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

By Prakash Loungani

Discussion by:
Tara M. Sinclair
George Washington University

November 15, 2012

GWU-IMF Forecasting Forum
In Honor of Herman Stekler
Summary

• Ball, Leigh, and Loungani have shown cross-country evidence that Okun’s Law is present and remarkably stable.
  o This mostly answers the second question of the title – forecasters should believe in Okun’s Law.
  o 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)

<table>
<thead>
<tr>
<th></th>
<th>Current Quarter 1968Q4 – 2011Q1</th>
<th>One Quarter Ahead 1969Q1 – 2011Q1</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Mean Forecast</td>
<td>Mean Actuals</td>
</tr>
<tr>
<td><strong>Real GDP Growth</strong></td>
<td>2.326</td>
<td>2.634</td>
</tr>
<tr>
<td><strong>Unemployment Rate</strong></td>
<td>6.238</td>
<td>6.204</td>
</tr>
<tr>
<td><strong>Inflation Rate</strong></td>
<td>3.833</td>
<td>3.849</td>
</tr>
<tr>
<td><strong>Mahalanobis Distance (D^2)</strong></td>
<td>0.013</td>
<td></td>
</tr>
<tr>
<td><strong>F-statistic</strong></td>
<td>0.363</td>
<td></td>
</tr>
<tr>
<td><strong>p-value</strong></td>
<td>0.780</td>
<td></td>
</tr>
</tbody>
</table>
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.
  o So we have a permanent loss in output to accompany our “jobless” recovery.