

THE OPTIMAL BUNDLE

THE PENN STATE ECONOMICS ASSOCIATION PRESENTS:
THE OPTIMAL BUNDLE

Editor: Steve Leonard

Contributors: Steve Leonard, Bill Ervin, Faith Koc, Obinna Alozie

October 27, 2015

Fall Semester 2015: Volume 4

optimalbundle.org

psuea.org

Oil Drives Middle Eastern Economies

Cheap oil seems to be all the buzz in international economics lately, and it's having a negative effect on the economies of the Middle East. The IMF estimates that the low prices have already caused \$360 billion in lost revenue to



the region, and certain countries like Saudi Arabia, Bahrain, and Oman, are running huge fiscal deficits as a result. For example, the IMF estimates that Saudi Arabia's budget is projected to break even with oil at \$106 per barrel, and with oil currently at \$45 per barrel the country will run out of money in less than 5 years. However, other countries like Kuwait, UAE, and Qatar are faring much better. Factors like lower break-even prices (Kuwait's is only \$49 per barrel) and enormous cash reserves will allow these countries to survive for upwards of 30 years by the IMF's estimates. With oil prices projected to remain the same, these estimates might become a reality for the entire Gulf region. - SL

Italy's 2016 Budget Offers Reforms for Eased Deficit Restrictions



Despite having the Eurozone's second highest debt-to-GDP ratio, Prime Minister Matteo Renzi has announced a continuation of expansionary programs intended to bolster a long-stagnant Italian economy. Within its fiscal budget for 2016 is €27 billion in expansionary measures including a €3.6 billion tax cut on primary residences, reductions in municipal taxes, and tax credits

for businesses investing in machinery. The budget offers much needed relief from austerity for many Italians, yet is likely to irritate EU officials in Brussels who have long advocated for fiscal tightening across the Eurozone following the debt crises of recent years. Though Italy's debt stands at 132.8% of GDP, modest deficit-reduction success, coupled with the lowest unemployment level in 2.5 years, has emboldened Mr. Renzi's case in front of fiscally conservative powerbrokers in the EU. Italy plans to cite progress in labor and judicial reforms and the burden from an influx of migrants in its case for looser budget restrictions. The Italian government has amended its standard of progress but it remains to be seen whether the Eurozone is satisfied with it. - FK



The Mortgage is Too Damn High

Earlier this month the new TILA-RESPA Integrated Disclosure Rule was implemented, which is the biggest regulatory change in the mortgage industry in the last 30 years. These new rules make it easier for borrowers to understand their financial obligations when taking a loan. Prior to the housing market crash preceding the Great Recession, borrowers found themselves stuck with debt burdens they did not fully understand, such as variable interest rates. By the new rules, within three business days borrowers will be provided with a loan estimate and a closing disclosure, which states interest rates, penalties, and other information regarding the loan. This better communication between lenders and borrowers will streamline the mortgage application process, provided the application is submitted on time. More clear communication and accessible information are key for borrowers to make better informed decisions in the complicated world of real estate finance. - BE

WRITE FOR US!
education.psuea@psu.edu

China's Continuing Struggle Against A National Economic Slowdown

The People's Bank of China cut interest rates on Friday for the sixth time since November 2014. The cuts are yet another attempt to combat a tenacious slowdown in economic growth and weakening demand. Data released the previous Monday revealed third quarter growth had slipped to 6.9%, the weakest quarterly expansion since 2009. The one-year lending rate is now set at 4.35%, down from 6% one year ago.

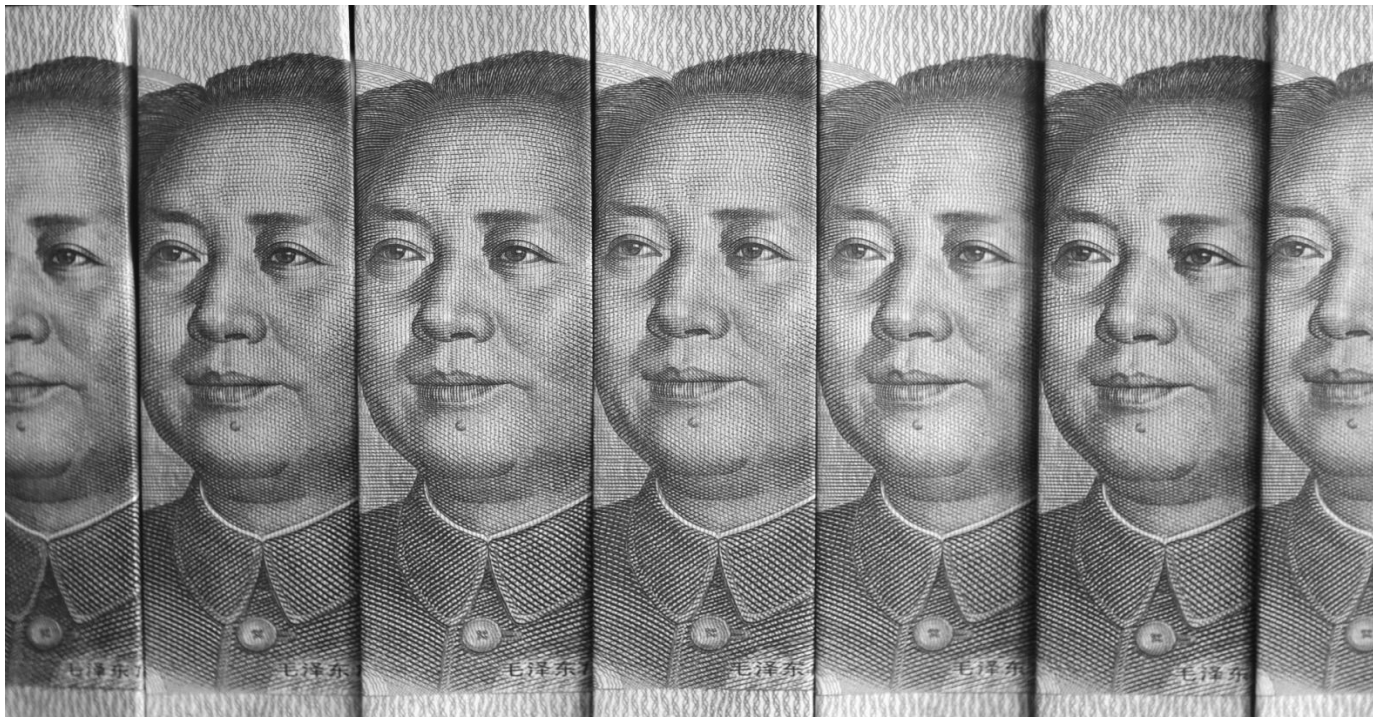
Deflation in producer prices, along with with relatively flat consumer prices, is the source of China's economic slowdown, as both of these parties recognize that goods will be cheaper tomorrow than they are today. If these trends aren't reversed, Chinese production could slow even further, having a ripple effect on the rest of the world's economy. Why would China keep cutting their interest rate? Because by cutting interest rates, money becomes cheaper to borrow and relatively less lucrative to save, which increases the incentive for the private sector of the economy to borrow and thus spend.

While this appears to be a step in the right direction, this is just a small part of what should be a much bigger effort in correcting China's economic growth. Since 35% of Chinese GDP is

from private sector consumption, an adjustment to an interest rate that addresses this sector of the economy will do little to solve the overall problem. The remaining 65% of Chinese GDP is generated from net exports, and this economic activity is not accounted for by the interest rate cut.

In the prior decade, China fueled its growth by funding its industrial sector with debt. As the burden of repaying its loans has begun to catch up, China has been forced to dial back its funding of this sector. As a result, Chinese demand for foreign raw materials is falling. This is then hurting foreign countries' revenues, which is in turn hurting their demand for Chinese finished products. This cycle is building on itself, and in the end, China's economy isn't the only one suffering.

China needs to accelerate its efforts in being less production dependent, and instead focus more on immediate growth in the private sector. How might China facilitate this? Reducing the high savings rate is a logical second step, as this would put more money directly into the pockets of consumers. If private firms and households were to replace government-owned firms as the main drivers of economic growth, the state would become less susceptible to future slumps in aggregate demand. Now is not the time to retreat from switching to a consumption based model, despite the apparent, albeit momentary slowdown in growth. - OA



Upcoming Events

Fed Speaker during the meeting on 11/10

Lend a Hand, Be a Mentor, Juniors & Seniors, 11/03

CEN Presentation on job hunting and internship and NETWORK SIMPLICITY, 10/29 at 6 P.M.

THONvelopes distribution on November 6th!

Fundraising night at Kiwi Frozen Yogurt, 11/03

STATA/306 study session this Wednesday the 28th in 001 Sparks at 7:00 PM!