Risk and the Perception of Risk

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There are a couple of pieces today on risk in Europe. The Telegraph.co.uk had this to say:

"After nearly two years of global economic and financial upheaval, shockwaves are still being felt, as we have seen with recent developments in Europe and the resulting financial market volatility," Naoyuki Shinohara, the IMF's deputy managing director, said in Singapore on Wednesday. "The global outlook remains unusually uncertain and downside risks have risen significantly."

They are right in that uncertainty and risk are high. I don't think they've changed much, though, in recent weeks. What has changed has been people's perception of the risk.

For some reason, unfathomable to me, people started getting giddy about our economic prospects last August or so. There were some good data points, but you had to look at them only in a cursory manner, and you had to ignore other discouraging data to believe we were headed for a robust recovery.

A more in-depth analysis and a broad look at the data gave no reason for a giddy attack. The gains were mostly transitory, driven by temporary government programs. Consumers, businesses, and governments were still over-leveraged. The financial sector was still weak.

Still, it became consensus that our economic challenges were behind us. The stock markets soared, and this was taken as another sign of economic prosperity just around the corner.

Now, the stock markets are down again, and some economists are talking about new risk. I'd say the risks were there all along, and our forecast reflected those risks.