Discussion of 'Do central banks' forecasts take into account public opinion and views?', by Ricardo Nunues

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What the paper does

- Romer & Romer (2008) showed that FOMC forecasts perform *worse* than those produced by the Fed's own staff ('Greenbook')
    - Higher MSE for FOMC forecasts
    - Optimal weight on FOMC forecasts (from MSE perspective) should be close to zero
- This paper studies the determinants of FOMC forecasts

Findings

- Main finding: FOMC forecasts are a combination of Greenbook's and other publicly available forecasts (SPF, White House)
- The question then is: why does the FOMC use information that *worsens* its forecast (in a MSE sense)?
- Author offers two justifications:
  - FOMC is 'institutionally designed to reflect or represent a variety of views in the economy'
  - A forecasting literature (e.g. Clements & Hendry, 1998, 2002) favors using weights different from MSE-optimal ones (e.g. due to changing economic structure)

Praise

- The paper studies an interesting topic
- It suggests a possible explanation for Romer & Romer's (2008) striking finding:
    - The Fed just takes into account other views about the economic outlook

Comments

- The author offers two possible justification for the FOMC's giving weight to views that actually worsen its forecasts
- How convincing are they?

Justification #1: FOMC's mandate to 'reflect other views'

- This is hardly comforting
- Paying attention to other views about the economy is justified if such views help *improve* the forecast ...
- ... not the other way around

Justification #2: literature advocates departing from MSE-optimal weights

- Forecasting literature argues in favor of alternative weighting schemes (e.g. equal weights) ...
    - The estimated weight on publicly available forecasts ($b = 0.25$) is in-between optimal ($b \approx 0$) and symmetric ($b = 1/2$) weights
- ... but it does so based on their out-of-sample forecasting performance
- The author needs to perform some kind of out-of-sample analysis
    - Otherwise, there is no justification for combining Greenbook forecasts with other forecasts

Come up with an alternative justification?

- One could think of yet another possible justification: the FOMC simply has a different objective function that MSE
- However, no formal analysis in this vein is provided
- E.g. Ellison and Sargent (2012) propose a theoretical framework in which it is optimal for the FOMC to deviate from Greenbook forecasts
  - Fed pursues a policy that is *robust* to model misspecification by its staff
- Author could propose an alternative, *formal* framework that underpins FOMC's forecasting procedures
  - E.g. central bank may gain credibility from staying close to private-sector forecasts

Other comments

- Forecasting rule,

$$F_t - G_t = a + b\left(X_t - G_t\right), \qquad X_t = W_t, S_t$$

  implies that even if Fed staff fully agrees with non-Fed forecast $(G_t = X_t)$, then FOMC still modifies Greenbook forecast by a constant term
- Why?

Conclusion

- Interesting paper on a relevant question
- Sheds light on why FOMC's forecasts perform worse than those of its own staff (Greenbook)
  - It takes into account other views about the economic outlook
- Next step: justify why