

# The Uncertain Effects of Economic Uncertainty

BY CHARLES GERENA

**“How Do Households Respond to Uncertainty Shocks?”**  
Edward S. Knotek II and Shujaat Khan, Federal Reserve Bank of Kansas City *Economic Review*, Second Quarter 2011, pp. 63-92.

Question marks hang over many things lately — from the pace of the nation’s recovery to the implementation of health care and financial market reforms. As a result, many believe businesses and consumers are holding back on spending decisions that would be costly to reverse.

But do sudden changes in uncertainty actually lead to significant changes in economic activity? Economists have tried to factor in varying levels of uncertainty into their models. But, note Edward Knotek II and Shujaat Khan of the Kansas City Fed, “the results have been mixed thus far, with some authors finding that fluctuations in uncertainty are a key factor in the business cycle, while others have found little such evidence.”

Knotek and Khan tackled this question by looking at how households respond to changes in two measures of uncertainty: first, the monthly appearance of the words “uncertainty” or “uncertain” in *New York Times* articles about the economy and second, an index of stock market volatility.

Knotek and Khan found that increases in uncertainty don’t necessarily lead to sharp pullbacks in household purchases and economic weakness. Rather, reductions in spending overall seem to be modest and take some time to occur. “In addition, movements in uncertainty account for only a small portion of the total fluctuations in household spending,” the authors write.

They concede that, overall, recessions tend to coincide with spikes in uncertainty and that expansions tend to coincide with low or declining uncertainty. However, they cite prominent exceptions to those correlations.

**“How Much of the Decline in Unemployment is Due to the Exhaustion of Unemployment Benefits?”** Luoja Hu and Shani Schechter, Federal Reserve Bank of Chicago, Chicago Fed Letter No. 288, July 2011.

Although the pace of the recovery in labor markets has been painfully slow, the national unemployment rate has been generally falling since its peak in October 2009. Some of that decline, however, may be due to a rise in the number of people dropping out of the workforce as they lose their unemployment insurance (UI) benefits, which are paid out only to those actively seeking a job.

Luoja Hu and Shani Schechter, two economists at the Chicago Fed, used data on unemployment duration to identify how many workers were within five weeks of exhausting

their UI benefits. Then the researchers tracked these so-called “exhausters” over time to see whether they found work, continued their job search, or gave up and left the workforce. They compared this group to “nonexhausters” — longtime unemployed who still had more than five weeks of eligibility for benefits.

“From 2008 onward, nonexhausters became increasingly likely to stay unemployed,” Hu and Schechter write in their paper. Meanwhile, exhausters followed a similar trend until mid-2009, when they started becoming less likely to stay unemployed. “This visible split between the two groups’ tendencies to leave unemployment, especially from September to December 2010, is not so much due to exhausters being more likely to find a job...but due to exhausters’ higher likelihood of leaving the labor force.”

**“Adopting, Using, and Discarding Paper and Electronic Payment Instruments: Variation by Age and Race.”** Ronald J. Mann, Federal Reserve Bank of Boston, Public Policy Discussion Paper No. 11-2, May 2011.

Can’t remember the last time you pulled a dollar bill out of your wallet? You’re probably among the millions of Americans who almost exclusively use cards or electronic forms of payments for their convenience and security.

The Boston Fed decided to find out more about this shift in behavior by conducting a survey in fall 2008. A recent paper details some of the survey’s findings, including demographic differences in how Americans have adopted new types of payment instruments.

For example, older adults (ages 45 years and older) appear much less likely to use debit cards or online bill payment, even when controlling for variables like income, education, and race. Also, a much higher percentage of blacks than whites use money orders. In general, “blacks are significantly less likely to use all of the products summarized here [paper, cards, electronic payments] except for debit cards,” notes Ronald Mann, an electronic commerce expert at Columbia University who wrote the paper.

Mann reran his model and controlled for various characteristics of the survey respondents to attempt to account for this difference. Each time, the model yielded a similar racial divide — except when he narrowed his focus to blacks and whites with checking accounts. There, he found no significant differences in adoption rates of payments instruments.

“The analysis sheds relatively little light on precisely what is causing [many] blacks to shy away from noncash payment instruments,” concludes Mann, “but it does suggest that it is closely related to whatever is keeping them from using mainstream institutions like checking accounts.” **RF**