Economics for Managers

Session 15-17| 01-Sep-2019

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Today's agenda

1. Case Studies:
   - US Meat Industry- Tyson Foods
   - Indian Auto Industry
2. Start with Macroeconomics
   - Why it is crucial for business managers
   - Impact of the Economic & Business Cycle

Case studies

- **Competition in the US Meat Industry**
  - How were changes on the demand side negatively impacting Tyson's business?
  - How were changes on the supply side negatively impacting Tyson's business?
  - How did Tyson manage to get to its current position of strength?
  - How many companies dominate the US Meat market?
  - How has that position impacted consumer prices?

Bringing together Demand, Supply, Competition & Regulation: Case of Indian Automobile Industry

- What market structure best describes competition in the auto sector?
- What regulations are impacting or likely to impact the auto industry?
- What is the likely impact of regulation on BS IV vehicles- demand or supply?
- Are the car companies colluding or fighting for market share?
- What factors on the demand side are impacting the auto sector?
- What factors on the supply side are impacting the auto sector?

Bringing together Demand, Supply, Competition & Regulation: Case of Indian Automobile Industry

- What is the role of overall environment?
- What is the likely impact of OLA/ Uber- in terms of demand & supply curves?
- Is entry/exit easy in the auto industry?
- Despite the slowdown in auto industry, how are companies able to launch & sell new models?
- Who is likely bearing the increase in taxes?
- What are some costs the auto industry never pays for?

Key Points

- Role of governments
- Public Goods
- Externalities

Part 2 of Economics for Managers

Macroeconomics

Why study Macroeconomics?

- Recessions can be tougher than competitors
- Develop an understanding of leading economic indicators to forecast the business cycle
  - Guard against recessions
  - Take advantage of expansions
- Strategic Business Cycle Management

Why Strategic Business Cycle Management?

Recession hits

Slash Advertising

Fire People

- Reaction of many corporate executives in the middle of a recession is to cut advertising spends & fire people!

Why Strategic Business Cycle Management?

Recession hits

Boost Advertising

- Build Brand
- Maintain Sales

"Cherry Pick" Talent Pool

- Top Talent
- Reasonable Wages

Example of a leading indicator

Bullish, upward trending Stock Market

Turns Bearish, Trends Down

Signals Recession

Normal Bond Market Yield Curve

Flattens or Inverts

Macroeconomic problems we will look at

Unemployment

Inflation

Economic Growth

Macroeconomic Problems

Budget Deficits

Trade Imbalances

Solutions to those problems

Monetary Policies

Fiscal Policy

Tax Policy

Macroeconomic
Tools

Trade & Exchange Rate
Policies

Regulatory Reform

From Macro Problems to Strategic Decisions

Accurately forecast impending recession

Implement Business Cycle Management Strategies

Cut Production

Defensive

Trim Inventories

Increase Capital Expenditure

Offensive

Acquisitions at Bargain Prices

Key Questions for Business Managers

Economic Expansion or Recession?

Interest Rates Up or Down?

Commodity Prices Up or Down?

Key Questions

Direction of exchange rates?

Trade Imbalances

Case Studies

- David’s ever-growing business
- Rita’s dream home

Micro vs Macro

Micro

- Demand, Supply & Equilibrium in single market.
- Market Structure: Competition, Monopoly etc.
- Price is the self-correcting mechanism; govt intervention not required in the ideal competitive market.

Macro

- Not always self-correcting.
- Inflation, unemployment, trade deficits can persist for long times.
- So, government intervention required.

The Big Macro Problems: Inflation

Inflation → Upward movement of prices from one year to next → Measured by % change in Price Indices

Consumer Price Index (CPI)

Producer Price Index (PPI)

GDP Deflator

The Big Macro Problems: Unemployment

Unemployment: number of unemployed people divided by the number of people in the workforce.

The Big Macro Problems: Economic Growth

Gross Domestic Product (GDP) → Defined as market value of all final goods & services in a given year

→ Income Approach (flow of cost)

→ Expenditures Approach (flow of product)

GDP Income Approach

GDP = Wages + Rent + Interest + Profits

Workers

Property Owners

Lenders

Firms

GDP Expenditures Approach

(Exports – Imports)

GDP = Consumption + Business Investment + Gov't Spending + Net Exports

GDP Expenditures Approach

The "GDP Keynesian Equation"

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GDP = Consumption + Business Investment + Gov't Spending + Net Exports

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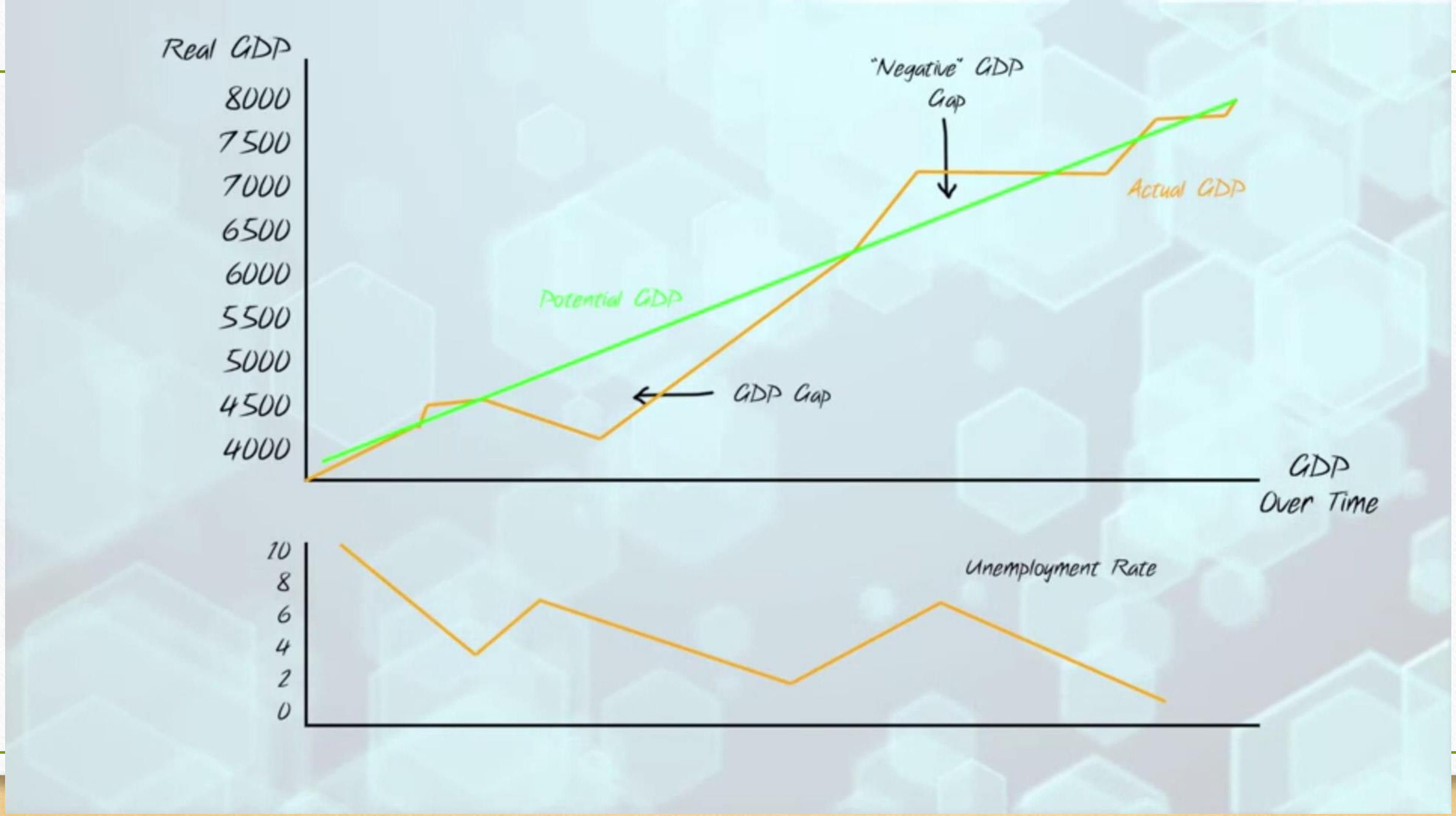
"GDP Forecasting Model"

Actual vs Potential GDP



Nominal vs Real GDP

Measuring GDP

Nominal GDP → Measured with actual prices → Distorted Picture

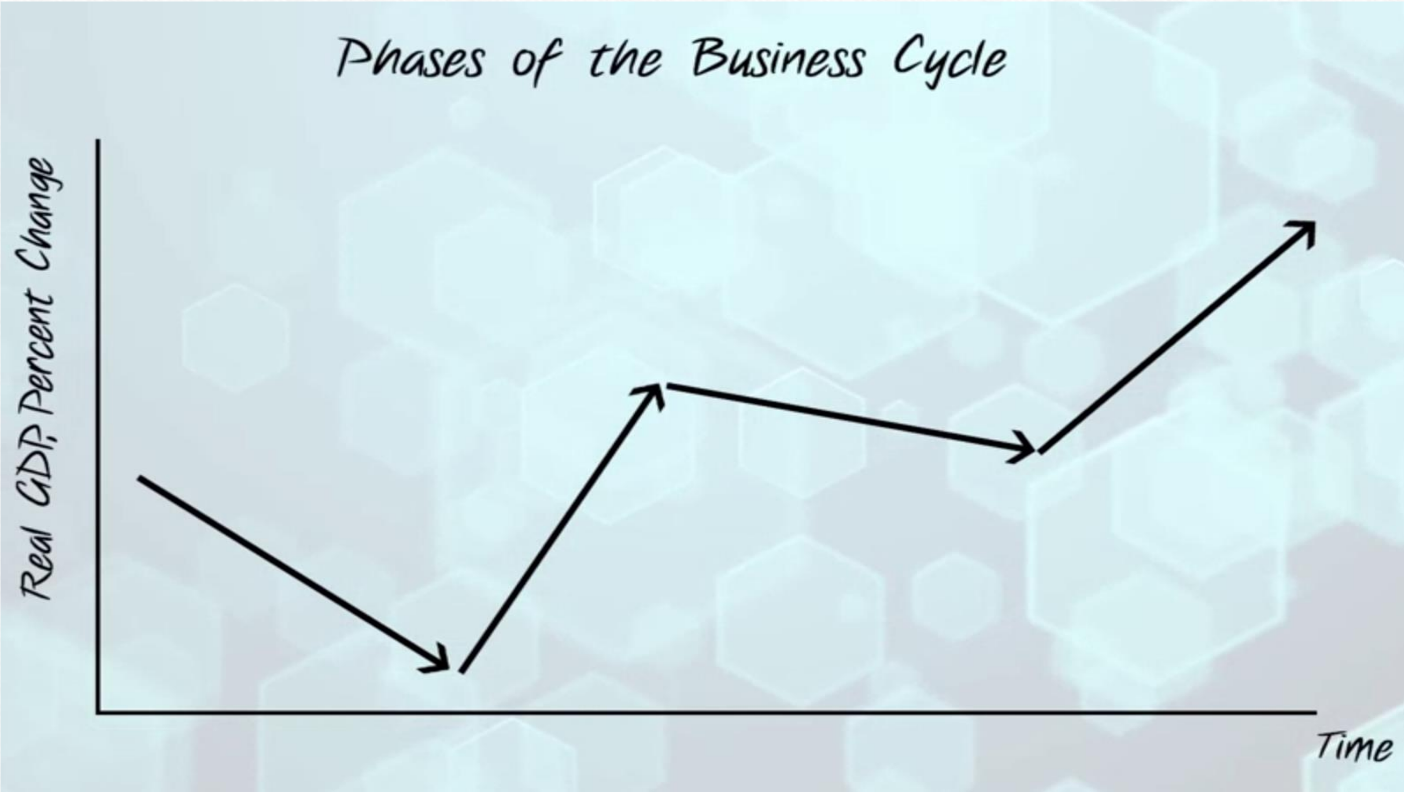
Real GDP → Adjusted for inflation → Constant prices for benchmark year

Key Point

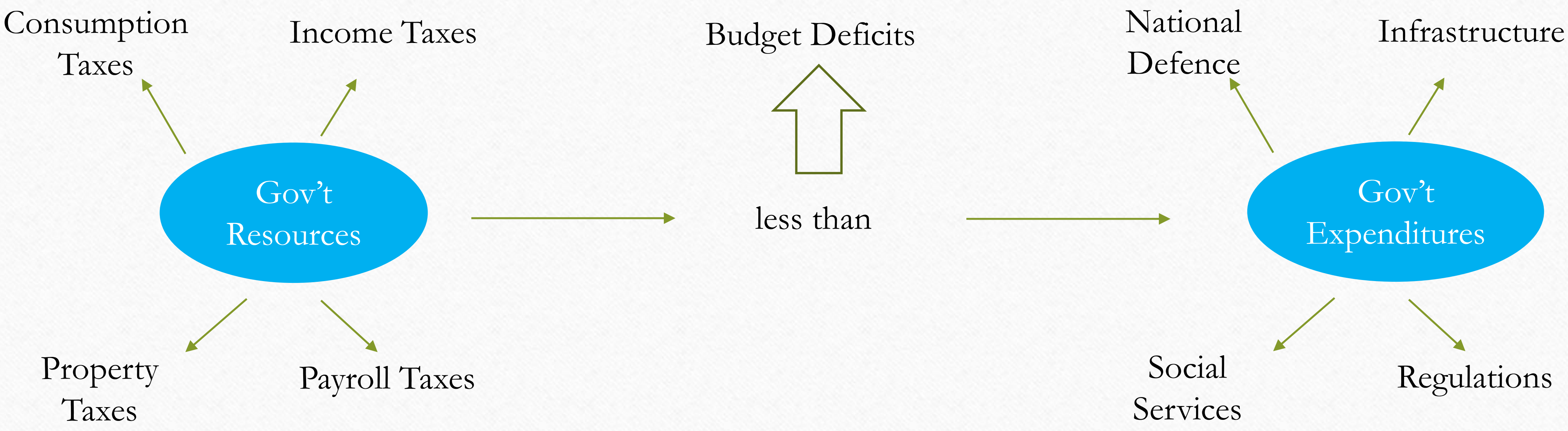
Best measure of a Nation's Output

Real Inflation-adjusted GDP

Movements in Real GDP chart the Business Cycle



The Big Macro Problems: Budget Deficits



The "Crowding Out" Effect

Gov't runs Budget Deficit → Sells bonds to finance Budget Deficit → Interest Rates Rise → Business Investment falls → Real GDP Growth slows

Interest Rates Rise ↓ Increase Inflation

The Big Macro Problems: Trade Imbalances

GDP = Consumption + Business Investment + Gov't Spending + Net Exports

If Exports < Imports,
then GDP goes down

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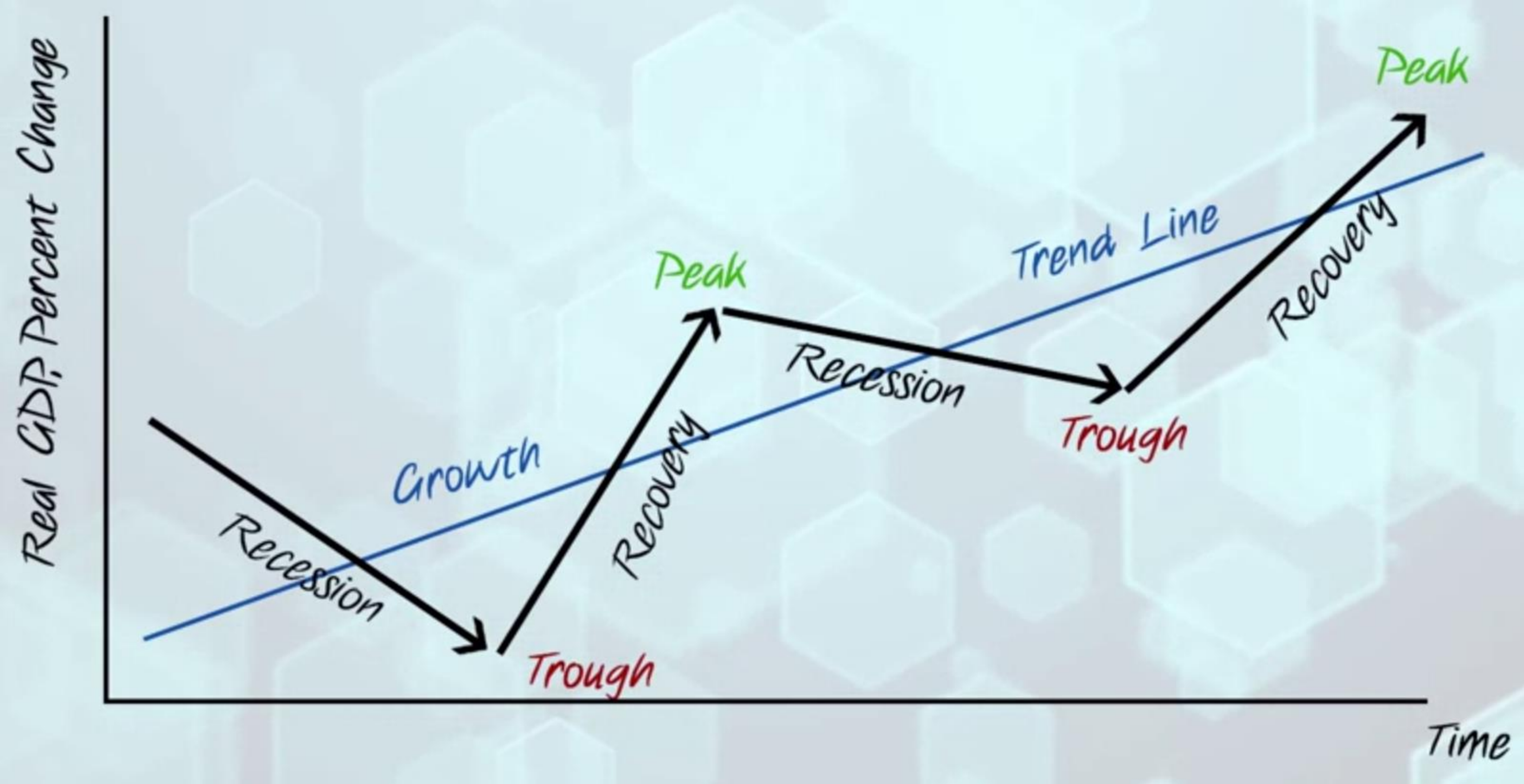
Key Point: Trade Deficits Drag Down GDP

Phases of the Business Cycle



Key Point

Business Cycles lack "Periodicity" → Nonrepeatable Internal Pattern → Can't Predict Future Cycles with Historical Data

What is a Leading Indicator?

Leading Economic Indicator → Measurable Economic Indicator → Changes in Advance of underlying Business Cycle

Example of a Leading Indicator

Consumer Confidence Rises → More Confident Consumers Spend More → "C" up => GDP up → Bullish Forecast

Consumer Confidence Falls → Less Confident Consumers Spend Less → "C" down => GDP down → Bearish Forecast

Key Point

GDP = Consumption + Business Investment + Gov't Spending + (Exports – Imports)

To forecast the business cycle, find & follow leading economic indicators for each of the five components of the GDP equation

An Illustrative Forecasting Model

- ECRI Leading Index
- Stock Market
- Yield Curve Spread

US Treasury Report on Budget Deficit

INFLATION INDICATORS
Consumer Price Index
Producer Price Index

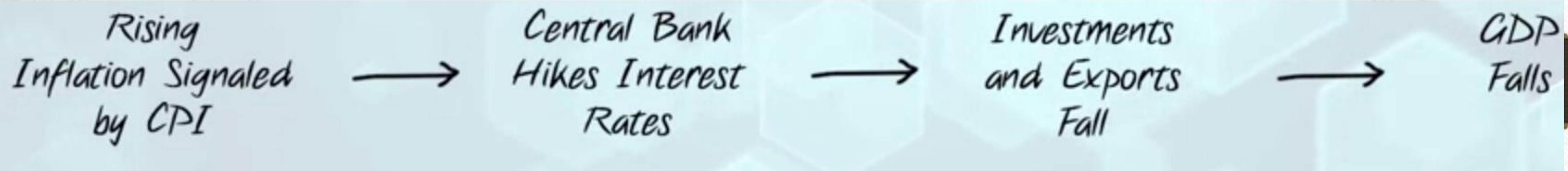
$$GDP = C + I + G + (X - M)$$

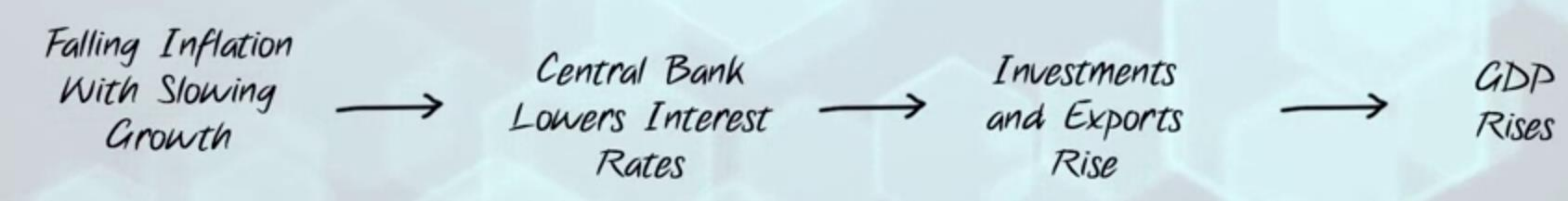
- Consumer Confidence
- Retail Sales
- New Home Sales

ISM Manufacturing Index

US Trade Report on Imports and Exports

Why Inflation Matters





Next Week

- Aggregate Demand
- Aggregate Supply