연세대학교
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Does Presidential Partisanship Affect Fed Inflation Forecasts?

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1. Motivation
2. Describing Forecast Errors
3. What Might Explain Forecast Errors?
4. Empirical Tests
5. Conclusions

Working Paper

The working paper is available on SSRN at:

http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2105301.

Presidential Partisan Inflation Forecast Bias:

When inflation forecasts are systematically different depending on the partisan identification of the United States president.

Why should we care about presidential partisan inflation forecast bias?

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

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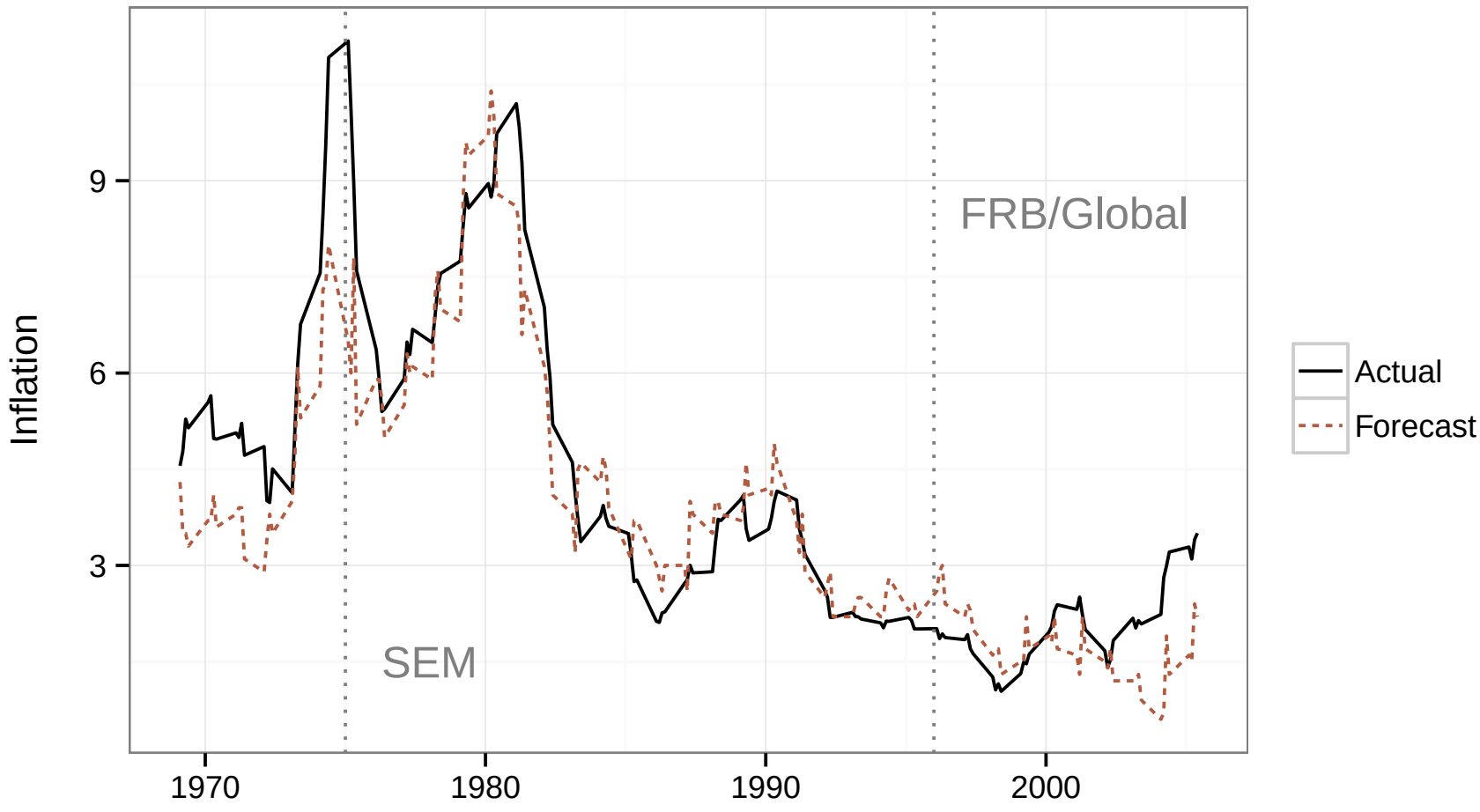
How accurate are Fed inflation forecasts?


Inflation
9
6
3
1970
1980
1990
2000
SEM
FRB/Global
Actual
Forecast

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.
- $E_q =$ the standardized inflation forecast error for quarter q.

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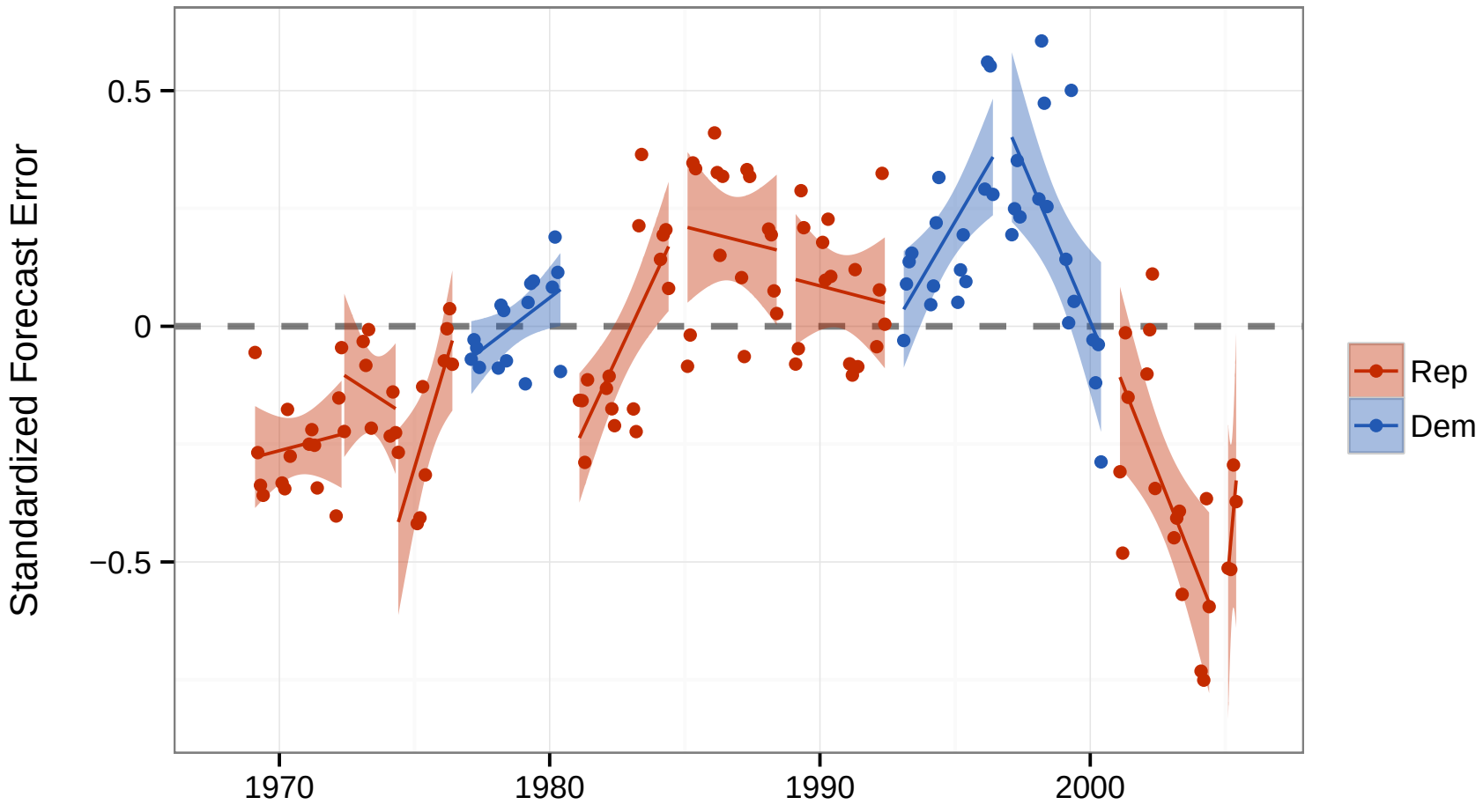
Ideally, the mean forecast error is 0.

Consistent errors $\rightarrow$ "wrong" policies.


Standardized Forecast Error
0.5
0
−0.5
1970
1980
1990
2000
Rep
Dem

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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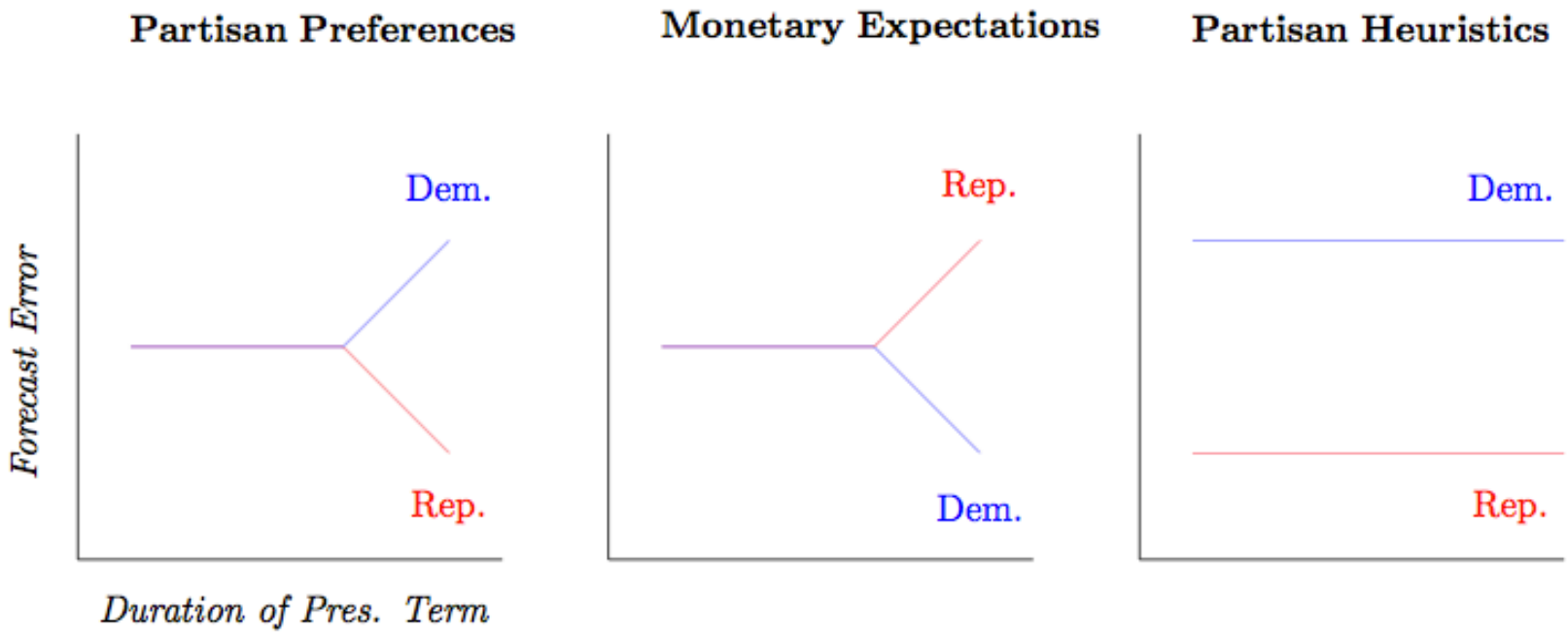
Partisan Preferences
Monetary Expectations
Partisan Heuristics
Dem.
Rep.
Rep.
Dem.
Dem.
Rep.
Forecast Error
Duration of Pres. Term

Empirical Analysis Overview

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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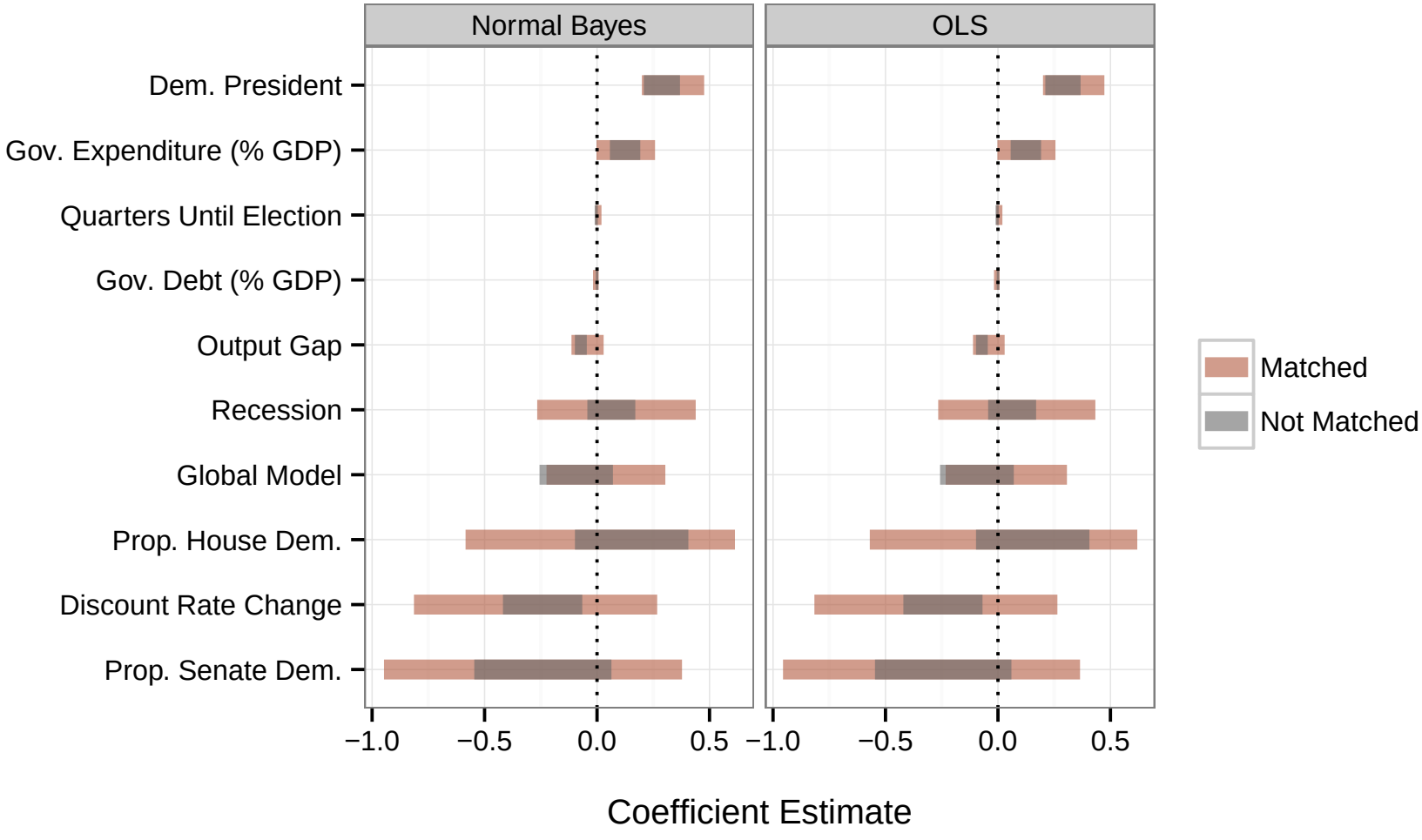
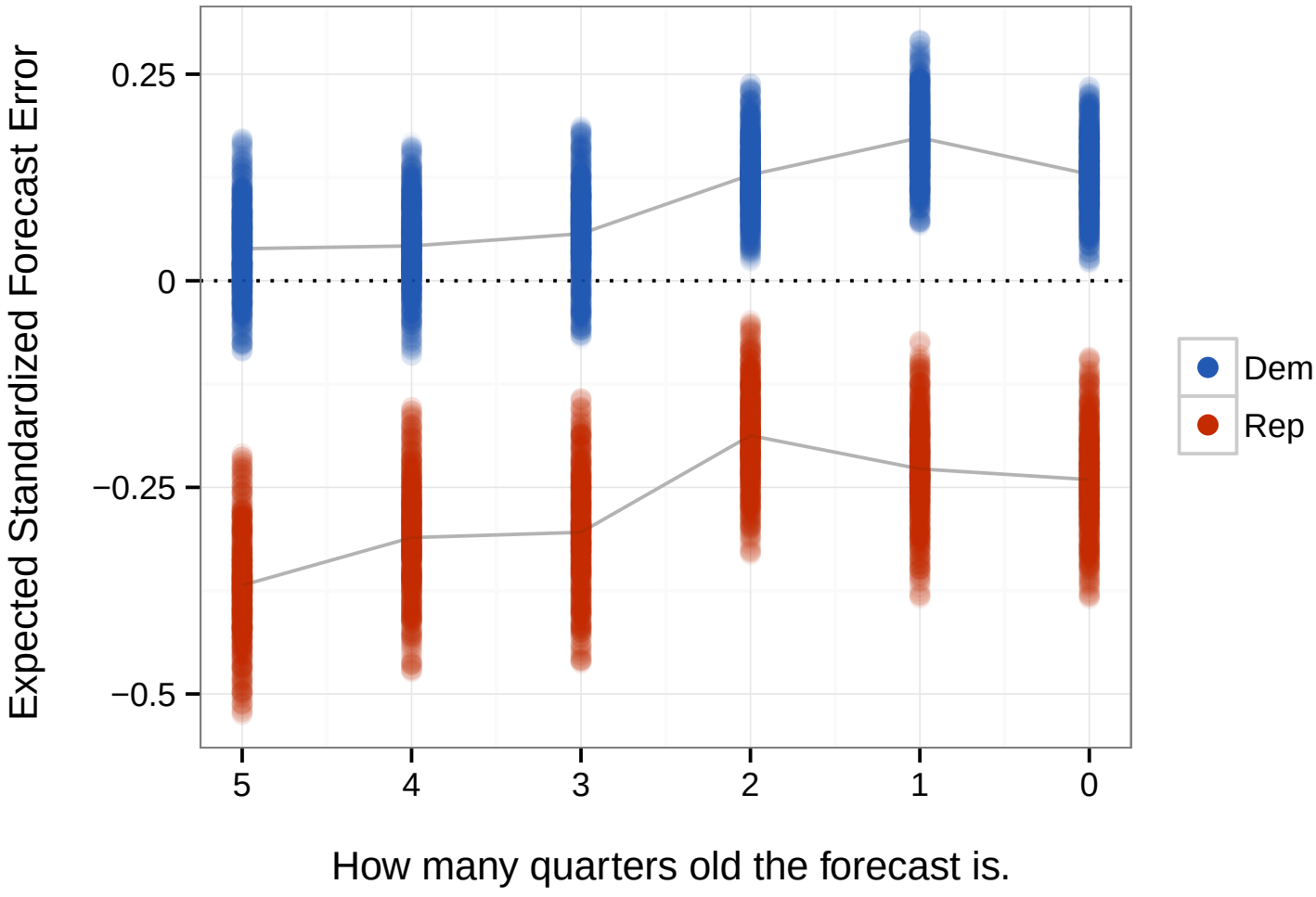
Results?

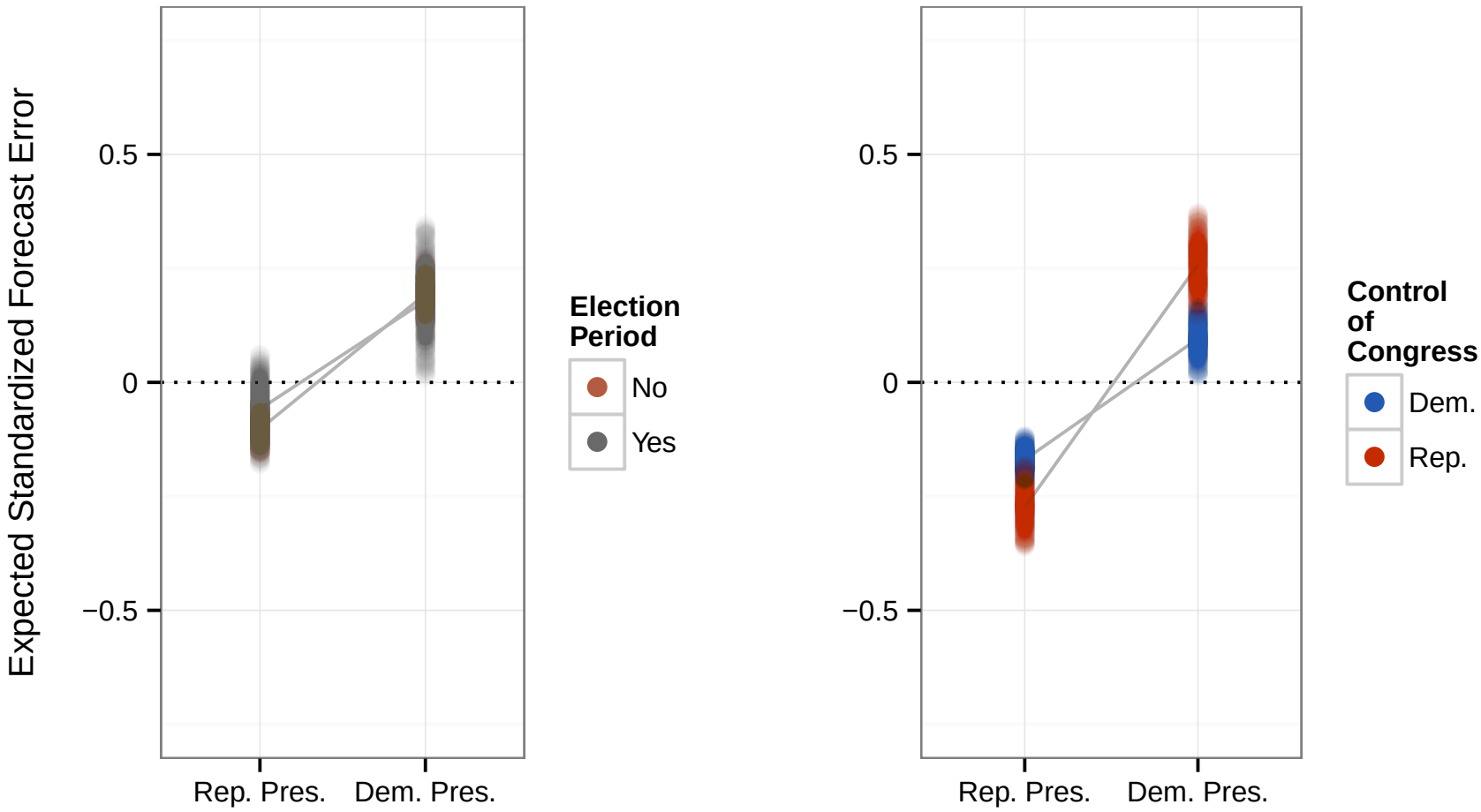
Main Results (2 Quarter Old Forecasts)



Simulated Errors (All Forecasts)



Interactions (2 Quarter Old Forecasts)



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 → interest rates **'too high'**.
  - This could hurt Democrats' re-election chances.
- Low forecasts during **Republican** presidencies → interest rates **'too low'**.
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- Of course, **more research is needed**.

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