Tracking a world mindset

Uncertainty is regularly accused of dragging down global economic growth. And the World Uncertainty Index, co-created by SIEPR Senior Fellow Nicholas Bloom, is the broadest assessment tool yet to track it. The index zeroes in on the nagging sense of the unknown felt in 143 countries from Albania to Zimbabwe.

MAY WONG

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Like a usual suspect, uncertainty is accused over and over again as an accomplice dragging down the economy in the past few months. *The Economist* recently said it was like a poison, and *The Wall Street Journal* said “uncertainty is the monster that lives under the bed of every CEO.” Federal Reserve officials invoked it, too, as they decided to cut interest rates, inserting a stent of sorts to stabilize the economy.

Economic and political uncertainty is indeed surging, and it’s nothing to be taken lightly. Just ask Stanford economist Nicholas Bloom, whose work is regularly tapped as a barometer for uncertainty — that nagging sense of the unknown, which in turn, can dampen investment and economic growth.

His pioneering Economic Policy Uncertainty Index, developed in 2016, covers 24 advanced countries and is already regularly used within the public and private sector to shed a bit of clarity on an otherwise nebulous disposition. And now, Bloom’s newest measure of uncertainty — the World Uncertainty Index — provides the broadest assessment tool yet of a global state of mind for 143 countries. Its current readings of heightened uncertainty — stoked apparently by the U.S. trade war and Brexit — also foreshadow a significant hit to global economic growth.

In a working paper that details the World Uncertainty Index and has an appendix filled with EKG-like charts for dozens of advanced and developing economies, Bloom and his co-authors from the International Monetary Fund (IMF) estimated that the overall rise in uncertainty in the first quarter of 2019 may drag global growth by as much as a half a percentage point for the year.

“That’s an enormous effect,” says Bloom, a senior fellow at the Stanford Institute for Economic Policy Research (SIEPR). “A half percent decrease is a huge reduction in growth.”

The grim projection aligns so far with recent economic growth downgrades by the World Bank and the IMF, whose leaders have similarly cast part of the blame to uncertainty from ongoing trade wars and a variety of geopolitical tensions.

The IMF’s latest World Economic Outlook report, released on Oct. 15, forecasts that GDP growth will be at 3 percent — its slowest pace since the global financial crisis and down 0.3

percent from its April forecast. And global growth could fall even lower in 2019 if monetary policy interventions or other economic factors don't mitigate the situation, the report cautioned.

"The weakness in growth is driven by a sharp deterioration in manufacturing activity and global trade, with higher tariffs and prolonged trade policy uncertainty damaging investment and demand for capital goods," the IMF's chief economist Gita Gopinath said on Oct. 15 at its annual meeting in Washington D.C. *(Gopinath is slated to speak at SIEPR on Nov. 14)*

In fact, when Bloom and his research colleagues at the IMF — Davide Furceri and Hites Ahir — recently teased out trade-related uncertainty in their World Uncertainty Index, the estimated effect worsened. The researchers wrote in an IMF blog that global growth for the year could be reduced by as much as 0.75 percentage points.

After staying low and stable for about 20 years, trade uncertainty in particular has now jumped tenfold from previously recorded highs, they say. And it's surging not only in China and the United States, where trade tensions are highest, but also in many other countries.

A reflection, a harbinger

The World Uncertainty Index gauges uncertainty by scouring Economist Intelligence Unit reports — quarterly country reports that provide a standardized snapshot of economic and political developments. The index covers 143 countries starting from 1996, as well as a subset of almost 80 of the world's larger economies back to 1955.

For each country, it tallies the number of times words such as "uncertain," "uncertainty," or "uncertainties" are mentioned. An increase in the index value indicates uncertainty is rising, and vice versa.

To specifically measure trade uncertainty, the researchers look for how often "uncertainty" and its variants appear in close proximity to trade-related terms, including "tariff," "protectionism," or the "North American Free Trade Agreement."

By extrapolating from historical patterns, the researchers use the index to help predict estimated economic effects.

Uncertainty has a stronger and more persistent effect on countries with weaker legal systems, the researchers find.

According to the index, the overall world uncertainty level is nearing its record-high from earlier this decade when the U.S. was still reeling from the financial crisis and was on the brink of a "fiscal cliff" in 2013 while a debt crisis loomed in Europe.

Earlier large spikes occurred during the 9/11 attacks, SARS outbreak, Iraq invasion, the failure of Lehman Brothers, El Niño and the European border crisis.

Global uncertainty climbed again in 2016 after the U.S. presidential election and the Brexit vote. The main triggers for the latest surge beginning in the first quarter of 2019 appears to be uncertainty concerning U.S. trade policy and Brexit, the researchers find.

“Give me a number”

It’s been long apparent that the risk of the unknown somehow puts a chilling effect on business investments, manufacturing and worker productivity — something that Bloom and other economists before him have studied.

“We knew that uncertainties affect investment, but fine, give me a number,” Bloom says.

In developing the Economic Policy Uncertainty index, Bloom and his co-creators — Scott Baker of Northwestern University and Stephen Davis of the University of Chicago — used what was then a relatively new technique of mining text from major newspapers for data. The subsequent high frequency of citations from academic, public and private financial institutions affirmed that their work had hit a chord.

“It was like an epiphany,” Bloom says. “I thought, wow, there’s clearly a demand for this.”

Since then, Bloom and his colleagues have spliced the Economic Policy Uncertainty index (EPU) to parse out uncertainty revolving around key policy areas, such as trade, monetary policy, national security or health care.

Today, the World Uncertainty Index “fills another gap,” Bloom says. Researchers can use the dataset to foreshadow GDP output or as an alternative measure of economic activity.

“The huge upside is it covers places like Ghana, where they don’t have a stock market or any totem for forecasts,” Bloom says.

The World Uncertainty Index, along with its trade uncertainty offshoot and EPU forbearer, are not perfect measures, Bloom cautions, but the tools appear to be useful, lending a kind of quantifiable clarity.

Bloom has also blended uncertainty with his other prong of labor economics work. His latest endeavor there is a major survey of firms in the United Kingdom to watch how Brexit and its accompanying uncertainty affects them. That work was featured in a recent SIEPR Policy Brief.

“Uncertainty is world-directed, and it has increased a lot,” Bloom says. “It makes sense to keep going with measuring it.”

The World Uncertainty Index is publicly accessible and updated quarterly at policyuncertainty.com, the online portal for the growing number of uncertainty indices that Bloom and other colleagues have constructed since the debut of the Economic Policy Uncertainty Index.