Forecasting the Fed's Next Move: The FOMC vs. the Blue Chip Consensus

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Figure 1
Growth Forecasts
(1983-2000)

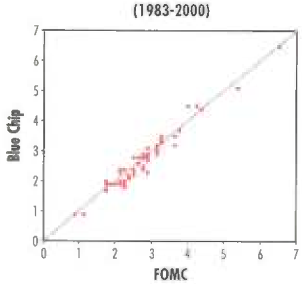
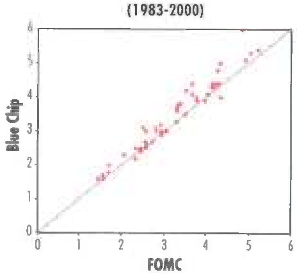


Figure 2
Inflation Forecasts
(1983-2000)



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People constantly wonder what the Fed's next move will be. They want to know what Fed policy-makers are thinking and what moves the Fed might have up its sleeve. Insights regarding what Fed policy-makers are thinking can be found by looking at the economic forecasts the Fed presents to Congress.

These forecasts, which are prepared by the FOMC, provide a good baseline for gauging when policy will change. They include vital information about the current state of the economy and the forecasters' beliefs about monetary policy. They also reveal information about long-run policy goals and what policy-makers think will happen as a result of their actions.

Through constant monitoring of incoming economic data, if the Fed sees the economy moving in a direction it did not expect (or want) at the time policy was made, the Fed will act accordingly. For example, if both inflation and output growth numbers come in higher than expected at the time monetary policy was set, a tightened monetary stance would seem in order.

Fed forecasts are available in February and July. They are annual growth forecasts of nominal GDP, real GDP and inflation. Fed policy-makers also forecast the average level of unemployment for the fourth quarter of the year. The forecasts made in February are for the end of the current calendar year. In July, the forecasts are updated and made for the end of the current calendar year and the following calendar year.

While Fed forecasts are only available twice a year, the Blue Chip consensus forecasts, which are made by a group of private-sector economists, are available monthly.[1] They are a good stand-in for Fed policy-maker forecasts.

Blue Chip consensus forecasts are collected on the first three working days of the month, and the information available to these private-sector economists is similar to the information available to FOMC members when they make their forecasts. Looking at the February and July Blue Chip consensus and FOMC forecasts for growth in real GDP and inflation from 1983 to 2000, we find that the two are very similar.

The scatter diagram in Figure 1 shows the relation between the GDP forecasts by the FOMC and the Blue Chip consensus. Each point on the graph is a coordinate, a place where the FOMC and Blue Chip consensus forecasts meet. If the two forecasts were identical, the points would lie on the 45-degree line. The seemingly even distribution of the points above and below the 45-degree line, and their close proximity to the 45-degree line, indicate that there does not seem to be any tendency for the Blue Chip economists to systematically forecast more or less output growth than the FOMC has.

However, the same cannot be said of inflation forecasts. Most of the points in Figure 2 lie above the 45-degree line, indicating that the Blue Chip economists usually forecast higher inflation than the Fed did. If the forecasts were exactly the same, the points in the figure would lie exactly on the 45 degree line. The Blue Chip forecasts are measured on the vertical axis and the FOMC on the horizontal axis. Because the Blue Chip inflation forecasts tended to be higher, the points are scattered above the 45 degree line. The period between 1983 to 2000 was a time of moderate and falling inflation.

Throughout its history, the Fed has had a goal of eliminating inflation. The FOMC inflation forecasts for the beginning of the period were lower than the Blue Chip forecasts; however, when the Fed achieved lower inflation during the 1990s, the two forecasts converged. The convergence of the two forecasts is indicative of the private sector's increased confidence in the Fed's ability to keep inflation in check.

The similarity in the Blue Chip consensus and FOMC forecasts makes the Blue Chip consensus forecasts a good proxy for the FOMC forecasts. Both private-sector economists and Fed policy-makers look at the same data releases and use similar economic concepts and theories to interpret the incoming data. Blue Chip economists and FOMC members seem to have similar views on output growth. Likewise, as the Fed has gained credibility in the private sector by keeping inflation low, the private sector and the Fed are now seeing more eye-to-eye on inflation, as well.

[1] *Blue Chip forecasts can be purchased through Aspen Publishing, www.aspenpub.com/. Click on "Economic Indicators," then "Blue Chip Economic Indicators."*