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Discussion of „Real-Time Evaluation of Inflation Report Forecasts for Inflation and Growth“

Comments on:

Real time evaluation of *Inflation Report* forecasts for UK inflation and growth

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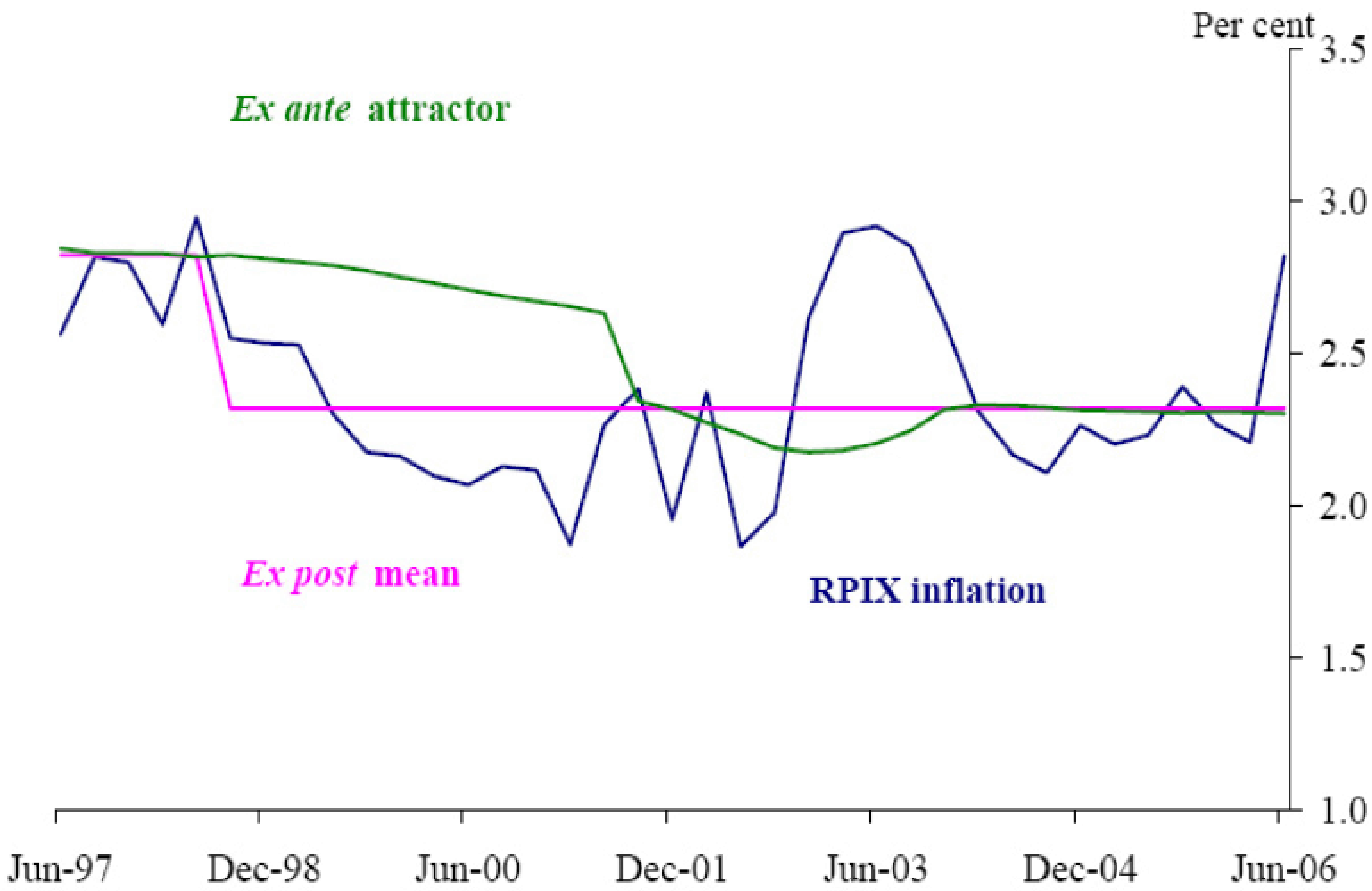
Summary and first comments

- ”Our aim is not to run a forecast horse race and find the best model, but to compare the official forecasts to sensible statistical benchmarks.”
  - What is the difference?
- Many benchmark models outperform the official GDP growth forecasts
- The official inflation forecasts appear to outperform the benchmark models
  - Potential reason: structural breaks in the inflation series
    - How many potential breaks are identified? (it is my impression that it is “only” the 1997Q3 BOE-independency)
  - Potential solutions to “correct” for this
    - Use de-meaned data (benchmark)
    - Use rolling windows (of 7-10 years)
    - Include long-term inflation forecasts
  - Conclusion appears to be quite robust (in the sense that it is difficult to beat the official forecasts)

Further comments

- Given that “the break” occurs in 1997Q3
  and the slow adjustment of the benchmark models to this (Figure 1),
  why not only compare the RMSE for the period 2002-2006?

Bai-Perron test breaks in RPIX inflation

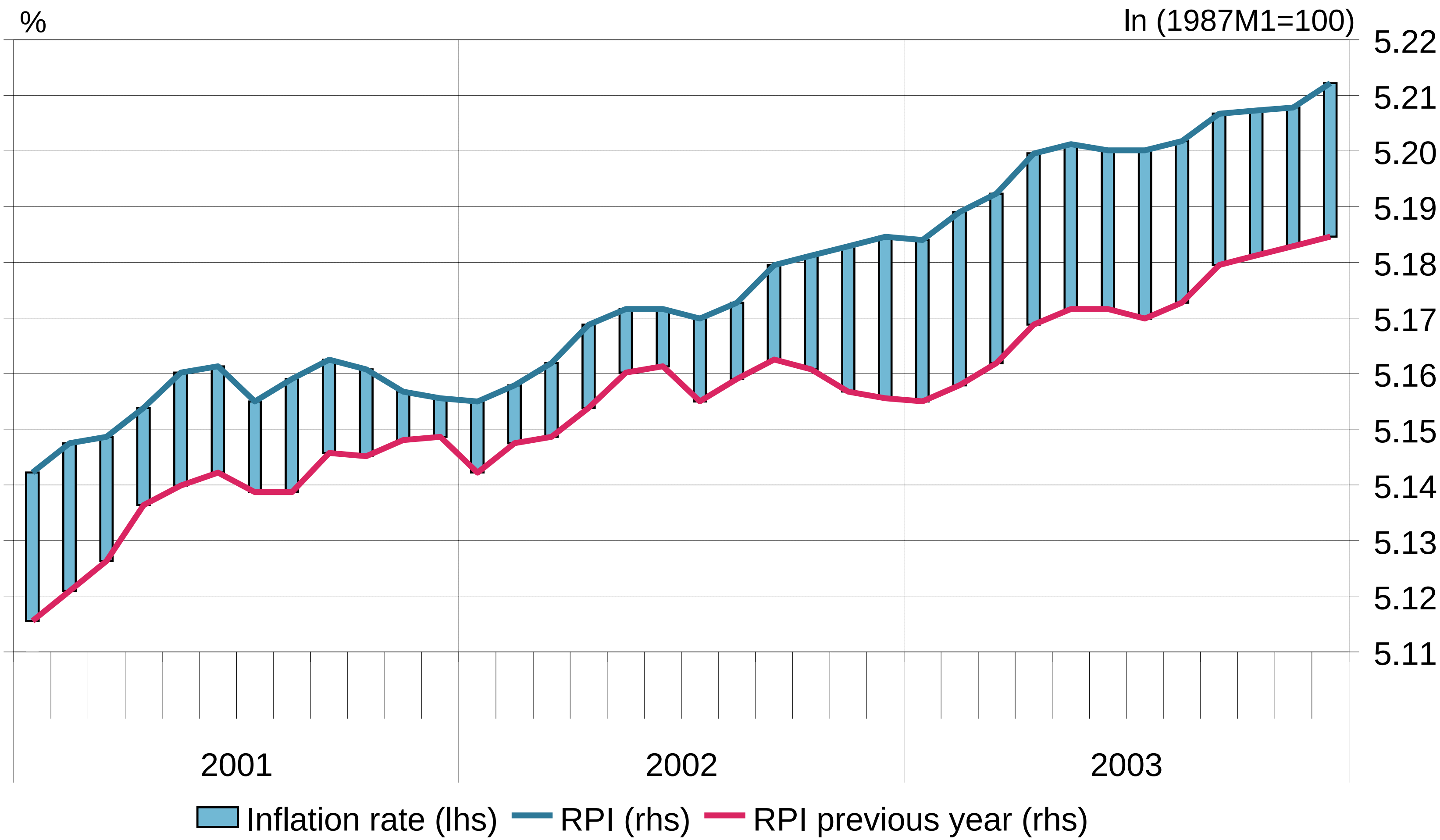


Further comments

- Given that “the break” occurs in 1997Q3
  and the slow adjustment of the benchmark models to this (Figure 1),
  why not only compare the RMSE for the period 2001-2006?

- The benchmark models appear to use “only” one lag
- The forecasts refer to year-to-year growth rates (of GDP and RPIX)
  - Next quarter year-to-year growth rates are not only affected by developments in the next quarter, but also by what happened throughout the previous three quarters (base effects)
    - This has consequences for the way the residuals are modelled
    - The base effects appear to be neglected in the benchmark models
      - Why not forecast quarter-to-quarter growth rates?
      - Why not include the fourth lag (next to the first lag)?

RPI data and the base effect



Final comments

- The vintages used are 1997Q2 – 2006Q1
  - It appears that the forecasts are confronted with the 2006Q2-vintage
    - Given that data are revised, this is not a fair competition: forecasts based on the 1997Q2 vintage will have it tougher than forecasts based on the 2006Q1 vintage
  - Make sure that the “final” data all bear the same “maturity”

- Given that you already have the data available
  - How do the BOE forecasts compare to the consensus forecasts? (Barclays BASIX Survey of Inflation Expectations)