Are the macroeconomic forecasts of the central banks better than those of private agents?

By Paul Hubert

Private expectations — about inflation, growth and interest rates — are a critical component of most modern macroeconomic models, as they determine the current and future realizations of these very variables. Monetary policy has been shaped more and more by the incorporation of these expectations in central bankers' calculations and the influence they have on private expectations through interest rate decisions and the way these are communicated. The establishment by the central banks of a forward-looking policy orientation, called "forward guidance", has further reinforced the importance of central bank macroeconomic forecasts as a tool of monetary policy for influencing private expectations.

A recent article in the <u>Revue de l'OFCE (no. 137 – 2014)</u> evaluates the forecasting performance of the US Federal Reserve relative to that of private agents. This empirical review of the existing literature confirms that the Fed performs better than private agents in forecasting inflation, but not on GDP growth. Furthermore, the Fed does even better over longer forecast horizons. Despite this, its superiority seems to have been declining in recent times, though it's still significant. This article highlights the potential reasons for the Fed's superior performance, and suggests that this could stem from better information about the shocks hitting the economy rather than from a better model of the economy. The publication of these macroeconomic forecasts therefore helps to disseminate information among economic

agents and boosts the effectiveness of monetary policy by allowing private agents to better foresee trends and possible developments.