

Forecasting Interest Rates and the Macroeconomy: Blue Chip Clairvoyants, Econometrics or Qrinkage?

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Abstract

This is the first paper to extract and evaluate the forecasting performance of the individual participants in the Blue Chip Financial Forecasts from 1993 to 2006. By running a horse race between a subset of the individual survey forecasters and a set of purely econometric models, this study examines the ability of different forecasting models to predict interest rates and the macroeconomic variables that influence them. Forecast evaluation based only on the average loss function does not account for the potential uninformative nature of the data, thus an emphasis is placed on the construction of Model Confidence Sets, a random data-dependent set that contains the best forecasting model with a pre-specified level of probability. Empirical analysis reveals that fed funds futures prices provide the best forecast of the fed funds rate at very short horizons, Bear Stearns' model is competitive at short horizon forecasts of short maturity interest rates, while US Trust is dominant at forecasting short rates at longer horizons. Econometric methods dominate the forecasting of long maturity yields. By shrinking the parameter estimates toward a set of priors, the Qrinkage family of econometric forecasting models outperforms standard econometric models across differing maturities and forecast horizons. Shrinking the forecasts toward the random walk forecast improves forecasting over shorter horizons, whereas shrinking the forecasts toward the long-run mean improves performance over longer horizons. Individual survey forecasters, including the mean forecaster, do particularly well at forecasting inflation.

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