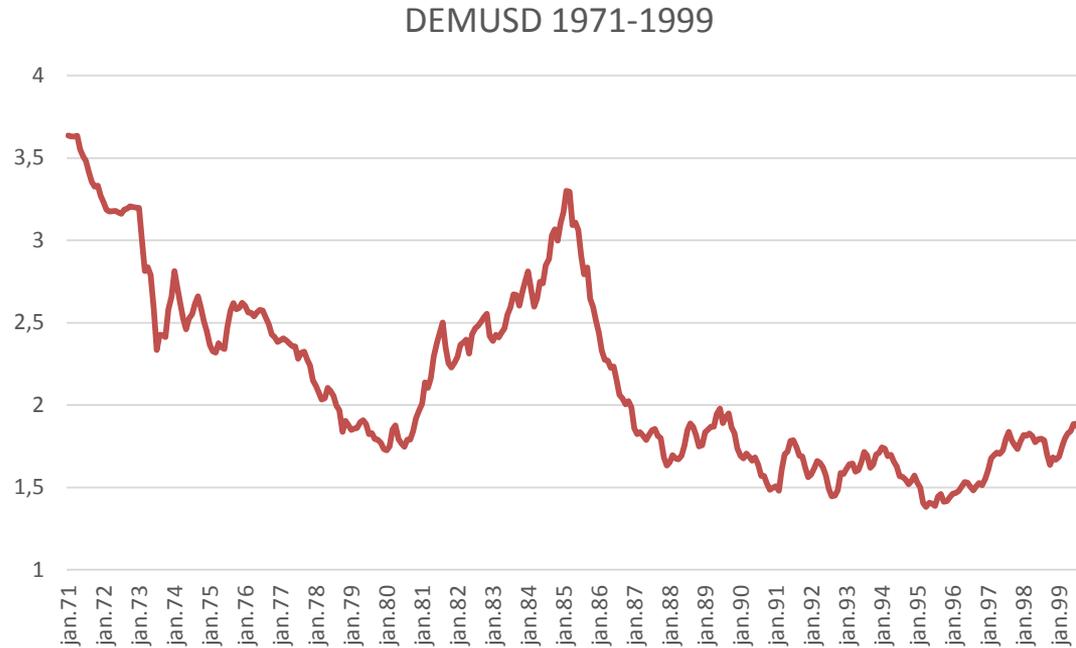
Hovedkryds

	16-jan-15	01-apr-15	01-jul-15	01-okt-15
EUR/ USD	1.16	1.17	1.15	1.13
EUR/ SEK	9.46	9.50	9.40	9.30
EUR/ NOK	8.90	9.30	9.00	8.80
EUR/ GBP	0.77	0.78	0.77	0.77
EUR/ CHF	1.02	0.99	1.00	1.01

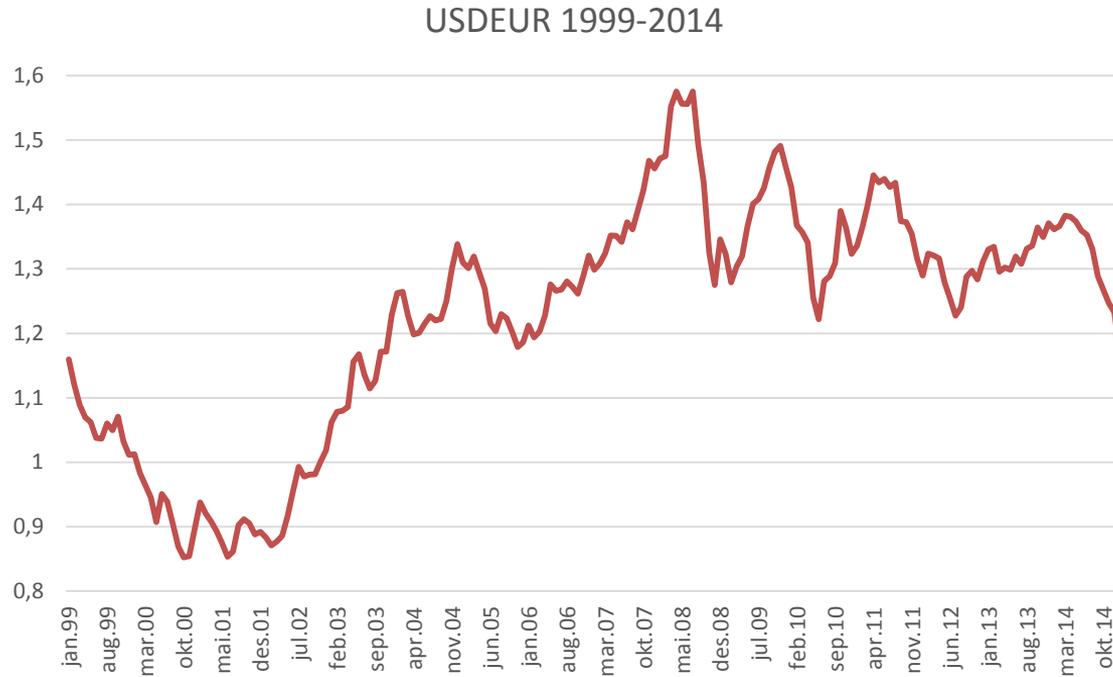
... More on Exchange Rates ...



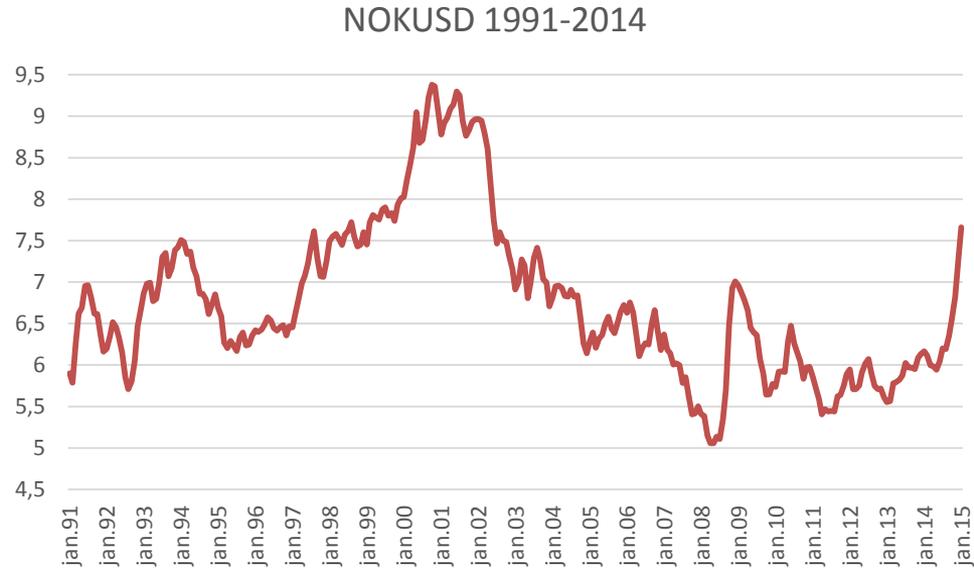
... More on Exchange Rates ...



... More on Exchange Rates ...



... More on Exchange Rates ...



... More on Exchange Rates ...

