



OFF THE NEWS

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The Fracking Factor

In Washington, the official view is that while not perfect, the U.S. employment picture seems to be improving. The official unemployment rate has come down, even though the labor participation rate remains at its lowest point since the 1970s. Yet the jobless situation since the 2008 financial crisis may actually be worse than it appears, which may be a large reason for the huge GOP wins in the U.S. mid-term elections. Most of America's job growth since the financial crisis seems to be concentrated in the state of Texas.

According to a report in *AEIdeas*, if you eliminate the healthy job growth in Texas since the financial crisis, the American economy experienced virtually no job growth at all. Since the beginning of 2008, Texas civilian employment jumped by 12 percent, from 11 million to 12.32 million jobs as of September 2014. And the rest of the country? Civilian employment actually dropped from 135.26 million to 134.27 million for the same period.



Currency Winners and Losers

Since 2011, the Japanese yen has plummeted 32 percent against the U.S. dollar. Since early 2013, the Chinese renminbi has jumped by 16 percent against the euro. The renminbi has declined only 1 percent against the U.S. dollar, but has soared to a record high against the yen.



The Euro Trap: On Bursting Bubbles, Budgets, and Beliefs

By Hans-Werner Sinn
(2014, Oxford University Press)

Important Questions

“The European Union has freed Europeans from the yoke of nationalism and greatly contributed to freedom and prosperity in the continent. Its stability lies in the voluntary, mutually advantageous cohesion of its peoples. This stability, however, is being threatened by the euro crisis, which has given rise to a great deal of contention and resentment between these peoples and has resurrected many old ghosts that had long since been presumed dead and buried.

As great as the beneficial effect of the European Union is, just as destructive has been the impact of the common currency on the cohesion of Europe.”

So begins the new book from respected German economist Hans-Werner Sinn. While international policymakers assume that Europe is suffering a Keynesian crisis that can be cured with Keynesian demand management via borrowing or loose monetary policy, this book shows that the European problem results from wrong relative goods prices and wages, caused by an inflationary credit bubble in southern Europe. It criticizes the policy of simply throwing money at the problems and demands a radical rethink, advocating a debt conference, a “breathing currency union” that allows temporary exits, and ultimately harder budget constraints. It argues that, after solving the current crisis, Europe should develop into a confederation modeled after the Swiss one, in which debt mutualization is not an option.

What, Me Worry?

Today 46 nations’ central banks operate monetary policies that, in one form or another, target inflation, according to *The Economist*. Two-thirds (thirty) are below their target.

Financial Mastermind

The financial report card on Russian President Vladimir Putin’s foreign policy aggressiveness is in. Since early 2014, the ruble has lost 24 percent of its value against the dollar. As the central bank continues to intervene to prop up the currency which has suffered mightily as a result of Western sanctions and plummeting oil prices, Russia’s once-impressive foreign exchange reserves are being devastated.

Question: With oil at \$140 a barrel, Russia’s oligarchs are always at political (or personal) risk. With oil at \$40 per barrel, would Putin be at political risk?



Vladimir Putin

Global Total Debt Scorecard

Households and Companies

| | |
|--------------------|--------------------|
| United States..... | 322 percent of GDP |
| Greece..... | 300 percent of GDP |
| Ireland..... | 400 percent of GDP |
| Spain..... | 300 percent of GDP |
| China*..... | 240 percent of GDP |

*Note: Since the 2008 financial crisis, China’s total debt has doubled as a percentage of GDP. Interest rates jumped to an average of 7 percent, so the cost of debt service is soaring. China’s largest banks report bad loans increasing at the fastest pace since the 2008 crisis.

—*Financial Times* (data from Finch)



Oil Markets on the Brink

Oil markets teetered on the edge of a precipice as *TIE* went to press. The benchmark Brent crude price had declined 33 percent from an August peak of \$115 per barrel to a mid-November low of \$74. Further decreases seem likely. Any attempt to paper over the crisis at OPEC's November meeting, the results of which are unknown as yet, is irrelevant.

Saudi Arabia has caused the fall in oil prices. The Saudis have watched as increased production from the United States and Canada has slowly but steadily whittled down OPEC's market. Initially, they apparently thought they could ignore this effect. However, as time passed the threat became larger and more immediate.

All OPEC members must know one other troubling fact: they no longer have significant market power.

The Saudi response has been to offer refiners a bargain they cannot refuse. The Kingdom does not set an absolute price for output. Instead, it offers customers deals tied to their markets. In the past, Saudi Arabia established price discounts no other suppliers could beat. They are doing that again today.

The declining demand for OPEC oil has led the Saudis to this action. Projections of the future "call

on OPEC" (and hence on Saudi production) have been steadily cut. Three years ago, the International Energy Agency wrote that OPEC production would need to surpass 32 million barrels per day in 2015 to keep prices stable at \$110 per barrel. The IEA prediction has been dropping ever since. Most recently, the agency warned that OPEC output would have to be less than 29.5 million barrels per day to keep prices stable at \$80.

The earlier forecast of 32 million barrels per day lulled the fears of oil exporters. The large exporters were also probably reassured by forecasts of stronger global economic growth and by output disruptions in countries such as Iran, Libya, Nigeria, and Syria. They were not yet worried about increased output from the United States.

More recent events have awakened producers, particularly Kuwait, Saudi Arabia, and UAE. They have recognized the present need to defend their market share, even if that means allowing prices to fall to very low levels for a time. The leading OPEC members understand that such prices will gradually suppress rising U.S. and Canadian production. They also realize that falling prices may hurt other countries such as Venezuela. In truth, they probably do not care who has to cut. They care only that it happens.

All OPEC members must know one other troubling fact: they no longer have significant market power. The market elasticities are such that a



The ExxonMobil oil refinery in Baton Rouge, Louisiana, the second-largest in the United States.

significant reduction in OPEC output will have an almost insignificant impact on their revenues. OPEC's exports, which today amount to around 21 million barrels per day, are worth a little less than \$600 billion at \$75 per barrel. A reduction in exports of 10 percent that raises prices to \$90 might boost revenues 3 percent or 4 percent at best. In short, OPEC has lost its leverage over the oil market.

Restoring oil prices to higher levels will require a prolonged period of lower prices or an agreement between several of the larger non-OPEC oil exporters (Canada, Norway, Russia, and Oman) to join in reducing production substantially. At this point, I anticipate the first scenario will come to pass. Lower oil prices will slow investment in new oil production across the world. They will also provide a needed boost to the global economy.

Back in 2011, I warned in these pages that the world would see three price cycles before 2020 (see "Blundering to \$300 per Barrel," *TIE*, Summer 2011). While I did not predict the precise cause, we are stumbling toward the bottom of the first cycle. The loss in investment in new production caused by low prices in 2015 will lay a foundation for much higher prices in 2016 or 2017.

—PHILIP K. VERLEGER
President, PKVerleger LLC

Two Views: Either China's Buying Up the World...Or the Elite Are Rushing To the Exits

“China's outbound direct investment is for the first time set to exceed investment into the country, highlighting the ongoing shift of global economic influence to the east. Outbound direct investment rose 21.6 percent in the first nine months compared with last year to \$75 billion and on Wednesday a senior Chinese official said that on current trends it would probably exceed inbound investment by the end of the year.”

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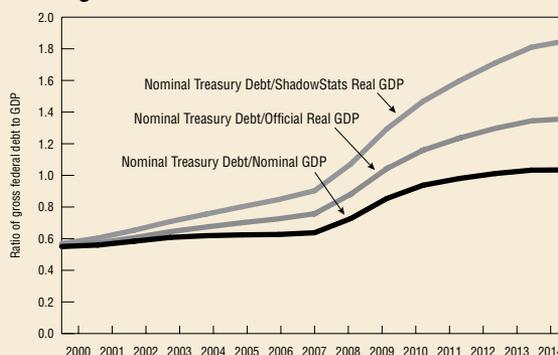
“China's economy grew at its slowest pace since the depths of the global financial crisis in the third quarter and is on track for its worst annual performance since 1990, when the country was under international sanctions in the wake of the Tiananmen massacre. ... Chronic overcapacity, particularly in industries that supply the real estate sector such as steel and cement, has led to China's longest period of producer price deflation on record, with prices falling at the factory gate for the 32nd straight month in September.”

—*Financial Times*

Department of Corrections

In the article “The Inflation-Debt Scam” by Paul Craig Roberts, Dave Kranzler, and John Williams in the Spring 2014 issue, the bottom line in this figure on page 43 was incorrectly labeled. Below is the corrected figure.

Figure 1: Debt-to-GDP Ratios



Sources: ShadowStats.com, U.S. Treasury, Bureau of Economic Analysis