How an economist can help you

If you are working on a project where the KPI is highly sensitive to economic conditions, a general modeller may struggle to make the model work because they are unaware of the details of the economic climate, or economic theory. This can cause stress and delays, resulting in a less robust model for the client, and lower job satisfaction in your team. Both run the risk of client dissatisfaction and loss and high staff turnover, creating a vicious cycle of inefficiencies and struggle, making it harder for you to meet client expectations. Having a dedicated economist to advise on economic conditions, theory and data sources can help improve and speed up the modelling process, thus minimising these risks.

Below are some case studies of how an economist can help:

Case 1:

Imagine if you are modelling demand for savings accounts and you expect demand to rise when interest rates rise, but you see the opposite. Sometimes this is just due to the nature of the data. However, there is also economic theory to back this up.

There are actually two effects on an interest rate rise on savings, each having an opposite outcome. Some people put less into savings because they need less in order to get the same return as before.

Other customers will want to cash in on the chance to make even more from their savings, with some people feeling like it's only worth saving when interest rates are higher.

To help determine which is the stronger effect and therefore whether the sign you see in the model is correct, you can look at other indicators, even if they are not explicitly included in the model. For example, GFK has an index measuring people's attitudes towards saving and whether they think that now is a good time to save. If this rises in line with interest rates then you have a good indication that higher rates are encouraging savings. If it falls when rates rise then you know that people feel that they need to save less. There could of course be other reasons for this fall in savings sentiment, but that is also where an economist will be able to help. A regular MMM modeller may not be aware of wither this theory or the existence of these additional series, or of the details of consumer sentiment, but a dedicated economist will.

Case 2:

A model is using CPI to show the cost of living but it fits very badly because it just trends upwards with little variation while the KPI shows no upward trend but has lots of variation. Inflation would work much better kin this case and this can be adapted to include a positive and negative effect by calculating a variable that shows deviation from target.

Case 3:

Right now you will see a decoupling of mortgage rates and bank base rate in the UK. This is because many anticipate that the recent NIC contribution rises will be passed on to consumers and cause higher inflation, and that many of the policies proposed by the newly elected president Trump are likely to be inflationary. When inflation is expected to rise, markets anticipate that central banks will raise interest rates to combat it.

Economic bulletin sample (UK)

November 2024

Inflation and job losses on the horizon as Budget increases costs for UK companies

Firms axe investment and hiring plans

The increase in employer National Insurance contributions and the National Living Wage, along with changes to employment law and increases in business rates are making many firms rethink their hiring and investment plans, with some even planning redundancies. For those in work the extra costs will mean lower wage rises, and some companies also plan to raise prices in order to cover the costs. The heavy and sudden burden is also causing some firms to shelve their investment plans, or shift them overseas, meaning even less job creation.

Inflation could go either way

While muted pay growth, slower hiring and redundancies will all put downward pressure on inflation, some sectors plan to increase their prices. In addition, it is expected that the short run effect of extra government spending will temporarily boost demand, also causing upward pressure on inflation. At present the Bank of England also reflects this view that it is too early to tell which will be the greater effect. However, my view is that it leans more towards the downside. The burden on business is an onerous one and will stifle growth, meaning that demand for investment goods is lower, and muted wages mean that consumer demand is weaker.

Causing a threat to longer run growth via lower investment

In the longer run however, lower investment means that the economy is less able to cope with any excess demand without putting upward pressure in inflation, because workers are less productive and need to work longer and therefore be paid more in order to produce more. This will put longer term upward pressure on inflation which could make it harder for the Bank to reduce interest rates.

Trump win offers some hope

Overall I feel that the outlook for the UK economy is not looking good, with growth prospects muted due to weaker demand for investment, and weaker employment growth leading to weaker consumption. One silver lining is that interest rates would likely come down if this risk materialises or looks likely to. One other ray of hope is that if the US economy holds up under the Trump administration then the UK could benefit from increased trade off the back of a stronger US economy. However, if he does go ahead with his proposed blanket tariffs then the UK could suffer a blow to its exports. Even if the tariffs were not applied to the UK, there are risks here too, as tariffs on other countries and some of Trumps' other proposed policies are inflationary such as decreasing the workforce by deporting illegal immigrants. Cuts to corporation tax should help however, and are already enticing some UK firms to invest in the US, which could see some revenue flowing back to the UK to help support their UK counterparts. However, all these measures are inflationary, which could mean slower rate cuts from the Fed, and may dampen demand from the US somewhat.

Economic tracker sample (UK)

26.10.2024		Chancellor set to raise employers national insurance	https://www.bbc.co.uk/news/articles/c9wrkngvyx4o
30.10.2024		Autumn Statement (Budget)	https://www.bbc.co.uk/news/articles/cdxl1zd07l1o
17.10 2024		Kemi Badenoch takes over as Tory leader	https://www.bbc.co.uk/news/articles/c1d59k513qgo
6.11.2024		Trump wins US election	https://www.bbc.co.uk/news/articles/cev90d7wkk0o
7.11.2024		UK Bank rate cut to 4.75%	
7.11.2024		Tenants may not be able to buy new council homes	https://www.bbc.co.uk/news/articles/cwygr168717o
22.11.2024		Shop sales in surprise fall as Budget fears hit spending	https://www.bbc.co.uk/news/articles/c4gmy9xldgno

This covers a wide range of topics in order to capture news items relevant to different markets. Not all will be relevant to each project but the file offers a comprehensive reference.

Please note that the bulletin and tracker are currently only available for the UK economy.

The tracker is a fairly new addition and currently only covers the last 6 months, but I have a wealth of news archives to draw on going back many years so can look back to find answers to any queries covering other dates.