ECONOMIST POINT OF VIEW

The Narrative Epidemic

The Covid-19 pandemic crisis provides the perfect test of Professor Shiller's narrative epidemic theory. He believes certain stories become viral and infect our view of economics as well as financial markets. As well as spreading through the world's population, the virus has created its own narrative and attitudes to this crisis are being shaped by other popular stories we tell ourselves. While he thinks concerns over a great depression are overblown, he is worried this could provide a technological pushback.

"It's been a long held conviction of mine that the economy is epidemic in nature."

Professor Robert Shiller
Professor of Economics at Yale University

Long before the outbreak of the Covid-19 pandemic crisis, Professor Shiller noticed the parallels between the way an epidemic spreads through a community and how certain narratives become entrenched and influence financial markets.

At a recent conference call organised by Natixis Investment Managers affiliate Ossiam, Professor Shiller said: "It's been a long held conviction of mine that the economy is epidemic in nature." A particular point of view is formed and that narrative becomes viral in nature spreading through society and changing the way we view the world.

In the past, popular narratives have been ignored by finance professionals because they seemed unscientific. Economic rationalists did not believe such anecdotes could have profound impacts on human behaviour.

Professor Shiller said: "It's often hard for us to appreciate why people behaved in a certain way at particular times in history because we no longer know what narratives were influencing their behaviour."

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But in his book Narrative Economics, Shiller argues studying popular stories which influence both individual and collective behaviour will help us to improve our ability to predict and prepare for future crises.

The perfect test
The coronavirus outbreak has created the perfect test of Shiller's theory: an actual pandemic has created its own narrative epidemic and influenced behaviour of central banks, governments and financial markets.

Professor Shiller said: "The narrative epidemic may overstress the importance to markets of a virus which has caused the Covid-19 pandemic."

The initial financial market reaction to the epidemic was severe. In the US the cyclically-adjusted price-earnings ratio was 31 times a few months ago and fell to 21 times at its lowest with a subsequent bounce back to 25. Professor Shiller said: "This steep fall suggests investors had a very different outlook."

While this sharp market correction reflects the impact of the lockdowns throughout the developed world on the economy, if the impact of the coronavirus disappears in one to two years, it should have been only a minor blip on long-term earnings.

Market mistrust
In other words, the impact of Covid-19 pandemic was not the only narrative influencing investor behaviour – there is another story playing out; a mistrust of the market. Investors are well aware of the strong performance of the US stock market from 2009 to the start of this year.

Professor Shiller said: "There was a sense we were going through an unwarranted euphoric period in the US which exacerbated the reaction to the Covid-19 pandemic crisis."

Whether the initial reaction was warranted or an over-shoot will be determined by the length and depth of the recession sparked by the lockdowns used to control the spread of the virus.

Professor Shiller said: "I think it is likely we are already in a recession, even though we do not yet have the data to prove. It seems likely given the scale of the economic shock."

The right response
How long that recession lasts depends on whether the measures taken by governments and central banks will be sufficient to offset the lockdown. The stimulus package has been put in place to engender the right behavioural response to the crisis.

Professor Shiller said: “These measures have been taken to make people feel economically sound. They help make it possible for people to stay at home and not worry about food or paying the bills.”

The more people stay at home, the fewer people die, the less healthcare system is over-whelmed and the more rapidly the economy can rebound. But despite this strategy, concerns linger about a possible depression being sparked by the virus.

The depression narrative

Professor Shiller said: “The depression narrative is a very powerful one, which like certain viruses frequently re-emerges, most recently from 2007 to 2009.”

But our fear of a depression may be overblown. Professor Shiller said: “The Covid-19 pandemic crisis is not the same phenomenon as the global financial crisis when the depression narrative was even stronger because of the parallels with the economic crisis in the 1930s.”

While fears of a depression may prove to be short-lived, another more worrying narrative could emerge which could dampen economic growth for a significant period: a fear of the impact of artificial intelligence and robotics on people’s livelihoods.

The technological scapegoat

As politicians have no way to prevent technology from replacing many people they have decided to make immigration the scapegoat. Professor Shiller said: “But if this becomes a period of high unemployment, people are going to start worrying technology is the cause of their problems.”

For example, during the Great Depression there were a lot of fears about robots replacing human beings. Professor Shiller said: “During the 1930s the dial telephone replaced the jobs of switchboard operators, making them redundant.”

This fear of machines replacing jobs was one of the narratives which meant the Great Depression lasted a decade. Professor Shiller said: “There was also a frugality narrative and a backlash against showing off.”

The 1920s were viewed as period of extravagance and people opted in the 1930s for less flamboyant way of living. There is a danger a similar mindset could take hold but it’s very hard to forecast. Professor Shiller said: “Predicting which narratives become popular is as hard as predicting the next movie hit.”

This interview took place in April 2020

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