

# THE OPTIMAL BUNDLE.

THE PENN STATE ECONOMICS ASSOCIATION PRESENTS:  
THE OPTIMAL BUNDLE

Editor: Steve Leonard  
Contributors: Michael Chubinsky, Joe Kearns, Steve Leonard  
January 26, 2016  
Spring Semester 2015: Volume 8  
optimalbundle.org  
psuea.org

## China's Economic Problems are the World's Economic Problems

China's economy is slowing; we *know* this. However, the effects of this trend are much more detrimental to the rest of the world than they are to China. Shares of major commodity exporting businesses, especially those in South America, have fallen by enormous amounts in recent years; some have fallen by more than 90 percent. Predictions from Barclays Capital even predict that Venezuela will be the first country to default in 2016 as a result of lower demand from China for metals and oil. Even western, service-driven economies are not safe. Through the first two weeks of 2016, a 16 percent decline in Chinese A-Shares prompted an 8.8 percent decline in the S&P 500, sending fear through institutional investors and those nearing retirement alike. As the Chinese economy continues to sink, the rest of the world will have to adapt relatively quickly if it is to keep its economies from sinking as well.— SL

## Recent Violence in Jerusalem and Its Economic Implications

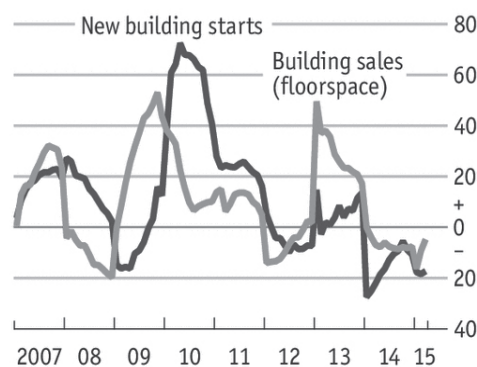
Violence in Jerusalem between Israelis and Palestinians has noticeable political implications, but more opaque economic ramifications. Although Israelis have shown some signs of slowed spending, most experts agree that the violence needs to spread across the nation and persist much longer to have undeniably significant economic consequences. Despite this, the Israeli media reports that credit card transactions for mid-October have declined by about 11% from the prior year. In addition, there are concerns that security blockades could disrupt the flow of the 100,000 laborers who enter Israel and the West Bank Settlements each day to work. A sustained shock to the labor force

could be detrimental, especially because such a shock has already occurred in the tourism market. Since the 2014 Gaza Conflict, tourism has seen a 15% decline, and, with the recent violence in Jerusalem, this decline could continue.

The Central Bureau of Statistics reports that the Israeli economy should grow by 2.5% in 2015. In Israel, the goal for growth is typically 3%. A 2.5% growth figure, paired with an increase in

## The slowdown lowdown

China's property market, % change on a year earlier



Sources: NBS; Wind

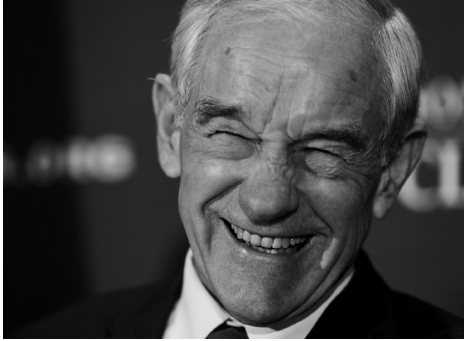
violence, is troubling because it indicates that an already slowing economy may experience more trouble. However, Fitch Ratings speculates that if conditions remain as they are, looming tax cuts and productivity in the natural gas market could indicate economic growth for the Israeli economy in 2016 and 2017. — MC

**WRITE FOR US!**  
[education.psuea@psu.edu](mailto:education.psuea@psu.edu)



# Article Spotlight

## Populist Candidates Threaten Fed Independence and Financial Market Stability



Former Representative Ron Paul's longshot campaigns in the 2008 and 2012 Republican primaries achieved a long-term win for the libertarian congressman.

Paul's hostility to

the Federal Reserve had historically been held by the periphery of the Republican Party and rejected by its establishment. During the 2008 financial crisis, President George W. Bush embraced emergency actions overseen by Federal Reserve Chairman Ben Bernanke including rescuing AIG, lending to money market funds, and cutting the federal funds rate to zero. Since then, many presidential candidates have echoed Paul. If the next President vilifies the Fed, the danger exists that during the next financial crisis, the Fed will lack the independence to prevent an economic depression again.

This year, Paul's son, Rand, has been eclipsed by other candidates in the polls who advocate similar ideas. Donald Trump criticized the Fed's decision to wait until last December to raise rates by arguing, "I'm just not sure it's a very good thing, because I really do believe we're creating a bubble." Though asset prices are high, market risk is limited compared to 2008 because banks have more capital and short-term borrowing is less prevalent. Moreover, anemic wage growth and low inflation rates indicate tight monetary policy would now do more harm than good. Yet, Senator Ted Cruz, neurosurgeon Ben Carson, and former Arkansas Governor Mike Huckabee go much further than Trump by endorsing the gold standard or tying the dollar to a commodity basket. However, the idea that fixing the dollar to a commodity like gold would yield financial stability is plainly false. The gold standard required central banks to contract the money supply at the onset of a recession in 1929, which exacerbated declining consumption and prolonged the

"...the danger exists that during the next financial crisis, the Fed will lack the independence to prevent an economic depression again."

Great Depression.

Yet, a more alarming trend is support from establishment Republicans on encroaching on the Fed's independence. Senator Marco Rubio has proposed that the "Federal Reserve Board should publish and follow a clear monetary rule to provide greater stability about prices and what the value of a dollar will be over time." However, Bernanke argues the shortcomings of rules-based monetary policy include lack of guidance on what to do when the predicted fed funds rate is negative and ambiguity over variables in monetary rules. Meanwhile, New Jersey Governor Chris Christie has echoed Trump's ad-hominem attacks against Fed Chair Janet Yellen, insinuating that monetary policy is conducted solely to benefit President Obama. Amidst Cruz's rise in recent polls, Ohio Governor John Kasich is alone among establishment Republicans in rebutting reckless monetary policy positions by vowing to work with the Fed to protect depositors in another crisis. Another reason to worry: Kasich got booed by the audience!

It is concerning that Democratic candidates politicize monetary policy too. Senator Bernie Sanders suggested the Fed should not increase interest rates until unemployment rates are below four percent, far below the level of full employment. He and Maryland

Governor Martin O'Malley have also accused the Fed of serving the interests of large banks. This is dangerous because populism in both parties threatens the Fed's independence and financial market stability. The Fed might be imperfect, but alternatives to central bank independence are fool's gold. – JK



### Upcoming Events

'Straight Outta Economics' t-shirts are still available @ \$10 each  
Tecolote February 9th before the meeting,  
food will be provided

Great Debate Auditions: sessions are next week Wednesday, 5 to 8pm at 108 Forum and Thursday, 6 to 8pm at 112 Kern, be sure to sign up for a slot if you want to participate!