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MonetaryTrends

THE FEDERAL RESERVE BANK of ST. LOUIS

Consensus and Monetary Policy Forecasts

Federal Open Market Committee (FOMC) members have prepared economic forecasts twice per year since 1979, as required by law.[1] These FOMC forecasts receive a great deal of attention, although neither individual member forecasts nor the mean or median forecasts are revealed. Instead, only ranges (minimum and maximum) are reported. The economy's future is always uncertain, and a wider forecast range reflects greater disagreement among the policymakers about the future. However, even if the forecasts of all the policymakers were identical (perfect consensus), they would likely be wrong because the future is inherently unpredictable. The table below attempts to gauge the degree of consensus about the outlook, relative to the economy's inherent unpredictability.

Forecasts are made of annual, fourth-quarter-over-fourth-quarter growth rates for nominal gross domestic product (GDP), real GDP, and inflation. Fed policymakers also forecast the unemployment rate for the fourth quarter of the year. February forecasts pertain to the current calendar year (referred to in the table as the 12-month forecasts). In July, forecasts are updated for the current calendar year (6-month forecasts) and preliminary projections are made for the next calendar year (18-month forecasts).

We define the FOMC consensus forecast as the midpoint of the range between the high and low forecasts. The table shows the root-mean-squared error (RMSE) of the consensus forecasts, one-half the width of the forecast ranges, and their ratio. (We use one-half the range to make the scale comparable to the RMSE, which is an index of unpredictability.) The width of the range is an inverse measure of consensus; as such, the ratios reveal, in a simple way, the degree of consensus among the policymakers about the outlook for a variable relative to the difficulty of predicting that variable. A high ratio, for example, indicates a strong consensus regarding the outlook, relative to the unpredictability of the variable.

In every case the RMSE is larger than half the width of the range. Paradoxically, the highest figures (where the consensus is strong relative to the degree of predictability) are for "real" variables such as GDP and the unemployment rate, over which the Fed has little control. At the same time, the smallest figures are observed for inflation, over which the Fed is widely regarded as having considerable influence. Among inflation forecast horizons, the least amount of consensus emerges for the longest horizon—18 months—where the Fed's control presumably is the strongest.

The figures reveal a wide difference of opinion among FOMC members regarding the medium-term outlook for inflation, relative to the underlying predictability of inflation. This may explain, in part, the FOMC's reluctance to publicly commit to an inflation target.

—William T. Gavin

[1]The reporting requirement of the Humphrey-Hawkins Act expired in May 2000, but the Congress amended and continued the reporting requirements in the American Homeownership and Economic Opportunity Act of 2000 (Section 1003).

FOMC Consensus 1979 Through 2001

	Forecast horizon		
	6-month	12-month	18-month
Real GDP			
RMSE (percent annual rate)	1.27	1.35	1.59
One-half width of range	0.62	0.81	0.85
Ratio	2.05	1.67	1.87
Inflation			
RMSE (percent annual rate)	0.59	0.97	1.12
One-half width of range	0.51	0.70	0.99
Ratio	1.18	1.38	1.13
Unemployment			
RMSE (percent annual rate)	0.55	0.68	0.97
One-half width of range	0.30	0.35	0.48
Ratio	1.86	1.96	2.01