Does Presidential Partisanship Affect Fed Inflation Forecasts?

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Why should we care about presidential partisan inflation forecast bias?

- ▶ Clark & Arel-Bundock (2011) find policymakers at Federal Reserve are not politically indifferent.
- ▶ Could be that the information they receive is biased.
- ▶ Economists have not considered political preferences in evaluating Fed accuracy.

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How accurate are Fed inflation forecasts?

Forecast Errors

Our **dependent variable**:

$$E_q = \frac{F_q - I_q}{I_q}$$

- $F_q =$ Green Book inflation forecast for quarter q. (We use forecasts made *two quarters* prior).
- $I_q =$ actual inflation in quarter q.
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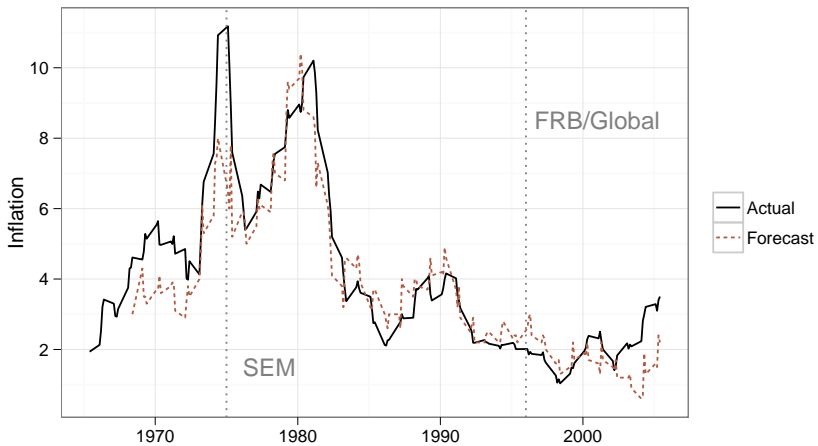
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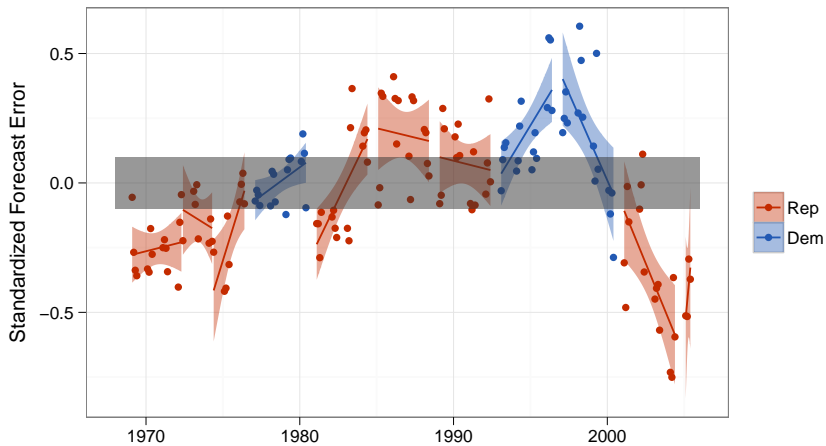
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Ideally, the mean forecast error is 0.

Consistent errors $\rightarrow$ "wrong" policies.

What might explain forecast errors?

Traditional understanding of Fed forecasting

- ▶ Forecasts produced for every FOMC meeting
- ▶ Over long run no bias (e.g., Romer and Romer 2000).
- ▶ Periods of over- and under-estimations (Capistrán 2008).
- ▶ No research on partisan influence of forecast errors.

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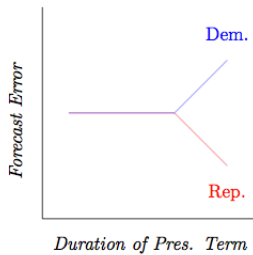- No research on partisan influence of forecast errors.

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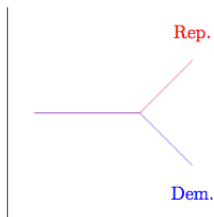- ▶ No research on partisan influence of forecast errors.

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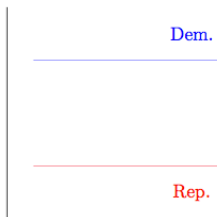- ▶ No research on partisan influence of forecast errors.

Partisan Preferences   **Monetary Expectations**   **Partisan Heuristics**

Forecast Error

Dem.

Rep.

Duration of Pres. Term

Rep.

Dem.

Dem.

Rep.

Followed Ho et al. (2010) to isolate
relationship between presidential
partisanship/elections and the other controls.

1. Two data sets **matched** on:
   ▸ *presidential party ID*
   ▸ *election period*

2. Used these in **parametric models** with standardized inflation
   forecast errors as continuous dependent variable.

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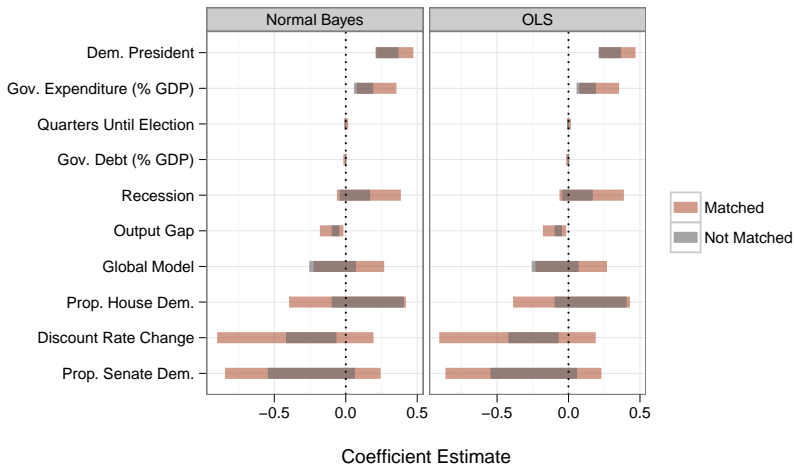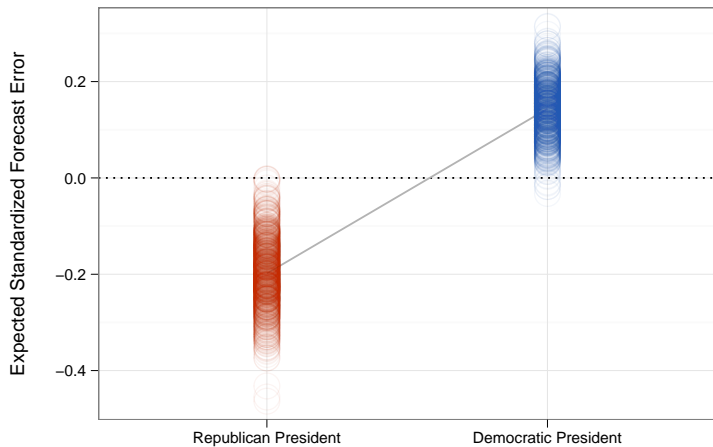
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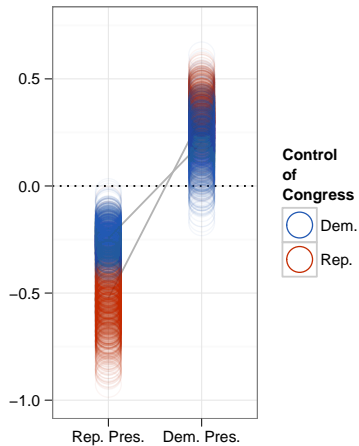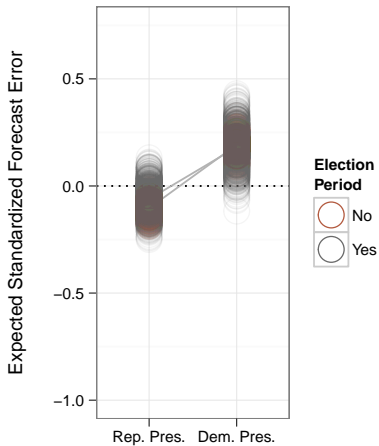
Results?

Main Results

Simulated Errors

Interactions

Does presidential partisanship affect Fed staff
inflation forecasts?

Probably.

How?

- ▶ Fed staff **don't** have an electoral bias.
  - ▶ Don't seem to try to influence election outcomes or compensate for FOMC political preferences.

- ▶ Fed staff **do** use a **partisan heuristic**
  - ▶ Leads to **systematic bias** in inflation forecasts across presidential terms.

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Possible political implications?

- ▶ High inflation forecasts during **Democratic** presidencies $\rightarrow$ interest rates **'too high'**.
    - ▶ This could hurt Democrats' re-election chances.
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