

Comments on Macroeconomic Models for Forecasting and Policy Analysis

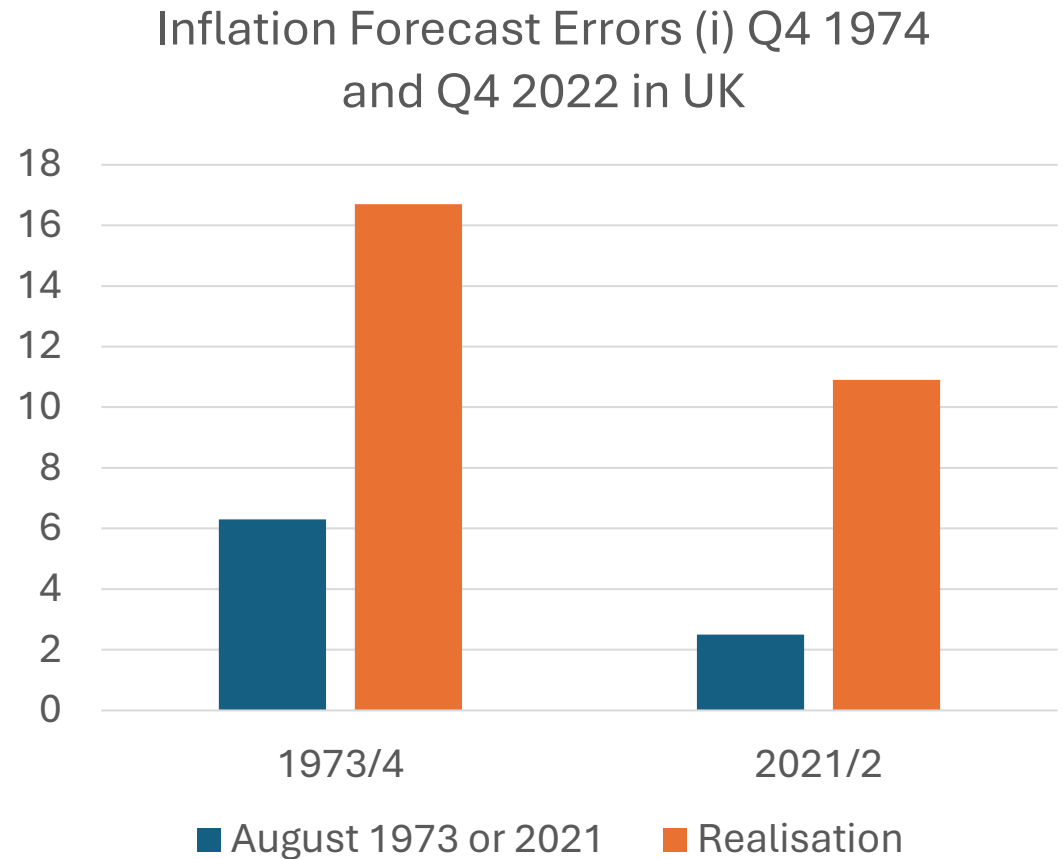
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ECB Modelling

- The modelling need is to forecast economic outturns and provide tools for showing the effects of policy changes.
- An impressive array of models spanning the full space of academic and policy achievement.
- DSGE models, VARS, semi-structural models reflecting academic advances and needs of policy-makers.
- A good account of the way the models are used to produce unconditional and conditional forecasts.
- In contrast to the situation in the UK, the models are maintained in a way which makes it possible to do more than simply look at what has changed since the last forecast.
- How far does the Council rely on the models?

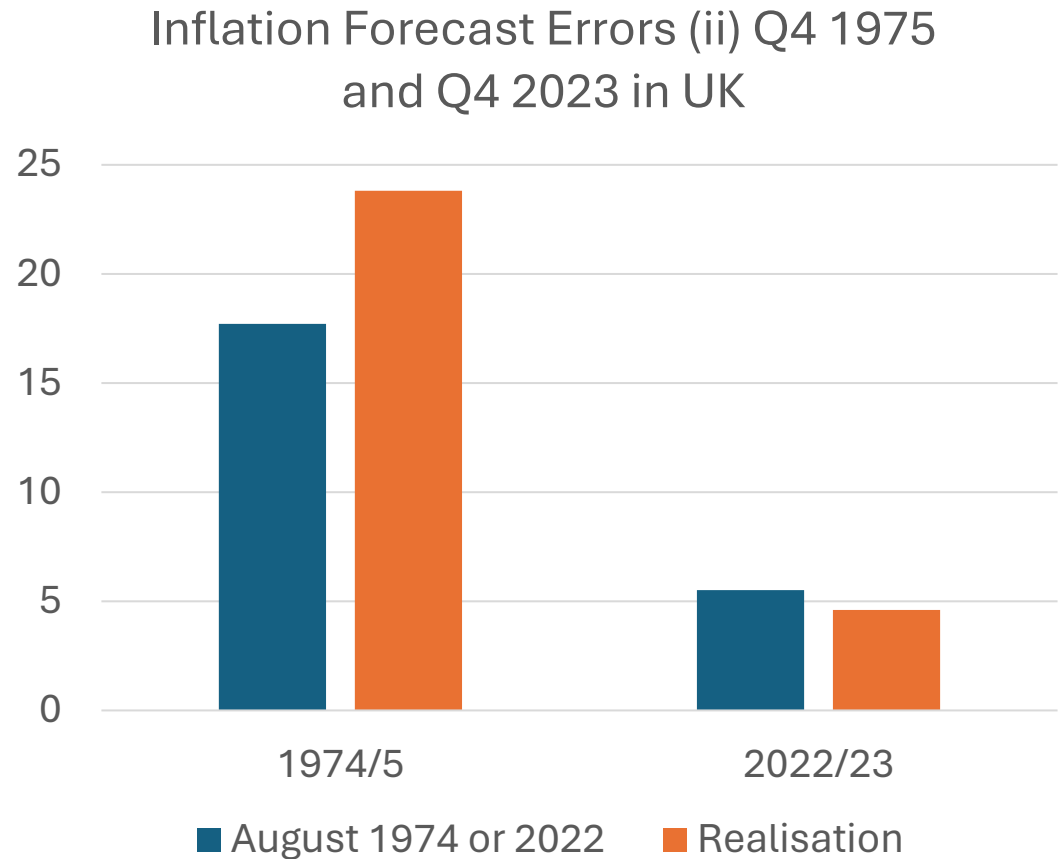
Has Forecasting Improved? Then and Now.

- Compare the UK forecast errors for 1973/4 and 2021/22
- Use 1973 NIESR forecast and 2021 MPC forecast.
- Look at August 1973 and 2021 forecasts for Q4 1974/Q4 1973 and Q4 2022 over Q4 2021 respectively.
- Not much of an improvement



Better-judged Follow On

- August 1974 and 2022 forecasts for Q4 1975 over Q4 1974 and Q4 2023 over Q4 2022.
- 1974's inflation persisted while 2022's largely faded.
- Expectations were perhaps adaptive in the 1970s and less so in the 2020s



- What stopped the follow-on in the 2020s?
- Probably the credibility of the inflation target.
- General view by the late 1970s that UK inflation was a random walk while now it is largely target-reverting. That makes forecasting more accurate.
- How far credibility of the target can be sustained is not a question likely to be answered by varied approaches to economic modelling as set out in the paper.

Limitation of Rational Expectations Models

- The Fisher equation seems to rule to roost.
- Policy-makers (with the exception of President Erdogan) tend not to believe it and with good reason.
- How far should we trust models whose conclusions we do not believe?
- This points to a reliance for forecasting purposes and many policy purposes on models such as FRBUS and ECB-MC.

Quantities and Prices

- Is all the information contained in prices or do quantities matter when thinking about the effects of say monetary policy on inflation.
- The twin pillars are not discussed but perhaps quantities do matter, as economists such as Charles Goodhart and Mervyn King have argued.
- HANK models show quantity effects because some people cannot borrow as much as they would like.
- Or they need governments to do it for them.

Prospects

- Never think the ideal model is just round the corner.
- Models are simplifications and will always remain simplifications.
- Deciding what to put in and what to leave out is an art, not a science, and is always eventually wrong-footed by events.
- Only young people would ever claim to be good at forecasting.
- NEVER let a run of good forecasting luck mislead you.
- The big problems have not all be solved. We may not even know what they are.