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The role of expert judgment in short-term economic forecasting

Forecasting process at wiiw

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Overview

1. Economic forecasting is notoriously imprecise but still useful
2. Role of expert judgement?
3. wiiw forecasting process

“How do you know economists have a sense of humour? They use decimal points.”

Macroeconomic forecasts - to be treated with caution

Economists can't tell you when the next downturn is coming [...]. Expansions don't die of old age: They're murdered by bubbles, central-bank mistakes or some unforeseen shock ...

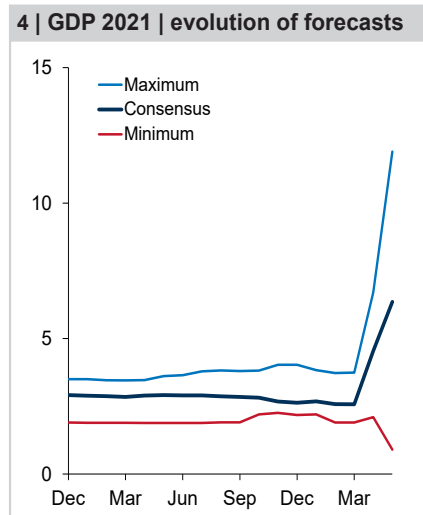
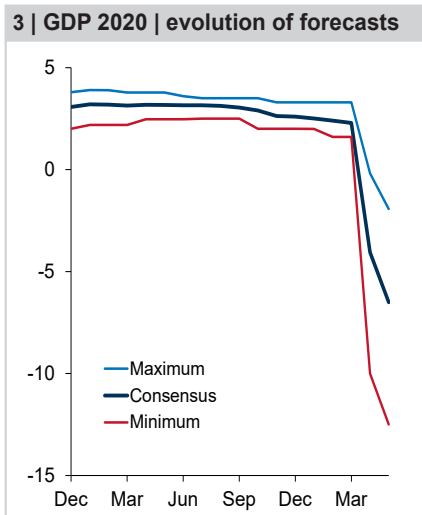
—Jared Bernstein, Washington Post, 7/5/2018

- Forecasting models are **far from accurate representations** of complex, dynamic modern economic and commercial systems (International Journal of Forecasting, Jul-Sep 2022)
- Forecasters made **systematic errors** when economies are subject to major perturbations - overestimated the rate of growth during slowdowns and recessions and underestimated it during recoveries and booms (Fildes, Stekler, 2002)
- Recessions were generally not forecasted in advance and forecasters did **not recognize the onset of recessions** slowdowns (Schnader and Stekler, 1990).

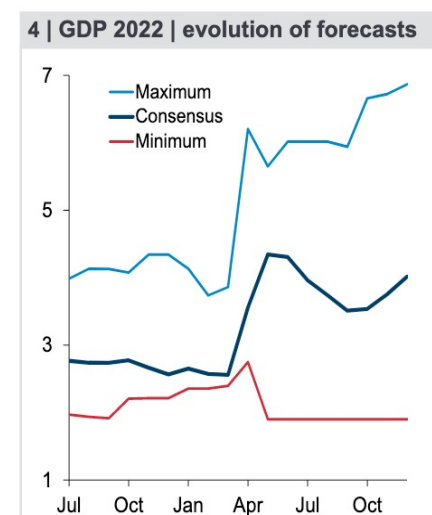
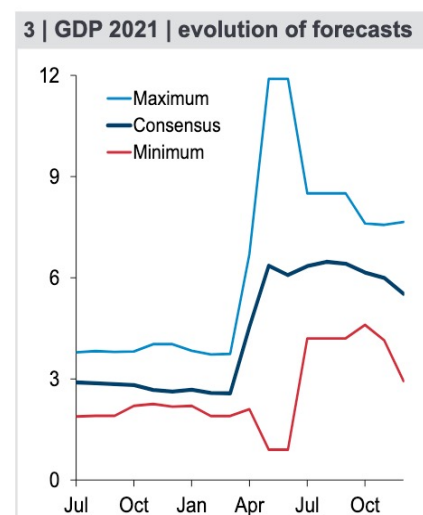
2020-2022 crises make forecasting exceptionally challenging

Slovakia GDP growth: 2020 **-4.4%**, 2021 **+3.0%**

05'2020



12'2020



Still forecasts are crucial for policymaking

Economists are like doctors, not soothsayers. They can't predict recessions, but they can help us understand why one is happening. And that can make all the difference for policymaking

—Thorsten Drautzburg, Economic Insights, Q1'2019

- Main contribution of forecasts – providing information on the **main interacting forces** in the economy, assessing the **balance of risks and uncertainties** regarding the economic outlook and policy responses rather than the specific point estimates of the outlook.
- Attempts to by-pass the need for forecasting by defining rigorous ex ante rules for the conduct of policy have typically been unsuccessful (OECD, 1994)
- While missing the exact timing, the forecasts did predict slowdowns in the economy (Fildes, Stekler, 2002)

Expert judgement improves forecasts precision

- Experts outperformed models in shorter-term forecasting (Braun, Yaniv, 1992)
- Expert adjustments to a model make forecasts more accurate, particularly when the forecast horizon is short (Franses, Kranendonk, Lanser, 2011).
- Combined expert-adjusted forecasts outperform combined model-based forecasts even when the individual expert-adjusted forecasts themselves are less accurate than the underlying model forecasts. Experts likely interpret news in a different way (van Dijk, Franses, 2019)

When is expert judgement particularly useful?

- Judgmental adjustments can help accuracy of forecasts if important variables are missing from the causal model, data are poor, relationships are misspecified, relationships are believed to have changed, or the environment has changed (Goodwin et al. 2011)
- Experts can improve the accuracy of forecasts by
 - making use of high-frequency indicators, insider information, and practitioners' intuition to predict rare events,
 - formulating forecast scenarios,
 - identifying the most important functional relationships in a model,
 - calibrating parameters of a model under regime shifts.

Macroeconomic forecasting process at wiiw

- 23 countries in CESEE in four sub-regions:
 - 17 country experts
 - 7 statisticians
 - Knowledge of local languages
 - Networks of contacts
- Regular monitoring of economic developments:
 - Convergence monitor
 - Business cycle monitor
 - Credit monitor
 - FDI monitor
- Modeling framework
 - Adjusting over time

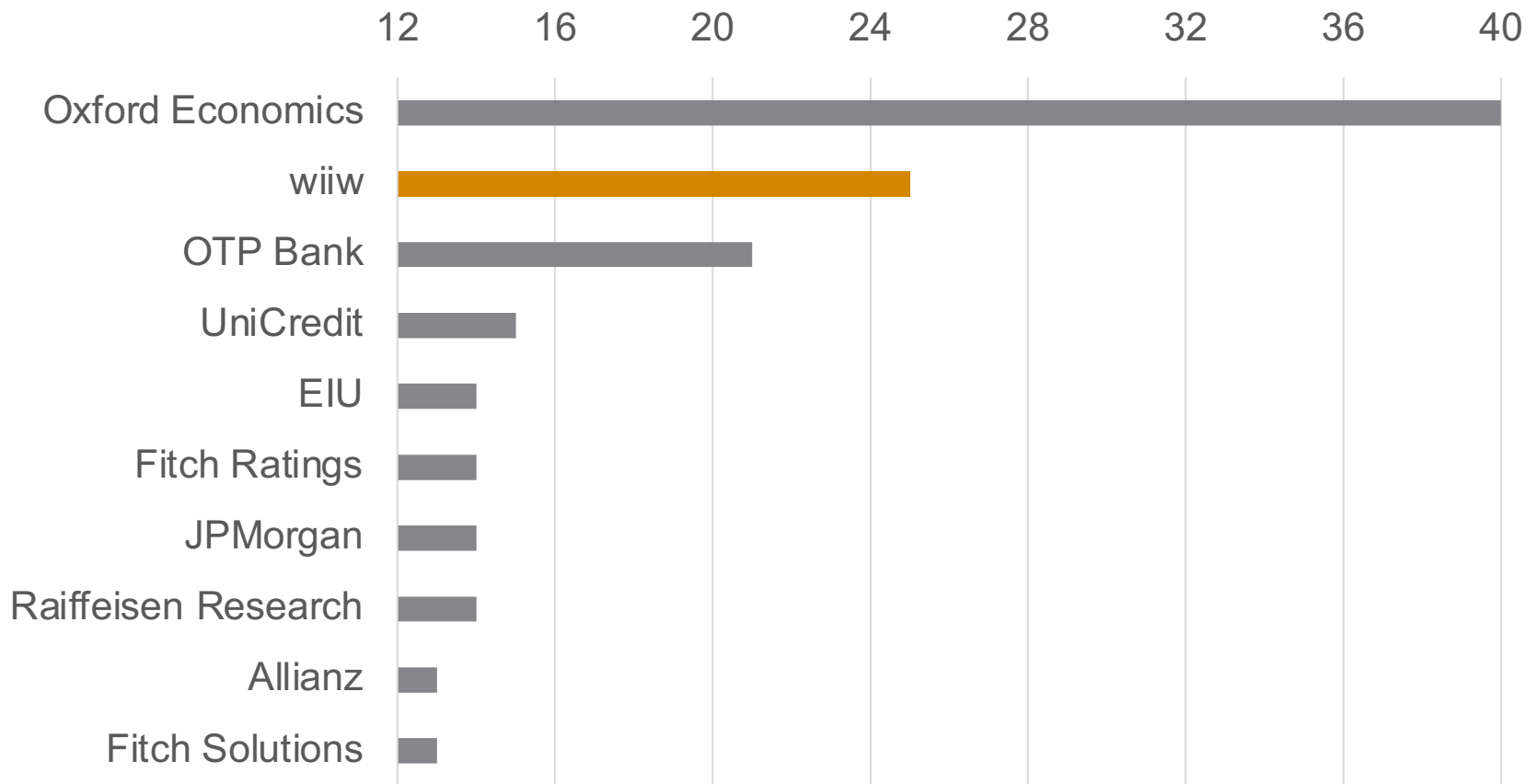


Controlling for biases

- Cognitive factors and motivational biases can lead to the inefficient use of information by experts and reductions in their forecasts' accuracy.
- Forecast support systems:
 - Formulating exogenous assumptions
 - Two-stage narrative consistency check
 - SNA-based forecast consistency tool
 - Forecasts alignment meetings

Accuracy of our forecasts for CESEE

Total top-3 place rankings for CESEE-21 macroeconomic forecasts in 2021



Thank you for your attention!

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