

Do Forecasters Believe in Okun's Law? Should They?

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Summary

- Ball, Leigh, and Loungani have shown cross-country evidence that Okun's Law is present and remarkably stable.
 - This mostly answers the second question of the title – forecasters *should* believe in Okun's Law.
 - The results are surprising, however, given other work, such as Owyang and Sekhposyan (2012).
- Based on Herman Stekler's work, however, we know there are clearly things that forecasters should believe in that they don't.
- Therefore, the key question is: do forecasters use information on the relationship between GDP and unemployment efficiently in their forecasts?



Why might forecasters not believe?

- It may be that the insignificant variation in the coefficient is enough to make the forecasters wary of Okun's Law.
 - Could forecasters be using different estimates of Okun's Law so that once you take the average it appears they don't use it when they really do?
- Forecasters may focus too much on the research that argues that simple univariate models perform best.
- One nice thing about looking at unemployment rate forecasts is we don't need to worry so much about real time data issues.
 - Revisions are general due only to seasonal adjustments.
 - Revisions can be a huge problem for GDP, however.
 - We also need to worry about estimates of Y^* and U^* .



Alternative Measure

Mahalanobis Distance – US Survey of Professional Forecasters

From Sinclair, Stekler, and Carnow (Economics Bulletin, 2012)

| | Current Quarter 1968Q4 – 2011Q1 | | One Quarter Ahead 1969Q1 – 2011Q1 | |
|-----------------------------------|------------------------------------|-----------------|--------------------------------------|-----------------|
| | Mean Forecast | Mean Actuals | Mean Forecast | Mean Actuals |
| Real GDP Growth | 2.326 | 2.634 | 2.656 | 2.629 |
| Unemployment Rate | 6.238 | 6.204 | 6.259 | 6.221 |
| Inflation Rate | 3.833 | 3.849 | 3.775 | 3.849 |
| Mahalanobis Distance (D^2) | 0.013 | | 0.002 | |
| F-statistic | 0.363 | | 0.051 | |
| p-value | 0.780 | | 0.985 | |

Lessons for Forecasting

- Cross series evidence can be useful and professional forecasters know it.
- The poor performance of these forecasts on other dimensions does not appear to be due to forecasters missing out on Okun's Law.
- From this study could we back out forecaster's estimates of the NRU and potential output?
- There appears to still be a large output gap because there was no bounce-back.
 - So we have a permanent loss in output to accompany our "jobless" recovery.