Conference on

# Forecasting and Monetary Policy

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## Discussion of „Conditional Forecasts in DSGE Models“

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# Conditional forecasts in DSGE models

*Comments by Christian Dreger*

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# Contribution of the paper

- Incorporte future information in DSGEs to improve forecasting record
  - Leading information, while keeping the model structure
  - Information restricted to model variables
- Uncertainty on conditional information
- Forecasting accuracy for other variables by univariate and multivariate measures

# Design of the analysis

- Different degrees of conditioning
  - Uncertainty in terms of standard deviation of conditional variable
  - Hard-conditional (0%) and unconditional forecasts (100% of standard deviation) are boundaries
  - Different degrees of uncertainty (soft conditioning) between them
- Lubik-Schorfheide (2007) as a benchmark

# Design of the analysis (II)

- Future information for financial variables
  - Interest and exchange rates
- Hard-conditioning does not dominate soft conditioning in all cases

- Data demeaned prior to estimation, mean is added back to compute forecast errors
  - Otherwise, forecasts are poor. Why?

# What did we learn?

- Incorporating future information has an impact on forecasting record
- Soft conditioning can perform better than hard conditioning
  - Information inaccurate
  - Model misspecification
  - Fut information does not matter for other variables
- Conditioning on information always (!) improves the forecasting record
  - Reduced from forecasts outperform perfect foresight?
  - Valid for demeaned data?

# Improvements

- Definition of unconditional forecasts
  - One standard deviation around actual value is not unconditional case
- Results should be replicated under settings relevant for the forecaster
  - Use predicted rather than actual values of the conditioning variables
- Reshape paper towards strategy for model evaluation
  - Dominance of soft conditioning points to specification errors in respective variables