

## The fear factor is a mover and a shaker

September 28, 2011

Ross Gittins

Read more: <http://www.smh.com.au/opinion/society-and-culture/the-fear-factor-is-a-mover-and-a-shaker-20110927-1kvba.html#ixzz1ZCJkmYdX>

**The peregrinations of the economy are as much about psychology - moods and feelings - as about tangible economic forces.**

IT'S not something economists emphasise. Indeed, they prefer not to think about it because it reminds them of the limits of their so-called science. But the peregrinations of the economy are as much about psychology - moods and feelings - as about tangible economic forces.

When you view the economy from outside, what you see is might and power. Big corporations with towering offices, huge factories, gleaming shopping complexes, thousands of employees and annual turnover of hundreds of millions of dollars.

Then you have the big governments supposedly running the show: the federal government spending \$360 billion a year, the Reserve Bank moving interest rates at will. The total value of all the goods and services Australia produces in a year is \$1.4 trillion.

And against all that is me or you. No wonder we feel like pawns in a huge game, pushed by forces beyond our control.

But last week a student reminded me how bizarre it is that the world economy is built on something as nebulous as "confidence". We may be as insignificant as ants, but when enough of us push in the same direction we can make the global economy tremble.

Take banks. They accept deposits from people who may withdraw their money at will, but then they lend that money to someone for 25 years. Were it not for government protections, a run of depositors demanding their money could bring down the mightiest bank. When people see a queue forming outside a bank, all their instincts tell them to join it.



Confidence and fear move  
the largest economies up and down.

*Photo: Rob Homer*

Take the sharemarket. If people are keener to sell a company's shares than to buy them at any moment, down comes the price - and, if it's one of our big companies, the retirement savings of people across the land take a dip. If a company's shares fall, or if shares fall generally, the chances increase that the next move will be down rather than back up.

Take consumer confidence. When the economy looks like it's slowing down, people postpone taking on commitments and cut back their spending on non-essentials, just to be on the safe side.

If enough people think and act that way, their fears become self-fulfilling and a self-reinforcing cycle develops. Their reduced spending causes businesses to lay off staff, news of this causes others to become more cautious and this and the greatly reduced spending of the jobless prompts a new round of job losses and belt-tightening.

Our being social animals - our moods and actions are heavily influenced by the moods and actions of the people around us - means these swings easily develop momentum. They work in both directions, of course. When we're confident we spend, move to bigger or better homes and push up share prices with gay abandon.

When things are on the up, we can't imagine they'll ever stop rising; when things are heading down, we can't imagine they'll ever stop falling. These swings in consumer confidence are matched by swings in business confidence. Business people take their lead from consumers, but they're just as susceptible to the mood swings of their own class.

The availability of credit amplifies these swings. Households and businesses borrow heavily to take advantage of the good times, get ahead of rising property prices and keep the party going. On the way down, their high levels of debt add to their fears, caution and cutbacks.

So the economy is driven by alternating waves of excessive optimism and pessimism. It looks inscrutable but the booms and slumps are driven by the nebulous moods and feelings of the human animal.

Note, it doesn't matter whether the fears that set off these chains of adverse developments are well-founded or not. Their consequences are real, regardless.

Adding to the insecurity and uncertainty is one of the hallmarks of the human animal, our insatiable curiosity. We always want to know what's happening, why it's happening, how the world works and what the future holds.

The economies of Europe have serious debt problems. They've been grappling with those problems for months without resolving them. We have no idea how well or badly this episode will end, or even when. But every other week the world's financial markets suffer another bout of nerves and drop share prices further. This increases the pressure on Europe's politicians to find a solution, but may also increase the likelihood of disaster.

Every time our shares take another dive the saga moves to the media's centre stage and they attempt, yet again, to explain its complexities and ask more experts to predict how things will turn out.

Our crazy, unceasing urge to ask people who can't know to speculate about what the future holds arises from what psychologists call our "illusion of control" - our tendency to overestimate our ability to control events. We want to know all about the events in Europe and elsewhere and how they will affect us because "forewarned is forearmed" and just in case there's something we can do to protect ourselves.

In truth, however, the main thing we're doing is putting the wind up ourselves long before it's possible to know what will happen and how seriously it will affect us in Australia. My guess is, what will hurt us most is our fear of the possibilities, not the ultimate events. The trouble with moods and feelings is their ability to influence hard economic facts.

Read more: <http://www.smh.com.au/opinion/society-and-culture/the-fear-factor-is-a-mover-and-a-shaker-20110927-1kvba.html#ixzz1ZCJiu6ND>