Group Economics

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The question of confidence….

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As we indulged in a dose of much-needed Olympics feel-good therapy earlier this month, the fifth anniversary of the start of the credit crunch came and went. As we watched Usain Bolt snap his countrymen's celebrations with a borrowed camera after a Jamaican one-two-three in the 200metres final, we nearly forgot that the same day marked five years since the words 'sub-prime', 'Fannie Mae' and 'credit default swaps' began to become as familiar to us as 'Peloton' and 'Repechage' are today. Confidence, then, as now, also become a much used noun.

Back in 2007, the lack of confidence was confined to financial products, before spreading to financial institutions. A year later, in September 2008, the collapse of Lehman Brothers provided a watershed moment as the crisis in confidence morphed from financial markets to the economic world. Fast forward five years and *(despite our dose of Olympics magic)* there is still a widespread crisis of confidence. Though, the source of the confidence deficit has shifted to areas that weren't even on the radar in 2007/08 – Greece and the eurozone.

Indeed in February 2009, the European Union's economics commissioner Joaquin Almunia noted that *'The Greek economy is in better condition compared with the average condition in the eurozone, which is currently in recession.'* Jason Manolopoulos uses this line to launch his book *"Greece's 'Odious' Debt: The Looting of the Hellenic Republic by the Euro, the Political Elite and the Investment Community"*.

Manolopoulos makes the point that the crisis of confidence we see today is a product of the *(crisis)* of over-confidence during the last decade and before. This featured in the way the Eurozone was set up and its membership composition, which was largely a triumph of politics over economics. Over-confidence was also a feature in the UK's public expenditure boom and in the property booms in Northern Ireland and the Republic of Ireland.

'Lack of confidence' is a phrase we frequently hear today. For some, a lack of confidence is the single biggest factor limiting a sustained economic recovery. Their logic is simple. Greater business confidence encourages firms to hire more employees and invest. Meanwhile improved consumer sentiment translates into higher levels of consumer spending. Ultimately, these should lead to a virtuous circle and a growing economy. Conversely, a lack of confidence can lead to a downward spiral of lack of investment, job losses and reductions in consumer spending.

Confidence is critical but perhaps not always in the way that everyone thinks. Confidence without substance is dangerous, as Manolopolous's point so clearly illustrates. Creating a false sense of confidence can be more damaging than a lack of confidence. Should firms be encouraged to invest for demand that isn't there, or consumers to spend money on goods that they neither need nor can afford? Such a well-intentioned 'confidence boost' could actually lead to worse outcomes than if no encouragement was provided at all.

For some people, confidence simply reflects the reality of economic conditions. Whilst for others it is something that can be manufactured and managed. Confidence, however, is a two-way street and closely linked to credibility. Jason Manolopoulos sums it up well: *'The narrative of a politician or other leader can have a positive impact on confidence among consumers and the markets. But there has to be a positive trend to nurture……positive rhetoric cannot fabricate a recovery; it can only encourage whatever positive developments there might be. Thunderous, positive declarations that are in denial of the reality on the ground serve only to weaken the credibility of the spokespeople involved, and distract attention from the necessary remedial action."*

In medicine, doctors tell patients what they need to know, not what they want to hear. They do it in a measured and sensitive way, but they don't hide the important facts, they don't beat about the bush, and they don't opt for a more palatable alternative diagnosis. Accurate information is key to the patient being able to make the right decisions and to take the correct actions to safeguard their health in the future.

Within an economy, there is the added complication of different players with potentially conflicting agendas. Indeed, *'telling it as it isn't'* or stifling those who seek to *'tell it as it is'* can be more profitable for some at the expense of others and the wider economy. This feature has been evident in financial crises throughout history, from the Great Depression in the US to the debt crisis in the eurozone today.

On 4 December 1928 President Calvin Coolidge gave his last State of the Union address. This was one of the most positive and optimistic addresses ever delivered. Coolidge told the country that they might *'regard the present with satisfaction and anticipate the future with optimism'.* The Great Crash of 1929 and the Great Depression quickly followed. Ever since, historians have lambasted Coolidge's superficial optimism and his failure to see the crisis coming. In particular, Americans should have been alerted to the desire of US citizens to get rich quick with minimal physical effort. This was a common feature in speculative bubbles, including Northern Ireland's property bubble of 2005-2007.

As with most crises, individuals warning of impending doom are rarely welcome. When herd behaviour takes over within a speculative bubble, alternative views are ruthlessly dismissed. This has been evident in the US, the eurozone and Ireland. In 1929, one of the most respected bankers of that era, Paul M. Warburg spoke out against the orgy of *'unrestrained speculation'* and foresaw a disastrous collapse and serious depression. Later that year, economist Roger Babson forecast a stock market crash. Both of these views were met with a furious reaction.

After a crash, invariably those who failed to speak out and apply the brakes to the over-confidence during the boom are the first to lobby for a dose of post-crash confidence. One example of this concerned J.P. Morgan. The legendary banker called on New York clergymen to preach sermons of confidence and encouragement to bring the 1907 crash to an end. Did divine intervention end the crash or would it have happened anyway?

Overconfidence and a lack of tolerance of dissent has also been a feature in Europe. Two books that elaborate on this theme are Jason Manolopolous's book and *"The End of the Euro: The uneasy future of the European Union"* by Johan Van Overtveldt. The latter suggests the euro project was oversold for political reasons and ignored the foreseeable economic problems that are evident today. According to the Nobel Prize winning economist, Paul Krugman, Europe was caught up in *'a mood of almost giddy optimism'* or *'Europhoria'. "Political leaders throughout Europe were caught up in the romance of the project, to such an extent that anyone who expressed scepticism was considered outside the mainstream".* Scepticism was not welcome but nevertheless American economists dutifully contested the optimistic view presented and raised the fundamental economic problems that are all too evident today. According to Van Overtveldt, *'Europe's decision to ignore American criticism was as complete as it was remarkable'.*

Europe's leaders also failed to see problems emerge once the single currency was launched. Various warnings went unheeded. Looking at Greece in particular, a blind eye was turned to the lack of reform that is now deemed essential. Did the fact that Greece was the highest purchaser per capita of Porsche Cayennes during the 2000s not raise an eyebrow? In 2006, the pro-EU Centre for European reform published a critique on the imbalances and weaknesses in the eurozone. The paper identified the problems of the Southern economies that would threaten the sustainability of the single currency. The pro-European think tank drew heavy criticism and was even accused of euroscepticism! 'Shooting the messenger' was also a feature in Ireland. In July 2007, in response to commentators' concerns surrounding the Irish economy, Bertie Aherne famously remarked: *'Sitting on the side-lines, cribbing and moaning is a lost opportunity. I don't know how people who engage in that don't commit suicide…'*

The balance between nurturing confidence when there are genuine reasons to do so and not creating false confidence has to be found. Realism must not be sacrificed just because we don't want to hear it. The economy and its various actors will not be thankful in the longer-run; not least because under-stating the problem underestimates the need for reform. What the economy needs to know is more important than what the economy, or sections within it, want to hear.

Usain Bolt's starting and finishing line capers are expressions of confidence that are backed by genuine talent, and are in contrast to the antics of some other competitors whose starting line routines are not matched by their performances. Likewise, bold pronouncements of economic confidence must have substance – otherwise they are in danger of being more Comical Ali than Muhammad Ali. I think we all know what happened to the former.

Richard Ramsey,
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