

Macro Roundup Article

Headline: [Long-Term Expectations and Aggregate Fluctuations](#)

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Summary: Business cycles are typically traced to “fundamental” shocks. A positive productivity shock increases current output and rational expectations about future productivity. In principle, such shocks could [also] explain stock market volatility, because stocks are just claims on firms’ fluctuating profits. In practice, they do not. We follow a different route. Key to our strategy is the use of data on stock analysts’ consensus expectations of the earnings growth of S&P 500 firms. One measure turns out to be critical: the analysts’ forecast of a firm’s long-term earnings growth (LTG), which captures expectations of fundamentals over a 3-to-5-year horizon. When LTG is high relative to historical standards, analyst forecasts of short and long-term profits are systematically disappointed in the future. We [further] connect LTG to real activity. We show that a 1 s.d. increase in LTG fuels an investment boom: growth in the investment-to-capital ratio is 3% higher than conventional levels in the following year, corresponding to a 0.4 s.d. increase. The investment boom sharply reverts 2 years later. Finally, we connect LTG to conventional business cycle analysis. In the short term, higher LTG acts like a positive shock: it predicts growth in consumption, employment, and wages.

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Primary Topic: Business Cycle

Topics: Academic paper, Business Cycle, Database, Financial Markets, GDP, Weekly

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