The certainties of uncertainty

Uncertainty is a subjective phenomenon. But its root causes are objective economic indicators — and those can be measured in detail.

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Ever since the 2007-08 banking crisis, global financial markets have experienced unprecedented fluctuations. No one is in any doubt about the more recent drop-off in global production or the severe recessions plaguing formerly healthy Western economies.

At times like these, feelings of uncertainty are more than justified. However, up until now, there was no specific indicator to provide objective data and enable that variable to be measured or compared with other periods and economic contexts.

One tool, four variables

To fill that void, the I3E Economic Uncertainty Index measures the level of economic uncertainty based on four key variables:

- the dollar/euro exchange rate
- the price of Brent crude
- the value of the IBEX35
- the return on 10-year Spanish government bonds

These four indicators — two international and two national, albeit largely determined by the global economic context — allow analysts to objectify and quantify the existing level of economic uncertainty. Published since January 2011, the index aims to help companies, individuals, governments and the media in their decision-making processes.

Uncertainty and volatility

The index reflects the volatility of its constituent variables. This volatility is significantly higher with respect to the price of Brent crude and the IBEX35 than it is with the dollar/euro exchange rate and 10-year Spanish government bonds, although the four indicators show a common pattern in terms of the long-term trend.

In general, when the four constituent variables are taken independently, the index shows greater ups and downs at the start of the 2000s, with more moderate fluctuations between 2004 and 2007, although the price of oil also experienced some significant variations during that period.

This correlation can also be observed in the short term. For instance, when analyzing the period from January 2009 to December 2010, we can see that the maximum value for that period (167 points) was recorded in May 2010. In that same month, three of the indicators — i.e., the value of the IBEX35, the dollar/euro exchange rate and the price of Brent crude — also posted their worst results.

The fourth component — return on 10-year Spanish government bonds — reveals a high degree of uncertainty, although the peak value was reported in November 2010 when speculation about EU intervention in the Spanish economy reached fever pitch.

A decade of ups and downs

Looking at the data between January 2000 and July 2010, we can see exactly how rises in the indicator have coincided with critical events from an economic or financial standpoint and with recessionary times.

Between 2000 and 2003, for example, the rate fluctuated between 100 and 150, reflecting the relatively high levels of uncertainty spawned by the dot-com crisis, the September 11, 2001, terrorist attacks, and the Enron and WorldCom scandals.

Then, as the situation stabilized, the index dropped to between 50 and 100 points, hitting its low point in mid-2007. However, just a year later, in the summer of 2008, the subprime crisis erupted.

This is reflected in a sharp increase that resulted in maximum levels of uncertainty of around 200 points, between late 2008 and early 2009. Following this sudden increase, the situation gradually improved and the index bounced back during the spring, with values close to the decade average (100).

Needless to say, this period of relative calm did not last long: the onset of the sovereign debt crisis — and particularly the eurozone interventions in Greece and Ireland — triggered peak levels of uncertainty that put the index back over 150 points.