Economic Forecasts

From NYT:

The Miracle Years Are Over. Get Used to It.

Across the world, economists have had to downgrade growth forecasts. It's not as bad as it sounds.

By Ruchir Sharma

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Last year looked like the time when President Trump had delivered on his promises to strengthen the economy. His tax cuts appeared to juice growth above 3 percent, a pace the United States had not topped since 2005. But on Thursday the Commerce Department revised 2018 growth downward to below 3 percent, even as forecasts for 2019 were also trending lower, toward 2 percent. It all has triggered another wave of disappointed commentary about doggedly "slow" growth in the United States.

But it is not just an American story, and it's not just Mr. Trump who won't deliver on promises of 3, 4 or even 5 percent growth. Across the world, economists have had to downgrade growth forecasts in most years since the global financial crisis of 2008.

Defying the hopeful projections, Japan has rarely grown faster than 1 percent. Europe has struggled to sustain growth faster than 1.5 percent. No one quite knows how fast China is growing, but it's clear that there, too, the economy is slowing. So why is the dismal science suddenly guilty of issuing overly optimistic forecasts that set the whole world up for disappointment?

Economists keep basing forecasts on trends established during the postwar miracle years, when growth was boosted by expanding populations, rising productivity and exploding debt. But population and productivity growth had stagnated by 2008, and the financial crisis put a sudden end to the debt binge. The miracle is over.

Politicians often promise to bring back a golden age, but serious economists also are encouraging a similar illusion. Even during the Industrial Revolution, in the 19th century, the world economy rarely grew faster than 2.5 percent a year, until the post-World War II baby boom began to rapidly expand the labor force. After 1950, the combination of more workers and more output per worker lifted the pace of global growth to 4 percent. Economists came to think 4 percent was "normal."

Yet by last decade, the baby boom had faded out from Europe to Japan and China. Even in the United States, younger and faster-growing than most developed countries, growth in the working-age population slowed to a mere 0.2 percent last year from 1.2 percent in the early 2000s. Because fewer workers correlates directly with slower growth, that decrease implied a 1-point drop in economic growth.

Roughly, economists should have expected that United States economic growth would slow to 2 percent from 3 percent — and it has. This is the new normal for the American economy. Stimulus measures like the Trump tax cuts can lift growth above this path, but at best temporarily, at the risk of higher deficits and debt.

For political leaders, the new age of slow growth is not a problem to solve; it's a reality they need to accept and explain to the public. Because it's just not that bad.

When populations are growing slowly, the economy doesn't need to grow as fast to keep incomes high. Thus in the United States this decade, growth in gross domestic product per capita has slowed much more gradually than the overall economy, by half a point, to an average of 1.4 percent. And though Mr. Trump likes to boast about how well the United States is doing against developed rivals, Europe has been growing just as fast in per capita terms this decade, and Japan has been growing slightly faster. In a rich country, that is fast enough to satisfy most people: Indeed, surveys show that Americans have rarely been more confident about the economy.

Slower growth in the working-age population also means less competition for jobs worldwide, which goes a long way to explaining why unemployment is now at record lows not only in the United States but also in Germany and Japan. Surely that's not a bad thing.

Whatever politicians tell the public, their attempts to bring back the miracle years are ill advised. Growth in the economy is driven by growth in the number of workers and in output per worker, or productivity. But since the postwar surges of 1950s and 60s, productivity growth has slowed, also defying government efforts to lift it.

For a time, the global economy kept motoring along anyway, fueled by a surge in debt. In the 1980s, central banks began winning the war on inflation, which allowed them to drop interest rates sharply. Lower borrowing costs unleashed a worldwide binge that saw debt surging from 100 percent of global gross domestic product in the late 1980s to 300 percent by 2008.

Then the global financial crisis hit, ruining many private borrowers and lenders, many of whom are still wary of taking on new debt. After growing faster than the economy for three decades, debt growth in many countries, including the United States, has fallen back in line with economic growth. Even China, the one major country that dodged the crisis and experienced a surge in lending after 2008, is now reluctant to build on the mountain of debt that already weighs down its economy.

So the postwar miracle is over. Economic growth is weighed down by the baby bust and the debt hangover. Yet because economists continue to base forecasts on miracle rates of growth — 4 percent for the world, 3 percent for the United States — policymakers keep fighting to hit these targets. This is very risky.

There are growing calls from economists on both the right and the left to lower interest rates, or increase government spending, to boost growth even if that risks higher inflation. At the Federal Reserve, too, there is an emerging view that letting inflation rise above 2 percent, long considered a red line, may not be unwise.

The underlying assumption seems to be that policymakers must take action because 2 percent G.D.P. growth is intolerably slow. But must they? The confidence surveys suggest Americans are quite content with record-low unemployment, benign inflation and 1.4 percent growth in gross domestic product per capita. Why then the rush to pump more money into the economy, which risks rekindling its debt problems and inflation?

The world does not need more debt and more inflation to counter trends of declining population growth and high indebtedness. Instead, economists need to adjust their forecasts and politicians need to rethink their polices to match this reality. Because trying to recreate a bygone golden age is a shaky way to build the future.

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From Bloomberg:

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Why Are Economists So Bad at Forecasting Recessions?

Professional forecasters feel safer in a crowd. There's not much incentive to stick one's neck out.

By Simon Kennedy and Peter Coy

In 1966, four years before securing the Nobel Prize for economics, Paul Samuelson quipped that declines in U.S. stock prices had correctly predicted nine of the last five American recessions. His profession would kill for such accuracy.

With recession talk returning to haunt financial markets and the corridors of central banks, a review of the past suggests that those who are paid to call turning points in economic growth have a dismal record. Unlike the stock market, they're more likely to miss recessions than to predict ones that never occur. The lowlight, of course, was the widespread failure to forecast America's Great Recession, which began in December 2007—nine months before Lehman Brothers filed for bankruptcy.

In February, Andrew Bridgen, chief economist at London-based Fathom Consulting, worked out that of 469 downturns since 1988, the International Monetary Fund had predicted only four by the spring of the preceding year. By the spring of the year in which the downturn occurred, the IMF was projecting 111 slumps, fewer than a quarter of those that actually happened. In a post on his firm's website, Bridgen wrote that while IMF economists monitoring Equatorial Guinea, Papua New Guinea, and Nauru can walk tall for their recession calls, the rest pretty much flopped. "Since 1988 the IMF has never forecast a developed economy recession with a lead of anything more than a few months," he says.

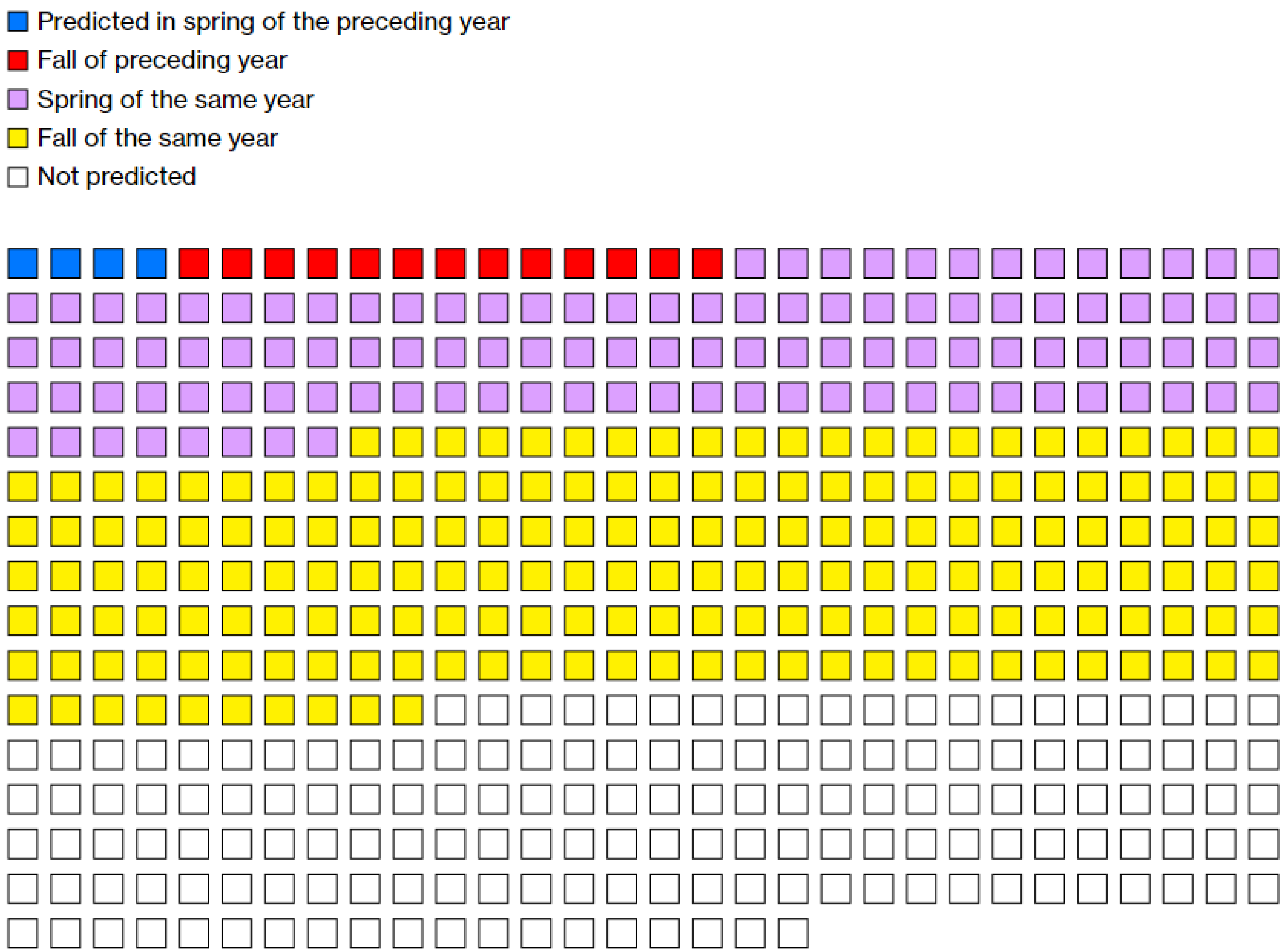
IMF economists point out that they're not alone in missing downturns. A recent working paper by Zidong An, Joao Tovar Jalles, and Prakash Loungani discovered that of 153 recessions in 63 countries from 1992 to 2014, only five were predicted by a consensus of private-sector economists in April of the preceding year. And the economists tended to underestimate the magnitude of the slump until the year was almost over.

The shortcomings of economists are in the spotlight again as the world economy traverses a soft patch. Growth in China continues to cool, while Europe is looking fragile. Italy is already in recession, and Germany and France risk stagnating. On March 22 the U.S. bond market flashed a warning sign when the yield on 10-year Treasury notes dipped below the yield on three-month Treasury bills. That reversal in the normal pattern of interest rates—known as an inversion of the yield curve—has generally been followed by a recession, although the length of time before a downturn varies widely. Meanwhile, in a recent survey of its members, the National Association for Business Economics found 42 percent anticipate a U.S. recession beginning next year, along with 10 percent predicting one this year and 25 percent expecting one in 2021.

What's behind economists' poor forecasting performance? The main reason is that it's simply a hard job. Information about the economy is incomplete and arrives with a lag. And turns in the economy tend to be abrupt. Some are caused by financial shocks, such as stock market panics, which are themselves unpredictable.

Few Hits, Lots of Misses

Recessions in 194 countries since 1988 by when they were predicted in the IMF's World Economic Outlook*



Data: Fathom Consulting
*Recession defined as an annual contraction in real GDP.

Loungani, who works at the IMF, says a lack of incentives may also be partly to blame. Unlike portfolio managers, economists don't have money riding on their ability to accurately predict downturns, and misses are rarely career-ending.

Groupthink may also pose an obstacle. Professional forecasters feel safer in a crowd rather than sticking their necks out with a recession call. Then there's a bias toward clinging to predictions even after contrary evidence emerges. The paper co-authored by Loungani shows that failing to forecast a recession is a much more common error than warning about one that doesn't occur. On the other hand, one way to make sure you never miss calling a recession is to constantly predict one—but be vague about when it will arrive. Stretching out the time horizon is a common gambit. Predicting a contraction 18 to 24 months in the future is a reasonable wager: Since 1959 the chance that the U.S. economy will be in a recession in any given month has been about 13 percent, according to Tom Stark, assistant director of the Real-Time Data Research Center of the Federal Reserve Bank of Philadelphia. (Stark says that stat can't be used to calculate the probability of a recession in the next, say, two years.)

Loungani nevertheless sees some room for optimism in economists' current behavior. In previous cycles, a lot of analysis was devoted to how times had changed and why the business cycle had been tamed, with more soft landings and fewer outright recessions. Stung by the failure of predicting the last recession, the profession has spent the past decade examining how expansions come to an end and discussing the policy tools that may be needed to stabilize an economy that's slowing. JPMorgan Chase & Co. economists currently tell clients there's a 40 percent chance of a downturn over the next year. "That's a better narrative than declaring we are in a new economy and the business cycle is dead," Loungani says.

BOTTOM LINE - Economists' inability to accurately predict recessions is a source of concern when key indicators in several countries seem to be flashing red.

Our thoughts

"I'm neither smart enough nor dumb enough to forecast the future." - Mike Nash

Fortunately, a crystal ball isn't necessary to be a successful investor. Step 1 is to arrive at an appropriate Risk Profile, with the understanding that it will need to be adjusted when your Capacity to bear risk changes. What shouldn't change with the vagaries of the markets is your Tolerance for risk. Step 2 is to build a Factor-based portfolio that reflects your Profile. Step 3 is to monitor performance, while watching for new opportunities.

"Investing is simple, not easy." - Warren Buffett