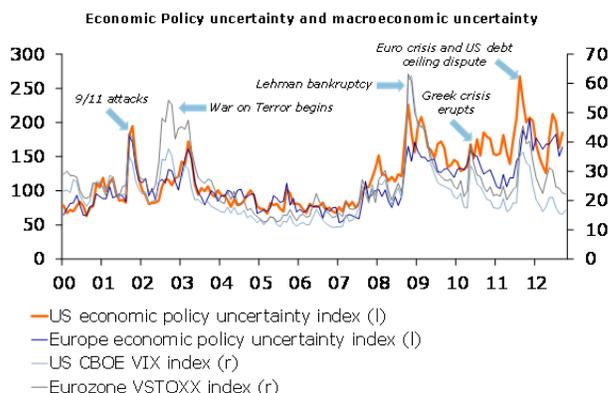




Economic visibility must improve quickly

Economic policy uncertainty in Europe and the US remains high and this will have negative repercussions for growth. Thus far, financial markets have remained optimistic, but policymakers should not expect this to continue for far longer if policy visibility does not improve.

Figure 1: The future remains very uncertain



Source: EcoWin; Baker, Bloom, and Davis (2012)

Uncertain economic times are undesirable since they adversely affect economic growth through a variety of channels. For example, firms usually postpone their investment and hiring plans until economic visibility improves. Equally, households respond by reducing their spending on non-essential goods and services. Meanwhile, greater uncertainty increases risk premiums in financial markets which in turn leads to tighter credit conditions.

The broadest definition of economic uncertainty is when little or nothing is known about the future state of the economy. But this does not allow us to monitor the evolution of uncertainty at any given time. To do so, one can consider the volatility of stock market returns as a measure of *macro-*

economic uncertainty. When volatility rises, the market is sending a clear signal that future economic development is becoming less certain. Another interesting topic is *economic policy uncertainty*. To capture this, Baker, Bloom, and Davis (2012)¹ use a weighted average of three indicators: the frequency with which terms like 'economic policy' and 'uncertainty' appear together in the media, the number of tax provisions that will expire in coming years and the dispersion of forecasts of future government spending and inflation.

Figure 1 shows how the two measures of uncertainty have evolved in Europe and the US since 2000. Interestingly, there were no big deviations between the measures of macroeconomic and economic policy uncertainty until end-2011. However, when looking at recent developments, we see that the volatility of stock market returns has diminished considerably while economic policy uncertainty remains at elevated levels. The latter is understandable given that we do not formally know whether and how the US government officials will eventually avoid the painful 'fiscal cliff' (automatic spending cuts and tax rises) due on January 1, 2013. We only know that Democrats and Republicans are reportedly broadly in agreement over the desire to avoid the full cliff. Also in Europe, it always remains to be seen how fast and how far the European leaders will move towards further European integration as a long-run solution to the current crisis.

Against this backdrop, one can expect that macroeconomic uncertainty will rise in time, thereby leading to tighter financial conditions and further hurting the fragile recovery, if policymakers do not quickly address policy uncertainty. The good news is that policymakers can bolster growth through bold and transparent measures that tend to improve economic visibility. We can only hope that they seize this opportunity before market optimism wanes.

¹ Baker, S., Bloom, N. and Davis, S.J. (2012). Measuring economic policy uncertainty. *Stanford University Working Paper*.

Economic visibility must improve quickly



Rabobank

Rabobank Economic Research Department

	Tel.	E-mail:
<u>Chief economist</u>	+31 30 21	
Wim Boonstra	66617	W.W.Boonstra@rn.rabobank.nl
<u>International Economic Research</u>		
Allard Bruinshoofd*	63272	W.A.Bruinshoofd@rn.rabobank.nl
<i>Macro</i>		
Shahin Kamalodin	31106	S.A.Kamalodin@rn.rabobank.nl
Tim Legierse	62677	T.Legierse@rn.rabobank.nl
Michiel Verduijn	30522	M.P.Verduijn@rn.rabobank.nl
Marcel Weernink	60973	M.Weernink@rn.rabobank.nl
<i>Country Risk</i>		
Erwin Blaauw	62648	E.R.Blaauw@rn.rabobank.nl
Fabian Briegel	64053	F.Briegel@rn.rabobank.nl
Jeroen van IJzerloo*	62406	J.IJzerloo@rn.rabobank.nl
Herwin Loman	31105	H.Loman@rn.rabobank.nl
Reintje Maasdam	31403	R.Maasdam@rn.rabobank.nl
Ashwin Matabadal	61601	A.R.K.Matabadal@rn.rabobank.nl
Reinier Meijer	31568	R.Meijer@rn.rabobank.nl
Anouk Ruhaak	64860	A.N.Ruhaak@rn.rabobank.nl
<u>National Economic Research</u>		
Hans Stegeman*	31407	H.W.Stegeman@rn.rabobank.nl
<i>Macro</i>		
Ruth van de Belt	60143	R.Belt@rn.rabobank.nl
Maarten van der Molen	64490	M.T.Molen@rn.rabobank.nl
Danijela Piljic	31104	D.Piljic@rn.rabobank.nl
Anke Struijs	31408	A.C.A.Struijs@rn.rabobank.nl
Theo Smid	67599	T.H.Smid@rn.rabobank.nl
Paul de Vries	30172	Vries.P@rn.rabobank.nl
<i>Regional</i>		
Rogier Aalders	31393	R.Aalders@rn.rabobank.nl
Cynthia Briesen	31411	C.C.Briesen@rn.rabobank.nl
Frits Oevering	64439	F.J.Oevering@rn.rabobank.nl
Anouk Smeltink-Mensen	66404	A.H.H.M.Smeltink@rn.rabobank.nl
Willem van der Velden*	62478	W.Velden@rn.rabobank.nl
<u>Financial Sector Research</u>		
Yvette Jorissen	64931	Y.M.Jorissen@rn.rabobank.nl
Dick Scherjon	31405	D.P.Scherjon@rn.rabobank.nl
August Sjauw-Koen-Fa	31406	A.R.Sjauw@rn.rabobank.nl
Nicole Smolders**	79108	N.M.P.Smolders@rn.rabobank.nl
Rachida Talal-Azimi	34021	R.Talal@rn.rabobank.nl
Leontine Treur	67084	L.Treur@rn.rabobank.nl
Bouke de Vries*	61195	Y.B.Vries@rn.rabobank.nl

*Head

**Telephone begins with +31 40 21