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The Influence of Narrative Economics on Financial Markets and Employment Trends

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Abstract

The paper examines the influence of narrative economics on financial markets and employment outcomes, with a particular focus on job creation and labour sentiment. It examines how prevailing economic narratives shape investor behaviour, affect hiring decisions, and contribute to broader market fluctuations. This research has been conducted using secondary and tertiary sources, including economic journals, financial reports, and previously published studies. The analysis highlights that collective economic narratives, driven by optimism or pessimism, play a critical role in determining both financial performance and labour market dynamics.

Keywords: Narrative, financial markets, job creation, AI , economic behaviour, SIR model

INTRODUCTION

"Tell me a story," many of us might say when faced with complex data, policy charts or stock market graphs. But what if the story is the market? The stories we share of numerous ideas of growth, fear, or innovation ripple through economies. Stories spread across societies through a grapevine-like network, influencing both microeconomic and macroeconomic decisions such as individual spending and national growth and employment respectively. This phenomenon forms the foundation of **Narrative Economics.**

Narrative economics, a term popularized by Nobel laureate Robert J. Shiller, is the proposition that economic fluctuations are not just driven by abstract fundamentals such as interest rates, productivity, supply and demand but also by the stories that circulate. It emphasizes the power of human stories in shaping economic behaviour. Traditional economics often assumes that individuals make rational decisions based on data and logic. However, **narrative** economics challenges this notion by highlighting the emotional and psychological dimensions. Economic events such as market booms, recessions, or shift in employment trends are often driven not merely by statistics but by the stories people believe and share about them. These **narrative**s spread across societies through intricate social networks, amplified by media, technology, and social discourse. By studying how **narrative**s emerge, evolve, and spread, a deeper understanding of the human factors underlying financial and labour market trends can be developed. Simply put, when enough people start believing a story such as housing never crashes, that tech will only rise, or that a recession is inevitable, their behaviour shifts. They invest or withdraw, spend or save, in ways that ultimately turn the story into reality. It is a basic human tendency.

Within this framework, these stories can be classified into distinct types that guide collective behaviour. **Emotionally charged narratives**, amplify shared sentiments and significantly influence how societies interpret and respond to economic phenomena. **Confidence narratives** are built around optimism and growth, often act as self-fulfilling prophecies, encouraging investment, innovation, and job creation. In

contrast, **fear-driven narratives** are often born out of recessions, inflation, or political instability, tend to contract markets as consumers and firms retreat into caution. **Technological narratives** encourage transformation, as seen in the rise of the digital economy. Meanwhile, **moral and social narratives**, surrounding issues like sustainability, and equity redefine what is considered valuable or ethical in markets. There exist **policy narratives** as well, propagated by governments, hold the power to restore or disrupt economic confidence depending on how they are framed and communicated. Together, these **narrative**s influence economic decision making and market sentiment.

Existing Literature Review

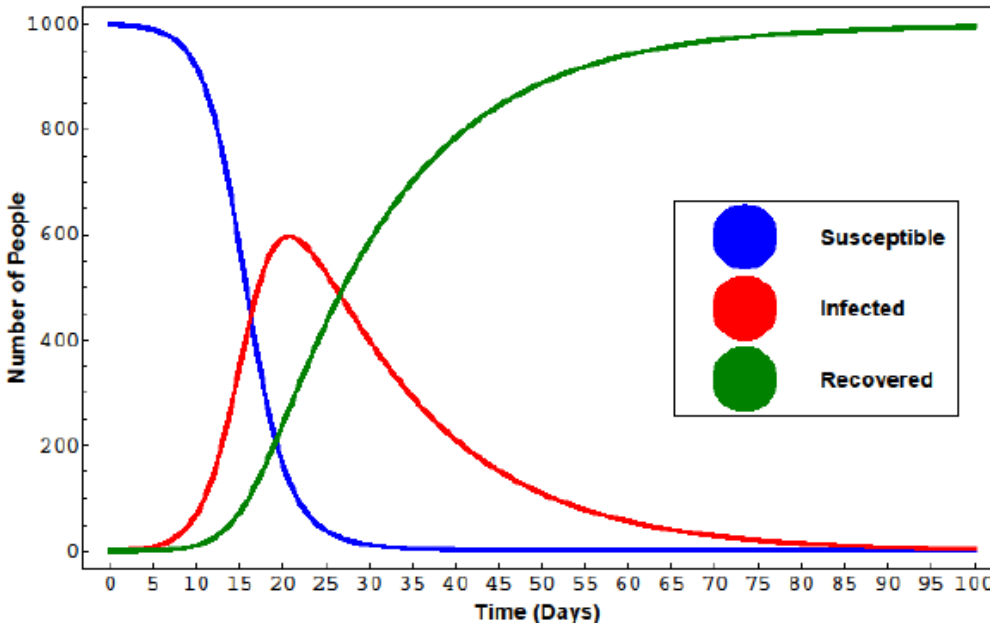
The concept of **Narrative** Economics was pioneered by Nobel laureate Robert J. Shiller, whose seminal paper in the American Economic Review (2017) [1] and subsequent book **Narrative** Economics: How Stories Go Viral and Drive Major Economic Events (2019) [2] explore how popular stories influence economic behaviour and policy. Shiller (2017) argues that the spread of emotionally charged **narrative**s, rooted in human interest and collective sentiment, can significantly shape macroeconomic fluctuations. He likens the transmission of such **narrative**s to the spread of infectious diseases, proposing that once these stories "go viral," they influence aggregate decisions related to spending, investment, and policy formulation. Using historical examples such as the Great Depression, the 2008 financial crisis, and the popularization of the "Laffer Curve" during the Reagan administration, Shiller (2019) demonstrates that economic events often stem from dominant social stories rather than purely rational market responses.

Shiller's framework draws upon interdisciplinary insights from psychology, sociology, and literary theory, merging them with behavioural economics to highlight the emotional and cognitive foundations of market activity. Earlier contributions from **narrative** psychology [3], storytelling sociology [4], and humanomics [5] have emphasized the role of stories in shaping social values and behaviour. Shiller extends this tradition into economics, framing **narrative**s as exogenous shocks capable of altering public sentiment and, consequently, economic outcomes. His research challenges traditional economic models that assume rational decision-making, arguing instead that the evolution and contagion of stories underpin many market trends and policy shifts. Through this perspective, **narrative** economics positions markets as cultural phenomena, driven not only by data and policy but by the collective imagination, emotions, and shared experiences of society.

Shiller further notes that, similar to an epidemic, economic **narrative**s exhibit infection peaks and progress through cycles of susceptibility, infection, and recovery, closely resembling the Kermack–McKendrick SIR model commonly used in epidemiology [6].

The **SIR model** is a dynamic mathematical framework that categorizes a population into three groups—**Susceptible (S), Infected (I), and Recovered (R)**—to analyse the spread and eventual decline of infectious diseases . When adapted to economics, this model provides a structured way to understand how **narrative**s diffuse through society, intensify collective behaviour, and gradually lose influence over time.

FIGURE 1



SIR MODEL- SUSCEPTIBILITY, INFECTED, RECOVERED

Just as an epidemic follows biological dynamics, **economic narratives** follow **social contagion dynamics**.

A **compelling and emotionally charged narrative** can rapidly infect public sentiment, leading to a rise in susceptible population.

During the 'infected' stage, the **narrative** gains virality through media, social networks, and public discourse, influencing investment, spending, and policy decisions. This parallels the steep rise and eventual peak of the red curve.

Over time, as reality adjusts and counter-**narrative**s emerge, people "recover", reducing the spread of that idea.

In **narrative** economics, the rise and fall of the "infected" curve represent **the lifecycle of collective economic emotions.**

Objective1: To understand historical and recent economic events influenced by contagion narratives

Historical Economic Events

The Great Recession (2008)

The Great Recession of 2008 serves as a striking example of how fear driven **narrative**s may amplify an economic crisis. Following the 1929 stock market crash, stories of financial ruin and widespread unemployment spread rapidly through newspapers and word of mouth, creating a contagion of panic.

In the years leading up to 2008, a dominant **narrative** circulated, "Housing prices will always rise." That simple, persuasive **narrative** drove millions of people to believe that real estate was a risk-free path to wealth. It encouraged banks to lend recklessly, investors to pour money into mortgage-backed securities, and homeowners to borrow far beyond their means. This **narrative** shifted aggregate demand by increasing consumption and autonomous investment in housing. As more people invested in real estate, the prices did rise, seemingly proving the **narrative** true.

But, when this **narrative** collapsed in 2008, a new **narrative** spread just as quickly, "The financial system is collapsing." This caused panic, froze credit markets, led to crashing stock prices, and deepened the

recession. National housing prices in the United States fell by approximately 33 percent during the recession, intensifying the downturn's macroeconomic impact.
The Great Recession thus demonstrated what Robert Shiller later formalized as **narrative** contagion

The Dot-Com Bubble (late 1990s–early 2000s):
In contrast, The Dot-Com Bubble was fueled not only by technological change but also by an emotionally charged and overly optimistic investment story that spread quickly through media, analysts, and investors. Between 1995 and March 2000, the **NASDAQ Composite Index**, which was heavily focused on tech and internet companies, climbed from around **743 points to a peak above 5,000[**7]. This represented a five- to seven-fold increase in value as investors sought the next big "internet winner."
This surge relied more on belief in explosive growth potential than on fundamentals like revenue or profits. Many startups with weak or no earnings raised hundreds of millions in venture capital simply by presenting themselves as part of the digital revolution. Analysts and media **narrative**s supported this belief, often justifying high valuations with talk of a **"new economy**" where traditional valuation methods did not apply.
However, this optimism turned out to be fragile. After peaking on March 10, 2000, the NASDAQ began a steep decline. Within a month, it had lost over 30% of its value, and in the next two years, it dropped nearly 78%, reaching around 1,100 points by October 2002[7]. The human cost of this collapse was significant. The market crash wiped out roughly $5 trillion in value, mainly from tech and internet stocks, as investors rushed to sell. Many companies that had once symbolized internet optimism, like Pets.com, Webvan, and Boo.com, burned through their capital and went out of business.
Even well-established tech companies experienced sharp declines in their valuations. Major firms like Cisco and Intel saw their share prices drop by over 80% from their peak levels as the bubble burst. The collapse also had lasting effects on risk tolerance. The NASDAQ did not fully recover to its 2000 high until 2015, about 15 years later, highlighting how much investor confidence had been damaged. [7]
The Dot-Com Bubble thus shows how unchecked emotion driven optimism and speculative stories can inflate asset prices well beyond what fundamentals justify. When those stories do not translate into real economic returns, they can quickly reverse, leading to significant wealth loss and a long-term drop in market confidence.

Recent Economic Event
The Contagion Curve of the AI Narrative (2019):
Today's global economy is being influenced by powerful new **narrative**s such as, "**AI** could impact 40% of jobs worldwide."[8]
On one hand, **AI** is highly capable of driving innovation and productivity. On the other hand, an equally powerful counter-**narrative** spreads, "**AI** will replace human labour, disrupt livelihoods, and widen inequality."
These two conflicting **narrative**s coexist. Investors rush to capitalize on the **AI** revolution, while workers and policymakers are instilled with fears of mass unemployment and social disruption. This emotional duality drives market behaviour and public opinion, proving that economic outcomes are as much psychological as they are statistical.
Across Southeast Asia, this tension is particularly visible. A survey found that 35.3% of respondents cited job security as their top concern about artificial intelligence. This highlights the power of a single

narrative.

The way these **narrative**s spread through media and discourse can be mapped onto an epidemic style **SIR (Susceptible–Infected–Recovered) model** of **narrative contagion**. According to this analogy, society transitions through three stages:

1. **Susceptible Phase (2019–2020):**

The **AI** story began gaining traction as machine learning tools entered mainstream use and investors, entrepreneurs, and tech media increasingly touted **AI** as the next transformative technology. The COVID-19 pandemic accelerated this trend, as remote work and digital transformation **narrative**s further embedded **AI** into economic discourse.

2. **Infection Phase (2021–2023):**

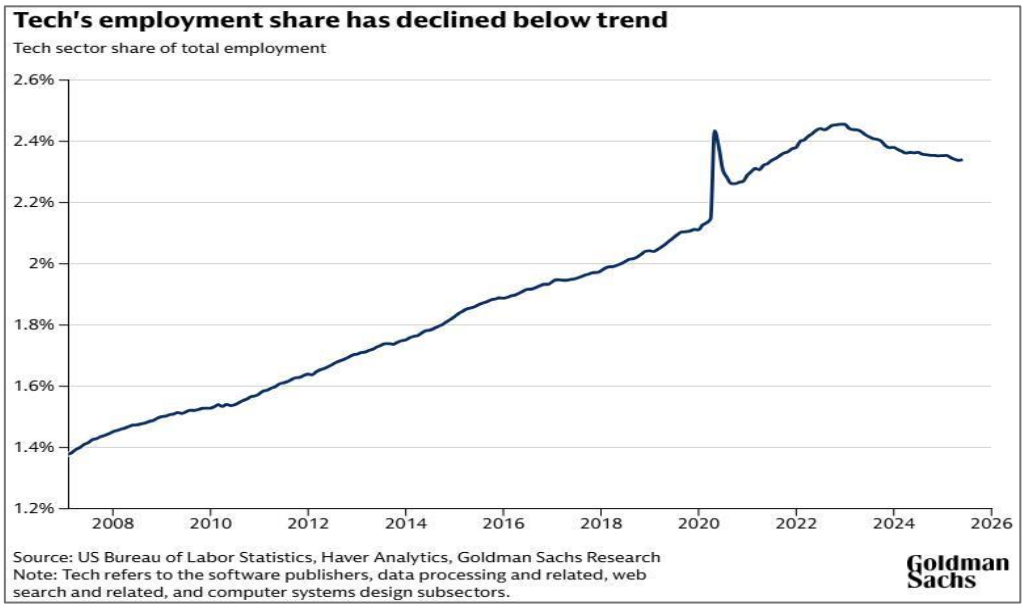
Enthusiasm for **AI** peaked in popular and financial **narrative**s. Advisory firms and research institutions reported rapid adoption and experimentations: in the Asia-Pacific region alone, a 2025 Boston Consulting Group survey found that 78% of employees used generative **AI** (Gen**AI**) at least weekly, with 60% of respondents optimistic about **AI**'s potential, yet 52% simultaneously fearing job loss due to the same technologies. [9]

3. **Emerging Decline Phase (2024–2025):**

As the **narrative** matured, early labour-market effects began to surface. Labour market data from Goldman Sachs and other research sources show concrete signs of shifting employment dynamics. For example:

- Early 2025 saw a rise in unemployment among tech workers aged 20–30 by about three percentage points, likely tied to hiring slowdowns and **AI** driven restructurings.[10]
- Research also suggests that **AI** could eventually displace around 6–7% of jobs in the U.S. workforce under expanded adoption scenarios, reflecting measurable labour impacts beyond speculative **narrative**s.[11]
- On a global scale, estimates indicate that hundreds of millions of jobs could be affected by **AI** exposure, although the nature of "impact" varies widely by industry and task. [12]

FIGURE 2



Tech Employment(2008–2026)- Goldman Sachs

Importantly, the **narrative** has not yet reached the "recovered" stage in the SIR model. Even as some labour market indicators moderate and slowdowns happen in certain sectors, both optimism and anxiety about **AI** continue to circulate widely. Policymakers, investors, and workers remain highly engaged with the story of **AI**. It is not just a technological change; it is also a social and psychological phenomenon that influences behaviour, market valuations, and policy decisions. As fear spreads, it doesn't just alter employment prospects, it influences household spending, and investment trends, reminding us that the financial world is not confined to stock markets alone.

Conclusion

Narrative economics highlights that economic trends are significantly shaped by shared stories that influence expectations and group behaviour. These **narrative**s serve as social tools that help create and spread beliefs about uncertainty, opportunity, and risk, often regardless of the actual economic situation. As these **narrative**s spread, they change incentive structures, guide how institutions respond, and create feedback loops that can amplify economic changes. Therefore, we cannot fully explain economic shifts using only equilibrium models or numerical data. A **narrative**-focused approach is crucial for understanding how belief formation, emotional spread, and social influence interact with economic systems. This makes **narrative**s a key factor in analysis rather than a minor one.

During times of **narrative** saturation, decision-making tends to become more aligned. This reduces the variety of expectations and makes systems more fragile. Adaptive behavior only returns when **narrative**s lose their credibility or emotional intensity, which allows markets and institutions to adjust. This perspective shows that **narrative**s are active forces that shape economic resilience and vulnerability over time.

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