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ECONOMIC VIEW

The Forecast for the Forecasters Is Dismal

By DANIEL GROSS

LAST week, Alan Greenspan proved that a retired maestro can still seem to conduct the world's financial orchestra, even if he no longer occupies the podium.

On Monday, Mr. Greenspan, the former Federal Reserve chairman, said that "it is possible we can get a recession in the latter months of 2007." His musings, to a group of executives in Hong Kong, were followed over the next 48 hours by a break in the frothy Chinese market and poor numbers on United States home sales and durable-goods orders. Together, the events contributed to a swift downdraft in the United States stock market, and led to renewed concerns about the health of the long-running economic expansion.

By Thursday, Mr. Greenspan was backtracking. Noting that while a recession in 2007 is possible, he elaborated: "I don't think it's probable." But his comments — and the global reaction — raise a larger question: If a recession were imminent, would Mr. Greenspan, or any less august economist, be able to forecast it?

The answer, based on recent experience, is a resounding no. "I don't think we, as a profession, ever had an ability to forecast recessions," said Jeffrey A. Frankel, professor of economics at the Kennedy School of Government at Harvard and a member of the National Bureau of Economic Research's Business Cycle Dating Committee, the official arbiter of recessions. "It's hard enough to know when a recession has started, looking at it with hindsight."

Indeed. No disrespect to Mr. Greenspan, but neither he nor the similarly numerate members of his professional fraternity have a particularly good record of forecasting recessions. As Yoram K. Bauman, an economist who teaches at the University of Washington and performs stand-up comedy, summed up an often-used line: "Macroeconomists have successfully predicted nine of the last five recessions."

The Economist reported that in March 2001 — the month the last recession began — 95 percent of American economists believed that there wouldn't be a recession. In February 2001, the 35 professional forecasters surveyed by the Federal Reserve Bank of Philadelphia collectively predicted growth at an annual rate of 2.2 percent for the second quarter of 2001 and 3.3 percent for the third quarter. It's as if meteorologists stood outside as the storm clouds approached and informed television viewers that endless sunshine was ahead.

Economists offer several explanations as to why their fellow dismal scientists collectively make such lousy forecasters. Nouriel Roubini, professor of economics at the Stern School of Business at New York University, believes that there are institutional reasons. Many forecasters surveyed by the Philadelphia Fed work for Wall Street investment banks or asset management companies, which tend to argue that it is always a good time to invest. There are powerful incentives and pressures not to be unduly bearish about the economy. "When your firm is bullish on everything else, and is peddling all kinds of stocks and bonds, nobody will be foolish enough to go the other way," he said. Of course, Mr. Roubini is perfectly willing to go the other way. Last summer, he boldly predicted a recession for the first half of 2007.

Lakshman Achuthan, managing director at the Economic Cycle Research Institute, which accurately predicted the 2001 recession, says that most economists are simply using the wrong tools. "Generally speaking, professional forecasters tend to extrapolate from existing trends, albeit in a very sophisticated way," he said.

Doing so, however, inevitably causes them to miss out on inflection points — at the beginning or the end of recessions, he said. Mr. Achuthan thinks that the institute's methodology, which focuses on a series of leading indicators and avoids specific numerical forecasts about economic growth, allows it to gauge turning points more accurately.

The complexity, dynamism and diversity of the United States economy also make forecasting recessions difficult. In small countries, which may depend on a single export, like oil, or where a natural disaster can wreak catastrophic results for the entire economy, it is comparatively easy to determine when and how one of these factors can cause a contraction, Mr. Frankel of Harvard said. But in the United States, whose overall economy has responded so well in recent years to a series of external shocks — from 9/11 to Hurricane Katrina — it's rarely sufficient to focus on a single factor.

Christina Romer, professor of economics at the University of California, Berkeley, says economists can't predict recessions for the same reason stock market analysts can't accurately predict market crashes. "Both kinds of events, by their nature, are not predictable events," she said. Almost all the postwar recessions were preceded by a shock, like a spike in short-term interest rates, or a sharp rise in oil prices. "It's impossible to see the shocks coming," Ms. Romer said.

The very infrequency of recessions in the United States may make it more challenging to detect their imminent arrival. An entire generation of economists has grown up believing that the business cycle is largely something of the past, like black-and-white TV. Since March 1991, there has been only one recession, which lasted eight months. It's like asking people who spend their time in Alaska to start forecasting tropical storms.

AS a group, forecasters certainly don't see a recession coming. On Feb. 13, those of the Federal Reserve Bank of Philadelphia collectively raised their estimates for real gross domestic product growth for 2007 to 2.8 percent, from 2.6 percent.

But just because they've been wrong in the past doesn't mean forecasters are wrong now. "There is no reason at the moment why the steady momentum of the economy, with gains in employment feeding back into consumption growth, should falter," said Robert J. Gordon, professor of economics at Northwestern University and a member of Business Cycle Dating Committee at the National Bureau of Economic Research.

To one of the few people who accurately predicted the 2001 recession, the glass seems half full rather than half empty. "We actually see a diminishing risk for recession in 2007," Mr. Achuthan of the Economic Cycle Research Institute said. "Our leading indexes for the vast service sector have turned up in 2007. This economy is much bigger than the housing or the manufacturing sector."

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