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National Economic Trends

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The Economic Outlook for 2000: Bulls on Parade?

The heartening U.S. economic performance during the past four years has seemingly benefited everyone except those in the forecasting business. It has also presented a challenge for monetary policymakers, because they use forecasts in their policy deliberations. The problem, in short, is that most forecasters have regularly under-predicted real GDP growth and over-predicted CPI inflation.

As an example, consider the forecasters surveyed in the *Blue Chip Economic Indicators* since March 1992. Each issue publishes a set of forecasts from about 50 individuals or organizations. Besides the well-known "Consensus" forecast, which is the average, each issue also contains the average of the "Top 10" and "Bottom 10" forecasts for real GDP growth and CPI inflation. Using the forecasts published in the March, June, September and December issues, it is thus possible to construct a series of one-quarter ahead forecast errors.

Based on the smallest mean absolute error, the Consensus forecast for real GDP growth proved to be most accurate just 13.3 percent of the time (see table). In contrast, the average of the top 10 forecasts—the most bullish—was most accurate nearly two-thirds of the time. Although the distribution of the inflation forecasts was slightly more balanced, the most accurate forecasts were still generated by those who believed future inflation to be lower than the Consensus. Moreover, since December 1995, those who have predicted faster real GDP growth and lower inflation were even more accurate. For example, the top 10 forecast for real GDP growth was most accurate 80 percent of the time, while the average of the bottom 10 CPI forecasts was most accurate 60 percent of the time (vs. 7 percent for the Consensus).

The recent apparent bias in the Consensus forecasts might serve as evidence supporting those who believe that the trend rate of productivity growth has increased in the 1990s—the so-called "New Economy" hypothesis. Assuming that adherents of the New Economy align themselves most closely with those who regularly predict faster real GDP growth and lower inflation than does the Consensus, it might be useful to give their forecasts greater weight. One way to do this is to construct a weighted average of the Top 10, Consensus and Bottom 10 forecasts for 2000. For this specification, the weights are the percentage of times the mean absolute error of each one-quarter ahead forecast was the smallest since March 1992.

Using the Dec. 10, 1999, issue of the *Blue Chip Economic Indicators*, a weighted average of the Consensus (2.9 percent), top 10 (4 percent) and bottom 10 (1.5 percent) forecasts pegs real GDP growth at 3.3 percent in 2000 (fourth quarter-to-fourth quarter). The latter-period weights suggest even stronger real GDP growth, at 3.7 percent. A weighted-average forecast for CPI inflation—using weights from either period—suggests roughly 2 percent inflation in 2000.

—Kevin L. Kliesen

Blue Chip Forecast Errors: Real GDP Growth and CPI Inflation

	Real GDP			CPI		
	Consensus	Top 10	Bot 10	Consensus	Top 10	Bot 10
Forecast Period: March 1992 to September 1999 (N = 30)						
Standard error	-1.1	-0.2	-2.1	0.4	1.0	-0.3
Mean absolute error	1.8	1.6	2.4	0.7	1.0	0.6
Number of times absolute error is smallest	4	19	7	8	6	16
Percentage, smallest error	13.3	63.3	23.3	26.7	20.0	53.3
Forecast Period: December 1995 to September 1999 (N = 15						
Standard error	-1.9	-1.0	-2.9	0.3	0.9	-0.3
Mean absolute error	2.0	1.6	2.9	0.7	1.0	0.7
Number of times absolute error is smallest	2	12	1	1	5	9
Percentage, smallest error	13.3	80.0	6.7	6.7	33.3	60.0

Source: March, June, September and December issues of the *Blue Chip Economic Indicators*.