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Editorial

Introduction to "The future of macroeconomic forecasting"

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Abstract

This paper introduces the presentations in the Special Section on the "The future of macroeconomic forecasting". Though the topic is not particularly new, new possibilities and new insights keep it on the agenda. The presentations and papers start from the concerning finding that, over the last fifty years, the accuracy of macroeconomic forecasts in the G7 has not improved. The present critique of forecasting has various roots, some of which are as old as the early 1960s' critique of macroeconometric models and model forecasting. Another part of the dissatisfaction with macroeconomic forecasts, however, stems from users' unrealistic expectations about the limits of forecast accuracy. The conference explored many of these issues, and the papers addressing these issues discuss forecast biases, data quality, the forecasting process, leading indicators, and the relationship between forecast accuracy and the forecast horizon.

Keywords: Forecast bias; Data quality; Forecast accuracy; Leading indicators; Forecast horizon

1. Why are we reflecting on the future of macroeconomic forecasting again?

The "future of economic forecasting" has been the topic of a number of papers and conferences over the past few decades (see for example, Diebold, 1998; Dawes, Fildes, Lawrence & Ord, 1994; Gardner & Makridakis, 1988b). This is not surprising. Economic knowledge and empirical potential are constantly increasing, and it is only natural to reflect from time to time about their consequences for economic forecasting.

Our view on the future of economic forecasting has undergone several considerable shifts even in recent times. Until the late 1960s and early 1970s, new methods, notably the "model approach" (econometric models, input–output models, systems dynamics, etc.), and new data systems had fostered the belief that it would soon be possible to have highly accurate pictures of the future of the economy. This optimism virtually stopped with the first oil crisis. Rather suddenly, the past appeared to have lost much of its predictive value for the future. We were forced to admit that our formal or informal models of the economy might not correctly capture economic expectations — that the dynamics of economic movements might have changed, or that they were

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too much biased towards equilibrium. Models had to be re-interpreted or re-designed. New forecasting methods, often free of "economics", appeared on the scene. As with most crises, this also marked the onset of new insights about the forecasting process itself, and was also associated with many new forecasting institutions. In 1982 the *International Institute of Forecasters* (IIF) was founded, the first journal devoted exclusively to forecasting issues was started, and yearly conferences that examine all aspects of forecasting were established. For the first time "forecasting" became an institutionalized, permanent research subject of its own.

In reading the special issue of this journal on the topic (Gardner & Makridakis, 1988b), one is particularly impressed by two facts. First, most authors saw clearly and correctly the analytical possibilities and limitations of the various methods that they presented; and second, the editors were very farsighted when they addressed topics like the need for synthesis, standards in forecasting and other empirical research, and for large databases for forecasting research (Gardner & Makridakis, 1988a). Much of the progress in forecasting since 1988 has been achieved along these lines. Of course, much work still remains.

There are many reasons to again discuss the future of economic forecasting. First, after nearly 20 years and at the beginning of the 21st century, it simply seemed appropriate to examine the accuracy of economic forecasts — whether there was "progress" in the sense that accuracy improved; in what areas "progress" has been made; what factors contributed to this "progress"; and why it did not occur in other areas. The answers to these crucial questions seem to be less clear cut than they were 20 years ago, as the abundant body of literature reveals. We are better able to identify and analyse the role of judgement and of "learning" in its various forms and at various stages of the forecasting process. But, of course, this complicates answers to questions about the sources of "progress". The future alone will tell, but our experience so far suggests that forecast accuracy will improve gradually rather than in a sudden leap.

Consequently, a second reason for holding another conference on this subject was to examine new ways of improving forecasts. This included discussions of general topics, such as those that had been addressed in 1988, and an examination of particular methods. A third reason was to address the question, how does one deal with the present-day level of forecast errors and the associated uncertainty? Although this is a problem that both producers and consumers of forecasts confront, the perception of this problem has not yet been realized in all quarters (Wallis, in press, p. 54).

It was clear from the beginning that the Leipzig conference[1] could only deal with a small set of these questions. The papers themselves could not present surveys, but would present significant findings. They were intended to throw light on important issues and were designed to stimulate broader discussions.

2. Taking stock: current knowledge

Fildes and Stekler (2002) surveyed the state of knowledge about forecasting, but did not examine such issues as consumers' perceptions about the accuracy of forecasts, the limits to forecasting accuracy, etc. For example, we know that the consumers of forecasts are not satisfied with their accuracy, and they often tend to perceive forecast accuracy in a very asymmetric manner. They are seldom excited when a forecast has been very accurate, but they are disturbed when the forecasts are erroneous. Memoirs of politicians, for example, often contain references to erroneous forecasts that led to wrong policies, but never mention the overwhelming majority of successful cases.

One source of such dissatisfaction may be an unwarrantedly high level of expectations about the accuracy that forecasters can attain.[2] We should also consider whether either the forecasters or the decision makers really present or want to know the "truth". Practitioners may adjust the forecasts to present what

[1] The conference was organized by the Institute of Empirical Research, Universität Leipzig, and the "Institute of International Forecasters", and took place December 16 and 17, 2005, at the Bibliotheca Albertina, Universität Leipzig, Germany. Papers were presented by Robert Fildes, Bernd Schips, Kajal Lahiri, Roy Batchelor, Lars-Erik Öller, Massimiliano Marcellino, Herman Stekler, Ken Wallis, and Victor Zarnowitz.

[2] It is hardly comforting for economists to note that in the natural sciences the forecasts of volcano eruptions, climate changes or clinical judgements (Fischhoff, 1988) are not superior to economists' predictions. On the other hand, weather forecasts have become more accurate in the past 30 years (Belzer, Enke, & Wehry, 1998, pp. 112ff.). This improvement was due to better models, more data, and quicker data transmissions.