Heterogeneity in FOMC Forecasts

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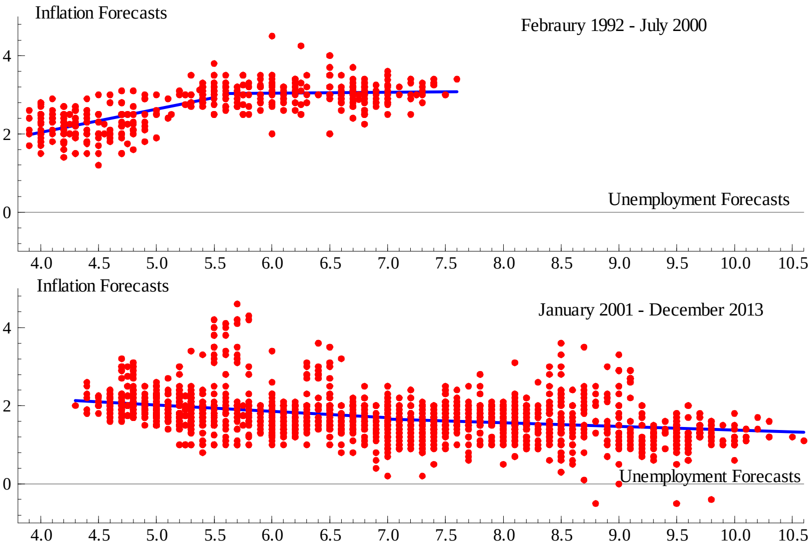
Tenet

- Macroeconomics textbooks assume that policy makers have
  - the same economic outlook
  - the same understanding of how the economy functions

- Romer (2010) reports evidence contradicting those assumptions

  "... there is no clear relationship between forecasts of real variables and inflation. None of the correlations between either real GDP growth or unemployment and either of the inflation measures is close to statistically significant." Romer (2010, p. 953).

Forecasts of FOMC Participants: 1992-2013



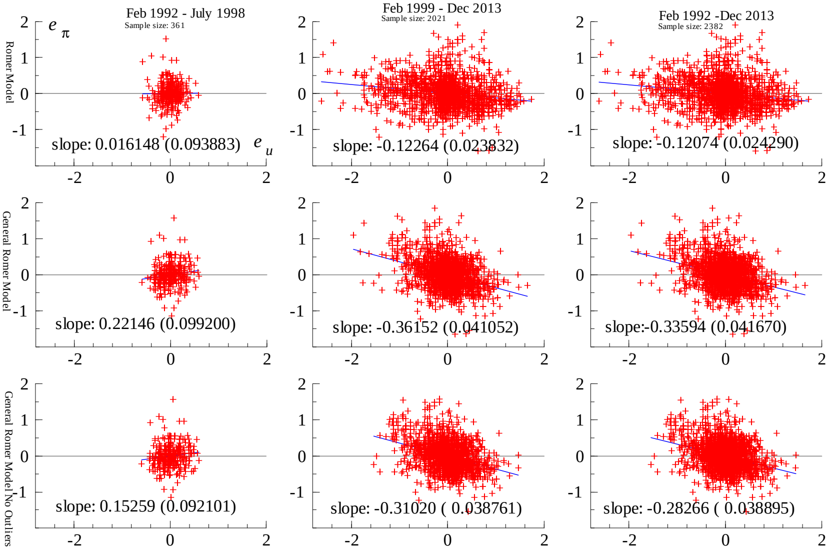
What is New?

- Change of FOMC chair from Greenspan to Bernanke
- Introduction of Summary of Economic Projections in 2007 which included the notion of appropriate policy.
- 2008 Financial Crisis
- Introduction of Unconventional Monetary Policy after 2008

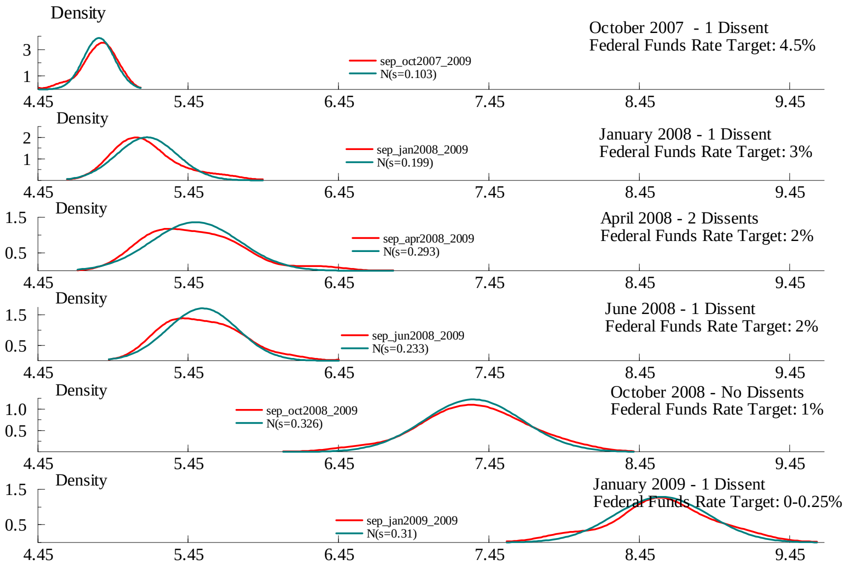
Romer's Methodology

- Start by using Romer's method of regressig FOMC inflation and unemployment forecasts on dummies for the dates of the FOMC meetings
- Augment his specification to control for technical factors such as the lenght of the forecast horizon, who is the FOMC Chair, and the measure of prices targeted by the FOMC.
- Focus on correlations of residuals

Residuals Correlations



Distribution of Unemployment Forecasts for 2009



Possibility 1: Bagehot and Financial Panics

Bernanke states at the January 2009 FOMC

> *It is a tradition of central banking that we lend against illiquid assets when there is a panic run, and we know that panic runs are equilibrium phenomena and they can occur even though the assets are worth more than the liabilities. I would argue that that kind of phenomenon has generalized into a lot of aspects of our economy.*

Possibility 2: Friedman and the Great Depression

When celebrating Friedman's 90th birthdate in 2002, Bernanke indicated that

> *I would like to say to Milton and Anna: Regarding the Great Depression. You're right, we did it. We're very sorry. But thanks to you, we won't do it again.*

Types of FOMC Heterogeneity Examined in the Paper

- *Institutional Heterogeneity*
  - participants' education,
  - voting status, and
  - regional affiliation

- *Dynamic Heterogeneity*
  - herd behavior,
  - extreme forecasts,
  - temporal aggregation,
  - macroeconomic shocks