

Research Insights

Will the better-than-average effect help put us on the path to economic recovery?

People who believe they will not be personally affected by COVID-19 as much as the rest of the economy may be the ones who kick-start Australia's economic revival.

Economic expectations crucial to recovery

As the country starts to re-emerge economically and socially, Australians systematically expect that the economy will take longer to deal with the fallout of COVID-19 than they themselves. This is according to the *Taking the Pulse of the Nation* survey in which representative respondents in Australia were asked the length of time they thought that COVID-19 would economically affect both the general economy and themselves. The most commonly chosen length of time for oneself was three to six months (25.2%), yet respondents believe the economy in general will still be affected beyond one year (49.7%).

This apparent systematic disconnect between expectations for oneself and expectations for a larger group, such as the economy in general, is known as the 'better-than-average effect' or 'optimistic bias.' Psychologists Alicke and Govorun (2005) describe this phenomenon as 'the tendency to overestimate one's chances of good fortune and to underestimate one's risk for misfortune.'

This Research Insight shows that females and those in employment have higher propensities to form their expectations with more personal 'optimism' or being 'better than average'.

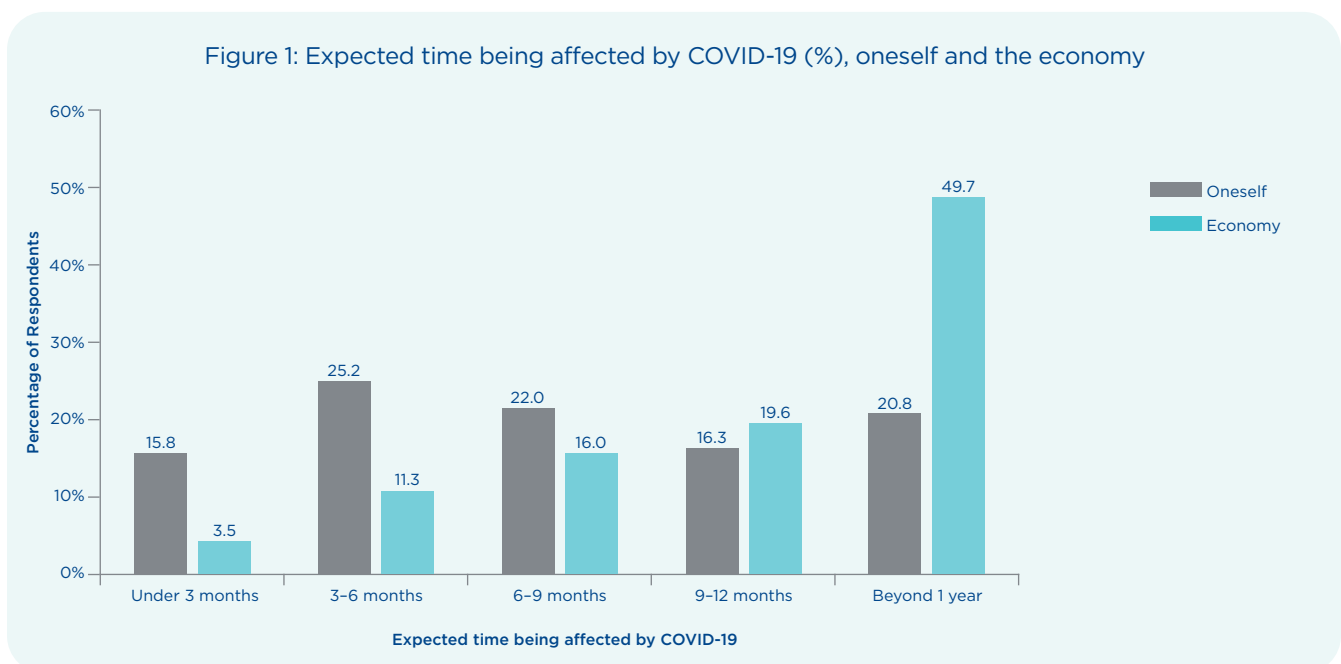
This better-than-average effect could be beneficial in kick-starting the economy. Sixty-six per cent of the respondents are in employment and likely to drive consumer spending, having the economic resources to do so. The bad news is that half of Australians expect the general economic effects of COVID-19 to last beyond one year. Expectations, good and bad, can become self-fulfilling prophecies.

Key Insights

1 Disconnect between oneself and the rest of the economy

We compare the period of time respondents (aged 18-64) expect the economy and themselves will be affected by the impact of COVID-19 (Figure 1). Strikingly, almost half (49.7%) of respondents believe the economy will still be affected by COVID-19 beyond one year, whereas only 20.8 per cent believe that they will be personally affected as long.

This leads us to examine systematically for *all persons individually* the difference in the time they expect the economy to be affected by COVID-19 and the length of time they expect to be affected themselves economically. One might expect that the sum of all differences in expectations would be close to zero, with some people thinking the COVID-19 effects take longer for the economy than themselves, and some thinking the reverse. However, we find surprising results.

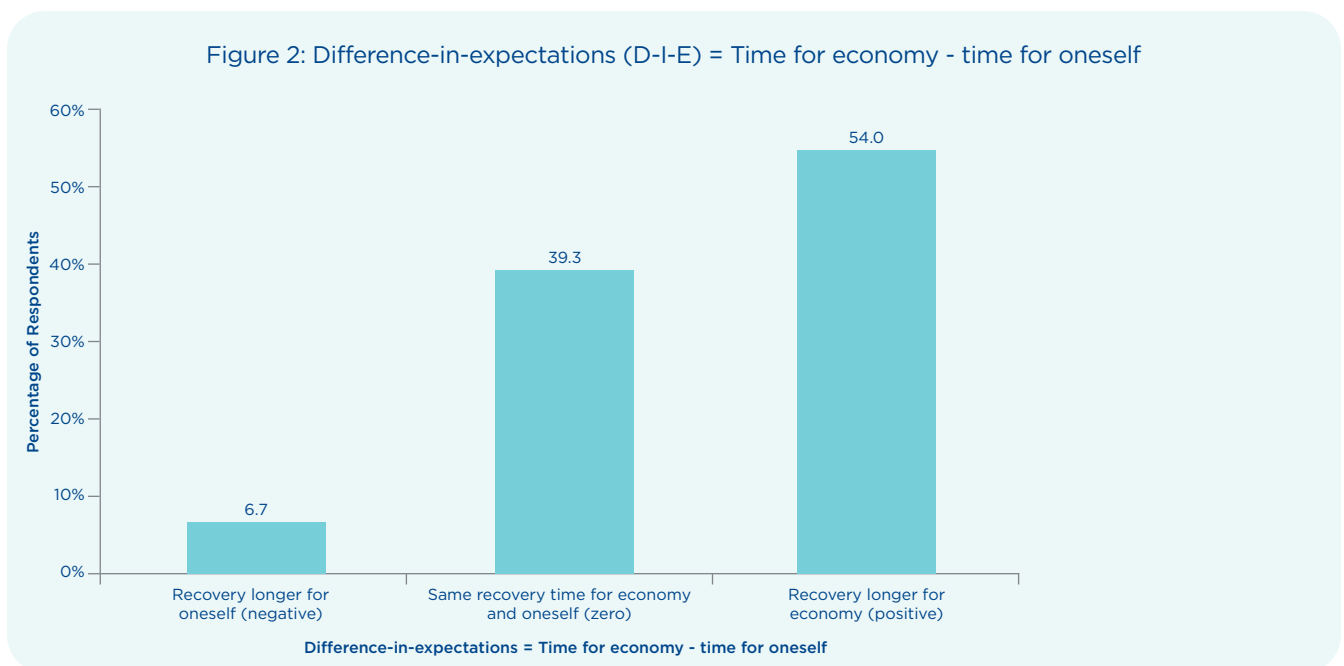


Source: Results based on responses from 2,553 Australian adults 18-64 surveyed during weeks 7, 9 and 11 of the *Taking the Pulse of the Nation* survey conducted 18 May-19 June. The sample is weighted to be representative of the Australian population on gender, age and location.

2 Belief that economy systematically affected longer than oneself

This study calculates the probability of respondents who think that: the they will be personally affected longer than the economy; the economy and oneself will be affected the same length of time; and the economy in general will be affected longer than oneself. This difference we will call the 'difference-in-expectations' or D-I-E (length of time for the economy

being affected minus the length of time for oneself). Using simple means, only 6.7 per cent of respondents say that they will be personally affected longer than the economy ("negative D-I-E") and 39.3 per cent expect the length of time to be equal ("zero D-I-E"). Yet 54.0 per cent expect the economy to be affected longer than themselves ("positive D-I-E"). (Figure 2)



Source: Results based on responses from 2,553 Australian adults 18-64 surveyed during weeks 7, 9 and 11 of the Taking the Pulse of the Nation survey conducted 18 May-19 June. The sample is weighted to be representative of the Australian population on gender, age and location.

3 Determinants of 'difference-in-expectations' (D-I-E)

We explore the extent to which socio-demographic factors are associated with the differences in expectations. These factors are gender, age, employment status and location (indicators for each state by urban/rural).

The analysis permits us to better understand the role of these factors with one's expectations for personal versus national recovery.

What matters most are gender and employment status. Age and location are not correlated with the difference-in-expectations for recovery.

Being male as opposed to female increases the probability of being more 'pessimistic' or 'negative' about the outlook for oneself by 2.7 percentage points. This is a large difference given that on average 6.7 per cent of respondents are more 'pessimistic' about their own circumstances than about the economy.

The probability of being more 'optimistic' or 'positive' for oneself decreases by 9.0 percentage points for males (from a baseline starting point of 54%), further suggesting that males are more likely to believe their personal recovery will be slower.

As these are probability models, if one outcome is predicted to be more likely, another outcome must become less likely. Therefore, being male increases the probability that one expects to be affected by the impact of COVID-19 for the same amount of time as the economy in general by 6.3 percentage points (+2.7+6.3-9.0=0).

Similarly, those who are employed are predicted to have a 5.1 percentage point higher probability of expecting the economy to be affected longer than themselves ("positive D-I-E"). Conversely, they are predicted to have a 3.5 percentage point lower probability of an equal expectation (zero D-I-E) and being personally affected longer than the economy (negative D-I-E) by 1.6 percentage points lower probability (-1.6-3.5+5.1=0) (Figure 3).

Figure 3: Predictors of difference-in-expectations (D-I-E)



Source: Results are marginal effects with 95% confidence intervals from an ordered probit regression of differences in expectations, based on responses from 2,553 Australian adults 18-64 surveyed during weeks 7, 9 and 11 of the *Taking the Pulse of the Nation* survey conducted 18 May-19 June. The sample is weighted to be representative of the Australian population on gender, age and location. The sum of "male" marginal effects is $+2.7+6.3-9.0=0$. The sum of "employed" marginal effects is $-1.6-3.5+5.1=0$. Effects with confidence intervals that do not contain the zero line are considered to be significant. "Positive": expectation for the COVID-19 effects on economy to last longer than for oneself. "Zero": expectation for the COVID-19 effects on economy to last the same length of time as for oneself. "Negative": expectation for the COVID-19 effects on economy to last shorter than for oneself.

4 The personal 'optimism' of the employed is key

The analysis *does not and cannot identify* whether respondents' expectations are true or false. Only time will tell. However, it does shed light on the extent to which there is a disconnect between beliefs about oneself, as compared to the rest of the economy, and the potential sources of such differences in expectations. In general, this is 'good news' for the economy, in that 66 per cent of the respondents are employed. If employed people have a higher likelihood of believing that the economy in general will be affected

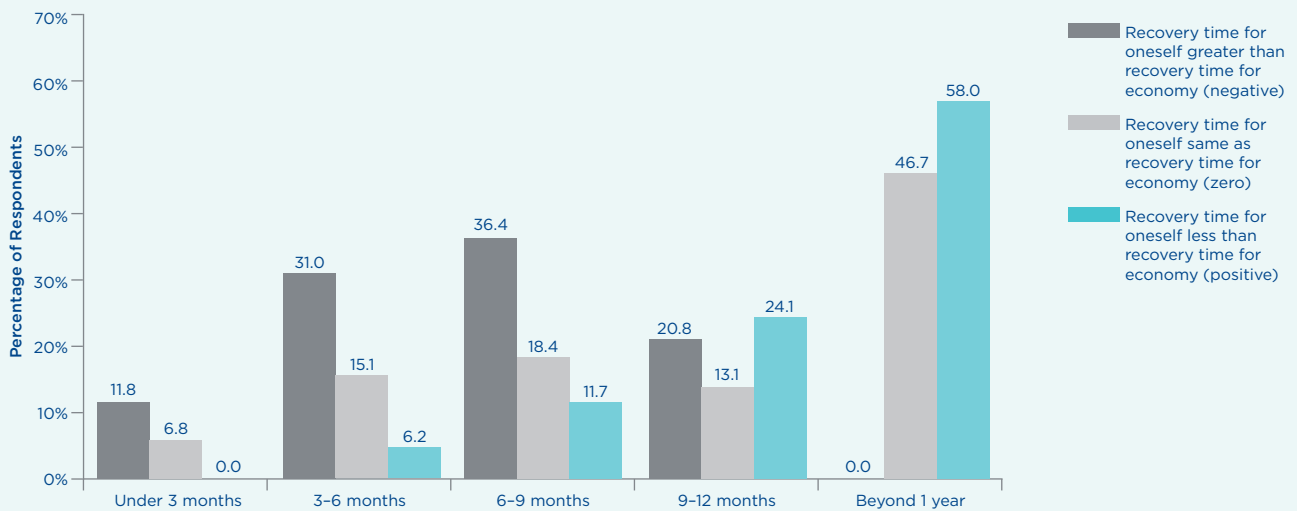
by the economic fallout of COVID-19 much longer than it will affect themselves, then they are likely to continue purchasing and consuming goods and services, purchasing durable goods, making investments and consume in a manner similar to their previous patterns (pre-COVID-19). This may help restart domestic demand and the economy. Conversely, the unemployed – despite receiving the JobSeeker payment – will likely follow a more precautionary savings strategy by prudently restricting expenditures.

5 Double-edged sword of expectations

The 'bad news' for the economy is that, of those who expect themselves to be affected just as long as the economy, 46.7 per cent say this effect will be beyond one year. Similarly, of those who are more 'optimistic'

for themselves being affected a shorter length of time than the economy in general, 58.0 per cent believe the effects of COVID-19 will last beyond one year for the economy. (Figure 4)

Figure 4: Expected time Australians will be affected by COVID-19, by difference-in-expectations



Source: Results based on responses from 2,553 Australian adults 18-64 surveyed during weeks 7, 9 and 11 of the *Taking the Pulse of the Nation* survey conducted 18 May-19 June. The sample is weighted to be representative of the Australian population on gender, age and location. Of those who expect the economy to take longer to recover than themselves, 58% believe the economy's recovery will take beyond one year. Those who believe the recovery would take just as long for the economy as themselves to recover, 46.7% believe the recovery will take beyond one year.

Subjective economic indicators matter for actual behaviour

The implication is that according to people's expectations, the economic effects of COVID-19 are likely to last beyond one year, yet those in employment are likelier to perceive that the effects on themselves will not take as long as for the general economy.

Subjective economic indicators matter for actual behaviour. Haisken-DeNew and Broadway (2018) show that 'a substantial increase in subjective economic uncertainty impacts substantially on real economic savings behaviour, increasing the cash savings rate. This effect of subjective uncertainty comes above and beyond that of objective uncertainty, and cognitive/non-cognitive abilities.' Gillitzer and Prasad (2018) analyse Australian consumer sentiment data and find, 'evidence that stated spending intentions are indicative of actual spending' and 'this suggests that consumer sentiment can contain important information not captured by other macroeconomic indicators.'

From a policymakers' perspective, divergences between consumer sentiment and the level of economic activity implied by macroeconomic data may contain important information about future consumption.'

Key to the recovery process after COVID-19 is restarting pre-COVID-19 demand levels for goods and services. If employed people disproportionately believe that they themselves will not be affected for as long a time as the general economy, then they are likely to resume spending and consume goods and services. *Those with the economic power to consume, are potentially most likely to do so.*

Further Information

Datasets

This analysis has been drawn from *Taking the Pulse of the Nation* – Melbourne Institute’s survey of the impact of COVID-19. The aim of the weekly survey is to track changes in the economic and social wellbeing of Australians living through the effects of the coronavirus pandemic whilst adapting to various changes in Federal and State government policies. Each week, the survey contains responses from 1,200 persons, aged 18 years and over. Sample weights can be used to make the sample representative of the Australian population on gender, age and location.

Author

Professor John P. de New

Melbourne Institute: Applied Economic & Social Research, University of Melbourne

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References

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