

Some Economic Forecasts May Be Biased

Desire for Publicity Appears to Color Judgment, Study Says

By FRED R. BLEAKLEY

Staff Reporter of THE WALL STREET JOURNAL

Should economists' motives be called into question when assessing their forecasts? Yes, according to a new study by the Federal Reserve Bank of New York.

What appears to be an honest difference of opinion may actually be inspired by a desire for publicity or to curry favor with bosses and clients, claims the 46-page report, "Rational Bias in Macroeconomic Forecasts." It maintains that there is a tendency among securities firms and independent forecasting firms to place a high value on generating business through media exposure. That, in turn, supposedly causes at least some economists to make maverick forecasts that don't fully reflect their views but attract attention to them and their firms.

If true, the study places a higher level of caveat *emplot* skepticism on economic forecasts than is already the case. Predictions about economic growth — as well as about interest rates, inflation and foreign currency — often serve as the basis for investment and other decisions by corporations and consumers. "Users of the forecasts should know there may be a bias," says David Laster, one of the study's authors.

Looking for Coverage

Such a claim, however, flies in the face of the common-sense notion that economists with the most accurate forecasts are the ones who get the media attention and high-profile jobs.

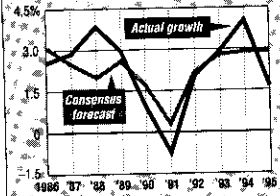
"Unless somebody is suicidal, he's not going to make a screwball forecast for notoriety," says A. Gary Shilling, who heads his own economic consulting firm in Springfield, N.J. Mr. Shilling was the top forecaster in The Wall Street Journal's poll of economists last June, although he has long been known for forecasts that are far out on the spectrum.

Still, some economists acknowledge that some of their colleagues are guilty of what the Fed study claims. "I've always contended that a lot of economists do forecasts to get their names in the paper," says David Wyss of DRI/McGraw-Hill. But for the most part, economists maintain that while there may be isolated cases of forecasters stretching their numbers to stand out from the crowd, they are by no

Going Out on a Limb

Economists' Track Record Predicting GDP Growth

Year-ahead Blue Chip Economic Indicators consensus forecast vs. actual



Source: Federal Reserve Bank of New York

Difference between economists' forecasts of growth and actual results, 1977-95, by group in percentage points



Note: Prior to 1993, GNP's used instead of GDP.

means as sweeping in some sectors as the New York Fed study indicates.

Mr. Laster concedes that there is no hard evidence that some economists shade their forecasts. He justifies the study's findings, nonetheless, saying: "We have drawn some logical conclusions based on letting the numbers speak for themselves."

Provenance of Predictions

According to the study, where an economist works often determines how far he departs from the prevailing consensus. For example, those who work for corporations and banks deviate the least from the consensus, the study says. The reason, the study speculates, is that their forecasts are used internally, where the principal goal is accuracy.

Consensus forecasts are generally the most accurate predictors of economic growth, though they also tend to miss turning points in economic cycles. Meanwhile, independent forecasters and economists working for securities firms deviate the most from consensus estimates, the study says, in part because they are considered marketing representatives and need to differ from the norm in order to attract attention. Firms are believed to be willing to give these economists more leeway on accuracy for the sake of getting and maintaining customers.

"We pose the question that if the consensus does well over the long term, why

aren't more forecasters centered there?" says Mr. Laster. The New York Fed study is based on 1,167 individual forecasts from 19 years of annual forecasts that appeared in December issues of Blue Chip Economic Indicators.

Not surprisingly, some economists take issue with the study's conclusions.

"That's far from the truth," Morgan Stanley & Co. chief economist Stephen Roach says of the report. He points out that his current forecast of higher interest rates is "not a particularly popular stand to take with clients." Adds Richard Rippe, chief economist at Prudential Securities, "In my 20 years on Wall Street, I've always been free to call it as I see it, without any pressure to come up with a different forecast."

An Independent Point of View

But Henry Kaufman, who spent most of his career at Salomon Brothers and now runs his own consulting and money-management firm, isn't so quick to absolve the Street. "It's difficult on Wall Street to maintain a high level of objectivity; in many instances economic research is folded in under someone in charge of [overall] research and trading." And Maria Ramirez, who was Drexel Burnham Lambert's chief economist in the 1980s and now heads her own firm in New York, says she believes institutional customers of Wall Street "look for an independent point of view because they fear the economic story a firm sells coincides with its own inventory [of securities]." Mr. Wyss of DRI/McGraw-Hill contends that even corporate economists, who are among the most unbiased in the Fed study, have a tendency to make rosier forecasts than what they believe. "They never want to show a downturn; their bosses may yell at them," says Mr. Wyss, who admits that DRI/McGraw-Hill itself "tends to have a little of the optimistic bias" of its corporate customers.

Mr. Shilling, whose firm doesn't par-

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Electricity Deregulation Sends a Chill Through Economies Near Some Plants

By ROSS KERBER

Staff Reporter of THE WALL STREET JOURNAL

HADDAM, Conn. — The Connecticut Yankee nuclear-power plant here once employed nearly 400 workers and the taxes it paid covered half of Haddam's town budget. That was before the plant faced

Fewer Utility Jobs

Total employment at investor-owned utilities, in thousands



Economists' Motives On Making Forecasts Questioned in Study

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participate in the Blue Chip surveys, gives another reason why forecasts aren't all the same. "It's my nature to constantly challenge things and not be reluctant to take a chance," he says. Mr. Shilling says that "we are looking for significant but undiscounted variations from the trend. I consider it the highest compliment when my client says 'Gary we don't take you literally, but you have a well-thought-out point of view that we need to consider.'"

Even so, Mr. Shilling concedes that some economists, including himself, modify their views to make sure clients don't miss an economic turn that is on the horizon. "I and others have a tendency, when we see something is coming, to forecast it will happen sooner rather than later . . . to create immediacy for the client," he explains.