The focus of financial reporting influences business cycles

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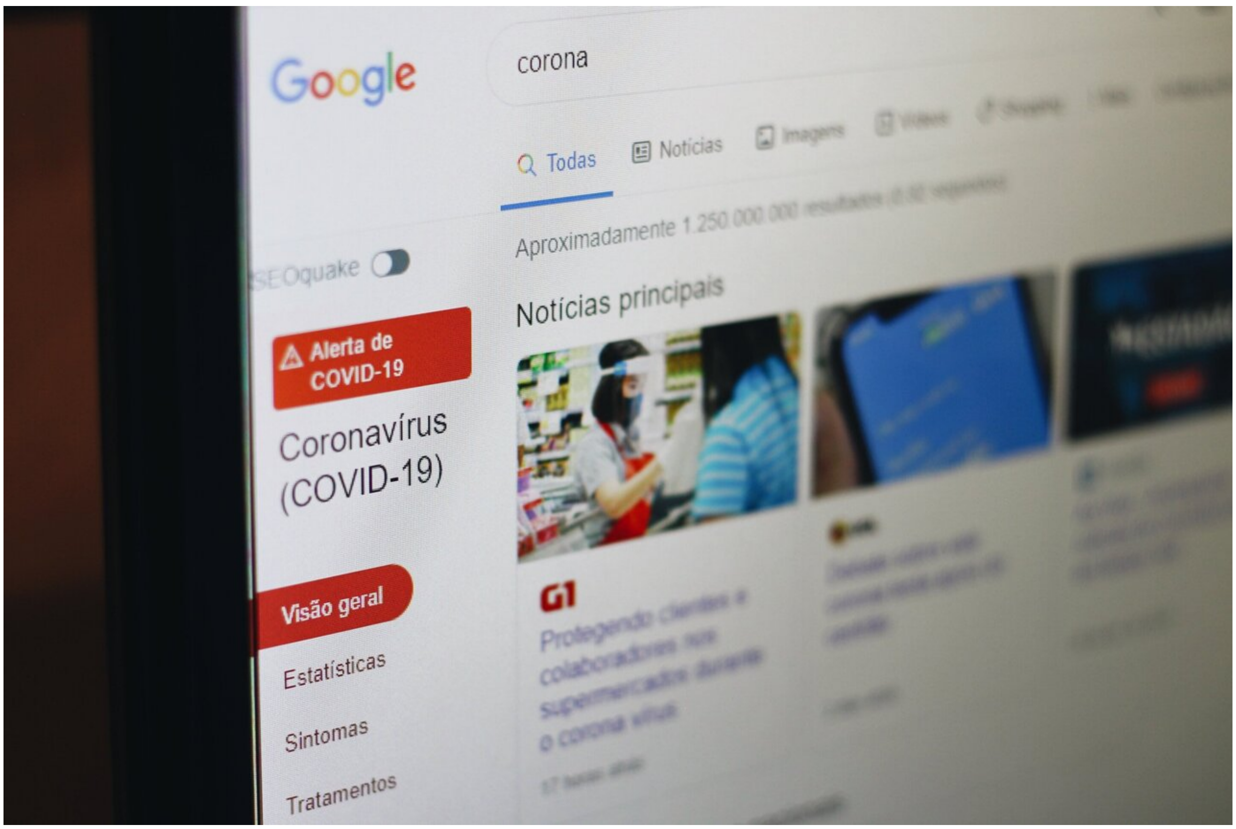

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Editorial choices can impact the amplitude of business cycles even if the information that is reported is correct. On reason is that the focus of the reports can be on sectors that are non-representative of the economy in general. A new study shows that financial reporting can explain up to 20 percent of the business cycles for GDP and 40 percent of the business cycles for unemployment.

In a scholarly article in the *American Economic Review*, researchers from Uppsala University describe a new model that can explain this process.

"News media are not just passive communicators of financial information. They can also directly impact business cycles in their selection of what is reported," says Stefan Pitschner, researcher in economics at Uppsala University and one of the study's authors.

Individual companies make decisions about hiring staff based on the expected demand for their products, and changes in business cycles can occur because many companies make hiring and production decisions based on news reports.

"If the news media systematically choose to report sensational news that is non-representative of the economy in general, this can influence both unemployment and economic growth. This type of reporting can make companies overly optimistic or pessimistic compared with what the actual economic outlook means, even if the reporting is true and correct. This, in turn, can influence how many people are hired and how much companies decide to produce."

The research team has developed a theorical model to allow them to understand different mechanisms and analyze such economic variations as those that characterize the severe 2008–2009 recession in the United States. During the crisis, American news media primarily focused on a few sectors that were experiencing difficulties, such as the auto industry and the financial sector. This was at the expense of reporting on developments in other sectors that were progressing relatively well, which led companies to be overly pessimistic, something that likely worsened the crisis.

In the article, the researchers present their model for how media influences hiring and production decisions. The authors have created a new database on how news media reported on different sectors during the period 1988–2018. The model has been calibrated to both resemble the actual structure of the US economy and financial reporting in American media. It can explain how the business cycle, news reporting and company expectations for demand interact. The model shows that non-representatives news reporting can explain up to 20 percent of GDP business cycles and 40 percent of unemployment cycles.

The study shows what role the media can play in the economy and, ultimately, the importance of decision-makers and others being aware of the media's role and how to compensate for this in different ways to provide companies with a fairer picture of the financial situation.

"For example, if the Swedish central bank, the Riksbank, sees that financial reports in the news media are more negative than justified by the actual situation, they can compensate for this in their own communications by pointing to the sectors in the economy that are doing relatively well," says Stefan Pitschner.

More information: Ryan Chahrour et al, Sectoral Media Focus and Aggregate Fluctuations, *American Economic Review* (2021). DOI: 10.1257/aer.20191895

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