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ECON 43345  
20 September 2024

## Paper Proposal

### **Research Question**

The purpose of this paper is to determine who is more accurate between consumers and professional forecasters in predicting inflation expectations. Since professional forecasters are, as the name describes, professionals, it can plausibly be expected that they have more accurate predictions than the average American, however this paper intends to determine if there is evidence for that, and to what extent the accuracy between forecasters and consumers differs. Additionally, the strength of predictions may differ under varying economic circumstances, such as in a recession or a period of economic boom, and this paper will examine if the conditions affect the precision of the predictions.

### **Motivation**

Since professional forecasters are supposed to have all the necessary tools to predict economic conditions, it would be reasonable to believe that they have accurate predictions of inflation. They have built out their economic toolbox and skillset much more than the average American, and it is their job to make decisions with these skills. However, consumers have their own special set of skills and sensitivities. While they may not have the economic literary or background of the forecasters, they could be more in tune to the everyday prices of goods, and have underlying intuitions about the future prices. This paper is designed to explore these underlying intuitions of consumers, determine their accuracy as compared to forecasters, and then compare the accuracies of both to the actual inflation rate. If it is determined that one of the two groups is a consistently better predictor of inflation, then that could provide insight to the Central Bank when making policy, or it could be used to better future predictions.

### **Data Source**

Data will be taken from both the Livingston Survey, provided by the Federal Reserve Bank of Philadelphia, and the Michigan Survey of Consumers. The Livingston Survey collects data from professional forecasters, which will serve as the predictions for the forecasters, and the Michigan Survey of Consumers (MSOC), which serves as the representation for consumers. In

order for chronologic accuracy, the June edition of each survey will be used and inflation expectations will be measured for one year in the future, which is the basis for the MSOC. From the Livingston Survey, expectations will be measured using the Consumer Price Index forecasts, for twelve months beyond the June survey date. From the MSOC, expectations will be measured using the consumers' "Expected Change in Prices During the Next Year." Both of these will be tied to the actual inflation rate one year in the future from the surveys – for example, the predicted inflation for June of 2023 taken in June of 2022 will be compared to the actual inflation in June of 2023 – and errors will be calculated and then examined.

### **Analysis Outline**

Using the data from the Livingston Survey and the MSOC, the error of predictions will be found. These will be examined over time, to understand if there are trends in the error of predictions and to see if one group is consistently better. After finding the error of predictions, and determining which group is a better predictor, certain variables will be controlled for to see if different economic or demographic conditions have an effect on prediction accuracy. Variables that could affect accuracy include the unemployment rate at the time of the survey, or even the rate of inflation. These can be included in a multivariable regression to determine the effect that different conditions change the accuracy of predictions. These regressions can be run for both the professional forecasters and consumers, to determine whether certain conditions estimate specific trends in errors at a significant level for either.