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Halloween, fear and the economy

■ Do fluctuations in uncertainty have a symmetric or asymmetric effect on the economy? ■ The question is important considering that since last year, uncertainty has been acting as a headwind to global growth. Moreover, recent news about the US-China trade negotiations and Brexit have raised hope that uncertainty may have peaked and that growth in activity could accelerate ■ Empirical research shows that an increase in uncertainty has a bigger effect on the economy than a decline, in particular in a subdued growth environment ■ This would suggest that, should the decline in uncertainty be confirmed, the pick-up in growth would be very gradual.

Halloween is big business. According to the US National Retail Federation, American shoppers are expected to spend USD 8.8 billion this year on Halloween items like costumes, candy, decorations and greeting cards. The numbers are huge but are not immune to what happens in the economy in general. Slowing growth seems to impact Halloween spending because this year's plans are down from last year's USD 9 billion and the record established in 2017 of USD 9.1 billion. People interviewed about their shopping intentions expressed concern about the trade war with China although Halloween merchandise had been imported before the latest tariff increase.

Halloween is, to some degree, about scaring off people: millions of adults plan to dress like witches, vampires, pirates or zombies. Apparently, a lot of people enjoy having a scary time: 22% of survey respondents intend to visit a haunted house. Of course, like with children playing trick or treat, it's only a game, so the feeling of fear doesn't last long. Although it is tempting to look for an analogy between trick or treat and trade negotiations (threatening in order to get something in return), the big difference is that one does not know how long the trade negotiation 'game' will last. Fear and uncertainty may linger on, raising the question of whether, when the dust eventually settles, things will quickly move to normal or not. To put it differently: do uncertainty shocks have symmetric or asymmetric effects?

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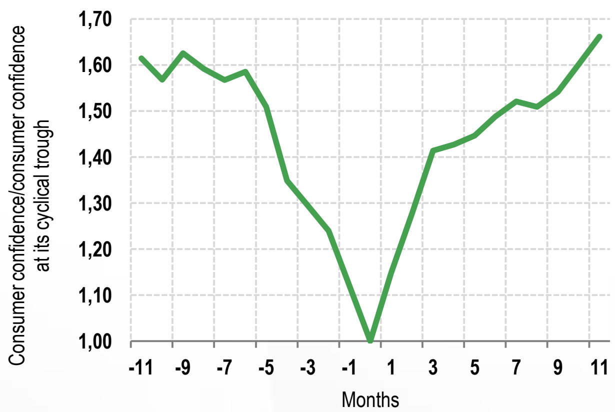
US CONSUMER CONFIDENCE (CONFERENCE BOARD)*



*The chart shows for each month the average level of consumer confidence divided by the average level of the cyclical trough of consumer confidence. The troughs are May 1971, January 1975, May 1980, October 1982, January 1987, February 1992, March 2003 and February 2009.

Source: Datastream, BNP Paribas

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Intuitively, one would expect the latter: economic agents are risk averse and will probably want sufficient evidence that the haunted experience firmly belongs to the past. This is confirmed by the chart which shows cyclical downturns and upturns of US consumer confidence. Whereas, on average, it takes about 6 months to drop from 1.6 to 1, it takes about 10 months to move back to 1.6.

The question of (a)symmetry was analysed in a more rigorous way by Paul Jones and Walter Enders[1]. The authors focus on uncertainty shocks during the recent financial crisis. They find that increases in uncertainty have a bigger impact on the economy than decreases. Moreover, the extent of this difference depends on the cyclical environment. This doesn't come as a surprise: when growth is strong, economic agents will be able to better cope with increases in uncertainty because, even taking the ensuing headwind into account, growth should still be satisfactory. This is quite different when growth was already soft when the uncertainty shock hit. Applying the insights from this research to the current environment, one can argue that the increase in uncertainty about tariffs and Brexit has had a bigger effect on the economy because growth was already slowing. Ongoing uncertainty clearly made things worse. It goes without saying that ending this uncertainty in a clear, credible and lasting way would be most welcome. Even then, the asymmetric nature of uncertainty shocks would imply that the pick-up in growth would only be gradual.

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[1] The asymmetric effects of uncertainty on macroeconomic activity, Paul M. Jones and Walter Enders, Macroeconomic Dynamics, 20, 2016.