



**연세대학교**  
YONSEI UNIVERSITY

# 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

The working paper is available on SSRN at:

[http://papers.ssrn.com/sol3/papers.cfm?  
abstract\\_id=2105301.](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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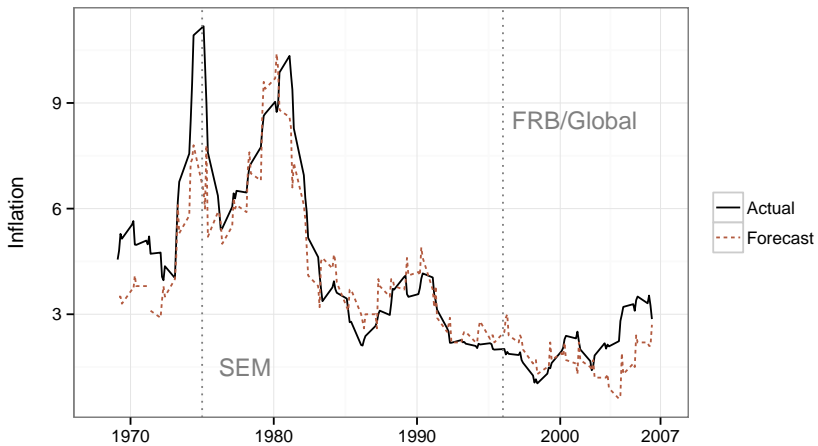
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How accurate are Fed inflation forecasts?





# Forecast Errors

Our **dependent variable**:

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

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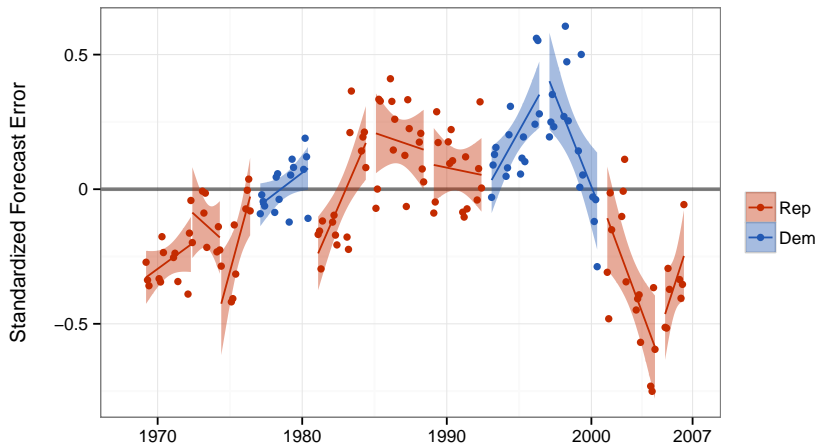
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Ideally, the mean forecast error is 0.

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).
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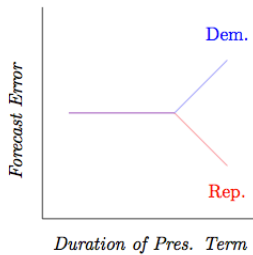
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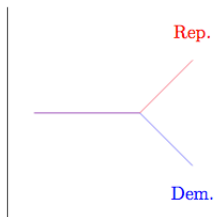
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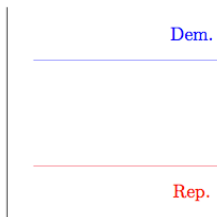
**Partisan Preferences**



**Monetary Expectations**



**Partisan Heuristics**



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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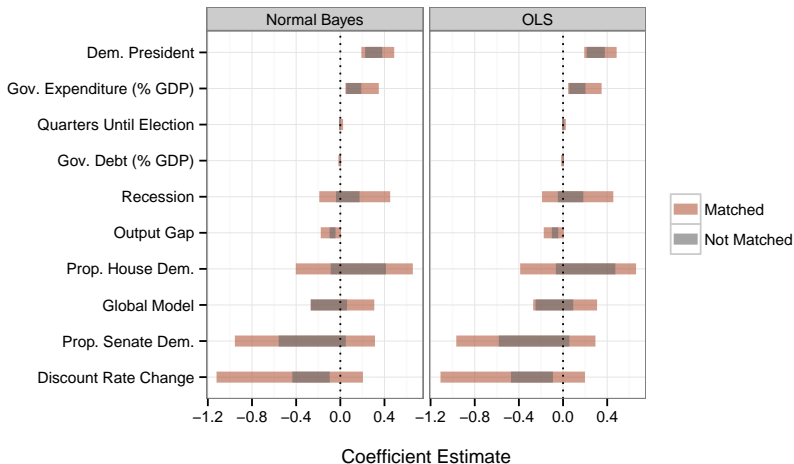
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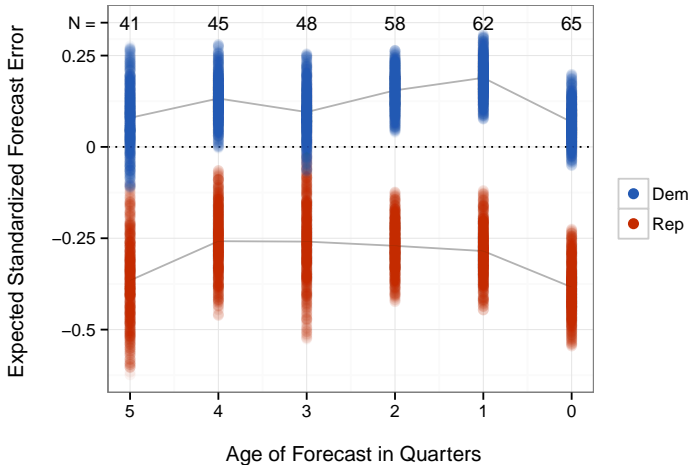


Results?

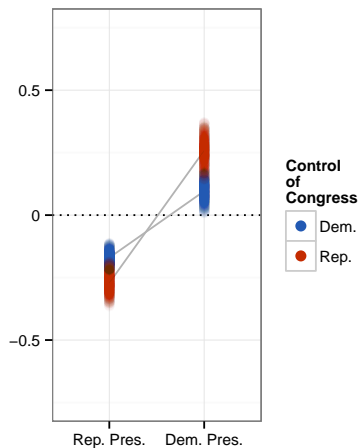
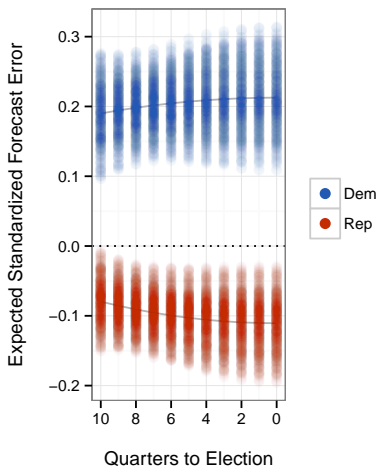
# Main Results (2 Quarter Old Forecasts)



# Simulated Errors (All Forecasts)

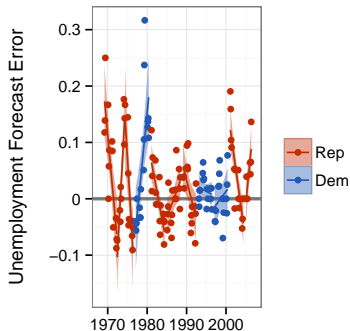


# Interactions (2 Quarter Old Forecasts)

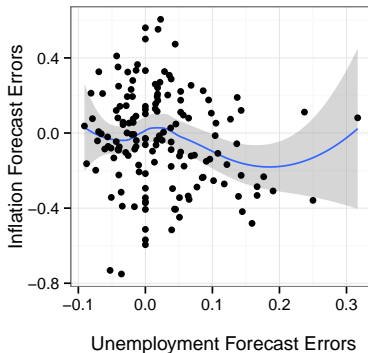


# Diagnostic Orthogonal Dependent Variable

Errors in Employment Forecasts  
Made 2 Qtr. Beforehand



Scatterplot of Unemployment and  
Inflation Forecast Errors



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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