OECD FORECASTS DURING & AFTER THE FINANCIAL CRISIS
A POST-MORTEM

OECD-BLOOMBERG EVENT
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The crisis and the recovery have been exceptional
Forecasts missed the downturn....

Successive forecasts of Q4-on-Q4 OECD GDP growth
...and accuracy was mixed during the recovery

Successive forecasts of Q4-on-Q4 OECD GDP growth
Forecast errors in the crisis were comparable to the first oil shock in the 1970s
UK forecast errors are similar to those of other G7 economies
Forecast errors were largest in the vulnerable euro area countries.
What can explain the forecast errors? Could they have been avoided?

Two approaches:

1. Comparing errors with data available at the time
   
   *These data could have helped to reduce our forecast errors*

2. Comparing errors with data available now (not available at the time)

   *These data help identify the “shocks”*
The downturn was deeper than projected in more open economies

Cumulative errors in May 2008 forecasts for GDP growth in 2008-09

![Diagram showing scatter plots with forecast error on the y-axis and trade openness or foreign banks' assets on the x-axis. The plots show a negative correlation between forecast error and both trade openness and foreign banks' assets as a percentage of total assets.](image-url)
Forecasts were too optimistic for countries with lower pre-crisis bank capital

Growth forecast errors for 2010-11, from May 2010

- Bank regulatory capital in 2007 (%)
- Forecast error (%pt)
Growth forecasts were less accurate in more heavily regulated economies.

Indicators are the OECD product market regulation index and the OECD measure of the strictness of employment protection (for regular workers).
Were we too optimistic about the negative impact of fiscal consolidation?
The intensification of the euro area crisis was a more important source of growth forecast errors.
“By seeking and blundering, we learn.”

Goethe
Lesson 1 – get better at spotting downturns

Directional accuracy of May growth projections

<table>
<thead>
<tr>
<th>OECD countries: 2007-12</th>
<th>Accelerations</th>
<th>Decelerations</th>
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<tbody>
<tr>
<td>Number in period</td>
<td>56</td>
<td>116</td>
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<tr>
<td>% correct: projections for same year</td>
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<td>88</td>
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<td>% correct: projections for next year</td>
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<td>46</td>
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<table>
<thead>
<tr>
<th>G7 countries: 1982-2006</th>
<th>Accelerations</th>
<th>Decelerations</th>
</tr>
</thead>
<tbody>
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<td>Number in period</td>
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<td>% correct: projections for same year</td>
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<tr>
<td>% correct: projections for next year</td>
<td>74</td>
<td>45</td>
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Lesson 2 – include more information on the financial system

Financial conditions index for large economies

- United States
- Euro area
- Japan
Lesson 3 – avoid “groupthink”

Average errors in forecasts from May - G7 countries

From the same year

%pt

From one year ahead

%pt

2007 2008 2009 2010 2011 2012

2007 2008 2009 2010 2011 2012

OECD  IMF  Consensus  EC
Lesson 4 – better recognise global linkages and spillovers

Financial openness is the sum of foreign assets and liabilities as a percentage of double GDP.
Lesson 5 – think more about risks

• More information about the risks around the main projections.

• Greater use of quantitative scenario analysis to illustrate possible outcomes.

• Horizon scanning to plan ahead for unlikely but potentially costly events.
Summary

• Forecasting in recent years proved very challenging and growth has been repeatedly over-estimated.

• We can learn from our errors to focus more on global linkages, the financial system and risks.

• There are limits to what forecasts can achieve. Accordingly, as much attention should be paid to the balance of risks as to point forecasts.

“OECD forecasts during and after the financial crisis: a post mortem”
OECD Economics Department Policy Notes No. 23