## Economic Forecasting and Policy

## **Second Edition**

Nicolas Carnot

Vincent Koen

and

Bruno Tissot



## Contents

List of Figures	viii
List of Tables	x
List of Boxes	xi
Foreword by Jean-Philippe Cotis	xiii
Acknowledgements	xv
List of Abbreviations	xvi
Introduction What is economic forecasting? The book's aims Roadmap	1 2 2 3
<ol> <li>Overview         <ol> <li>What to forecast?</li> <li>Why forecast?</li> <li>How to forecast?</li> <li>How to forecast?</li> <li>Frequently asked questions</li> </ol> </li> </ol>	5 7 12 16 21
<ul> <li>2 Business Cycle Analysis</li> <li>2.1 Monitoring the ups and downs</li> <li>2.2 Collecting economic information</li> <li>2.3 Business and consumer surveys</li> <li>2.4 Making sense of the data</li> <li>2.5 Bridge models</li> <li>2.6 Final health warning</li> <li>Appendix 2.1 Some useful concepts and tools</li> </ul>	24 25 26 29 38 54 59 61
<ul> <li>3 Real Sector Building Blocks</li> <li>3.1 Business investment</li> <li>3.2 Household spending</li> <li>3.3 Imports and exports</li> <li>3.4 Employment</li> <li>3.5 Prices and wages</li> <li>Appendix 3.1 Sectoral forecasting</li> <li>Appendix 3.2 Commodity prices</li> <li>Appendix 3.3 Semi-structural estimation of the NA</li> </ul>	66 70 80 88 93 95 107 112 4 <i>IRU</i> 117

4	Financial Sector Dynamics	119
	4.1 Dealing with volatility	121
	4.2 Short-term interest rates	125
	4.3 Long-term interest rates	145
	4.4 Bond prices and yield spreads	151
	4.5 Stock prices	153
	4.6 Real estate prices	155
	4.7 Exchange rates	159
	Appendix 4.1 Integrating the financial stability perspective – lessons	
	from the 2007 financial crisis	170
	Appendix 4.2 Technical analysis	182
	Appendix 4.3 Country risk analysis	184
5	Public Finances	191
	5.1 The macroeconomic view	193
	5.2 The detailed approach	193
	5.3 Long-run fiscal trends	203
	5.4 Fiscal policy analysis	205
	5.5 Forecasting performance	215
	Appendix 5.1 Fiscal implications of financial sector rescues	219
	Appendix 5.2 The fiscal response to the 2007 financial crisis	221
6	Medium- and Long-Run Projections	223
	6.1 The medium run	225
	6.2 The long run	246
7	Risks and Accuracy	265
	7.1 Conceptual issues	267
	<ul><li>7.1 Conceptual issues</li><li>7.2 Analysing errors</li></ul>	267 271
	-	
	7.2 Analysing errors	271
	<ul><li>7.2 Analysing errors</li><li>7.3 Forecasters' track record</li></ul>	271 274
	<ul><li>7.2 Analysing errors</li><li>7.3 Forecasters' track record</li><li>7.4 What causes errors?</li></ul>	271 274 281
	<ul> <li>7.2 Analysing errors</li> <li>7.3 Forecasters' track record</li> <li>7.4 What causes errors?</li> <li>7.5 Can accuracy be improved?</li> <li>7.6 Accuracy is not enough – assessing the risks around forecasts</li> </ul>	271 274 281
	<ul> <li>7.2 Analysing errors</li> <li>7.3 Forecasters' track record</li> <li>7.4 What causes errors?</li> <li>7.5 Can accuracy be improved?</li> <li>7.6 Accuracy is not enough – assessing the risks around forecasts</li> <li>Appendix 7.1 Measuring accuracy in practice</li> </ul>	271 274 281 285
	<ul> <li>7.2 Analysing errors</li> <li>7.3 Forecasters' track record</li> <li>7.4 What causes errors?</li> <li>7.5 Can accuracy be improved?</li> <li>7.6 Accuracy is not enough – assessing the risks around forecasts</li> </ul>	271 274 281 285 288
	<ul> <li>7.2 Analysing errors</li> <li>7.3 Forecasters' track record</li> <li>7.4 What causes errors?</li> <li>7.5 Can accuracy be improved?</li> <li>7.6 Accuracy is not enough – assessing the risks around forecasts</li> <li>Appendix 7.1 Measuring accuracy in practice</li> </ul>	271 274 281 285 288
8	<ul> <li>7.2 Analysing errors</li> <li>7.3 Forecasters' track record</li> <li>7.4 What causes errors?</li> <li>7.5 Can accuracy be improved?</li> <li>7.6 Accuracy is not enough – assessing the risks around forecasts</li> <li>Appendix 7.1 Measuring accuracy in practice</li> <li>Appendix 7.2 Can forecasters predict severe crises?</li> </ul>	271 274 281 285 288 296
8	<ul> <li>7.2 Analysing errors</li> <li>7.3 Forecasters' track record</li> <li>7.4 What causes errors?</li> <li>7.5 Can accuracy be improved?</li> <li>7.6 Accuracy is not enough – assessing the risks around forecasts</li> <li>Appendix 7.1 Measuring accuracy in practice</li> <li>Appendix 7.2 Can forecasters predict severe crises?</li> <li>Recent lessons</li> </ul>	271 274 281 285 288 296 302
8	<ul> <li>7.2 Analysing errors</li> <li>7.3 Forecasters' track record</li> <li>7.4 What causes errors?</li> <li>7.5 Can accuracy be improved?</li> <li>7.6 Accuracy is not enough – assessing the risks around forecasts</li> <li>Appendix 7.1 Measuring accuracy in practice</li> <li>Appendix 7.2 Can forecasters predict severe crises?</li> <li>Recent lessons</li> <li>Policy Making and Forecasts</li> </ul>	271 274 281 285 288 296 302 <b>309</b>
8	<ul> <li>7.2 Analysing errors</li> <li>7.3 Forecasters' track record</li> <li>7.4 What causes errors?</li> <li>7.5 Can accuracy be improved?</li> <li>7.6 Accuracy is not enough – assessing the risks around forecasts</li> <li>Appendix 7.1 Measuring accuracy in practice</li> <li>Appendix 7.2 Can forecasters predict severe crises? Recent lessons</li> <li>Policy Making and Forecasts</li> <li>8.1 Economic forecasts' virtues and limitations</li> </ul>	271 274 281 285 288 296 302 302 309 311

8.5 Transparency	331
8.6 Science or politics?	334
Appendix 8.1 A world tour of the forecasting institutions	339
Epilogue	354
Annex I The data	357
AI.1 The national accounts framework	359
AI.2 Quarterly national accounting	374
AI.3 Technical hurdles	377
AI.4 Open questions and limitations	388
Annex II Time series methods	396
AII.1 Time series methods used for macroeconomic forecasts	398
AII.2 Volatility modelling	422
Annex III Macroeconomic models	435
AIII.1 General features	436
AIII.2 Macroeconomic logic	437
AIII.3 Estimation and simulation properties	443
AIII.4 Forecasting with a model	448
AIII.5 Overall assessment	456
Bibliography	463
Index	484