It’s about human behaviour

The economic future deals with tomorrow’s human behaviour – such as decisions, actions, plans, expectations, motivations and preferences. None of these are easy to quantify, and despite ongoing research and an abundance of literature on the business cycle, forecasting a boom or recession will always be a bit like an opinion poll.

Therefore, economists use assumptions which frustrate business people and investors who want certainty as foundation for their plans and strategies. Economists never agree, and when forced to make a prediction they are wrong more often than not. Apparently, former American president Ronald Reagan once said that there should be a Trivial Pursuit game for economists, with 100 questions and 3,000 answers.

But, says Prof Eon Smit, professor in Business Forecasting, Derivative Instruments and Decision Analysis at USB, one of the key lessons that he learnt from more than 20 years as adjudicator of the Afrikaanse Kaans Economie van die jaar (AfriKaans Economist of the Year) Competition is that most participating economists over time contribute to the reduction of uncertainty and hence to improved management of business and the economy in general.

"...the greater the uncertainty and turbulence, the greater the demand for certainty."

Prof Smit says the format of the Economist of the Year Competition is unique in so far as it tries to pool the collective wisdom and insights of the most prominent economic forecasters in the country into an overall consensus forecast of the key economic variables – 12 in all. Some variables relate to economic growth while others relate to exchange rates, the current account balance, metal and gold prices and a bouquet of interest rates. A first set of forecasts is usually produced in February and then revised monthly until year-end. The winner is the forecaster who could anticipate best over the longest time horizon.

There is no one-size-fits-all approach

"We do not know which forecasting tools participants use, but these can range from formal econometric models with numbers or equations which describe all the key variables and linkages in the economy to simple qualitative judgements made on the back of cigarette boxes." There is no evidence that one approach, forecaster, company or organisation consistently produces superior forecasts.

"Some individuals have won the coveted award more than once, but it is still impossible to predict the best forecaster in a particular year. Hence, the consensus forecast is a very attractive mechanism to learn from the combined expertise. The consensus forecast comes with a standard deviation which provides the end-user with a measure of the dispersion in the values between forecasters. Within a particular year these deviations typically contract as the final moment of truth approaches," says Prof Smit.

He finds no reason to believe that forecasters today are more accurate than two decades ago. "The world is still full of surprises, and forecasts are critically dependent on a whole set of assumptions which can go awry. The value of a forecaster cannot be judged by a single error or once-off success but only over time by the extent to which he or she contributed to reducing the uncertainty to save the decision-maker’s face."

Covering a range of outcomes

Prof André Roux, economist, USB professor in Management Economics and director of the Institute for Futures Research at Stellenbosch University, acknowledges that, strictly speaking, economists cannot predict the future. "What we could and should be trying to make is forecasts which cover a range of possible outcomes. But economists are expected to make predictions – statements about a specific outcome or event which has not yet been observed."

"For better or for worse, numbers and statistics are the barometers that tell us what the economy is doing, and what it intends doing. These indicators provide the backdrop that will ultimately affect corporate earnings, interest rates, inflation and the exchange rate. Governments, businesses and consumers need macroeconomic forecasts to devise appropriate strategies. And the greater the uncertainty and turbulence, the greater the demand for certainty and preciseness in forecasts. Nobody wants to hear about the great uncertainties and turbulence, which will determine how the economy will look a year from now. Instead, they want numbers, preferably with decimal points, and precise timelines!"

People often accuse economists of being the bearers of bad news. Politicians do not like being told that their schemes will not work, that they cannot have their cake and eat it too, that there is no free lunch. Is this understandable when we consider that a good forecasting model is based on the unanticipated strength of forecasts by households, businesses and governments to global imbalances."

In a similar vein, the failure of economists to predict the 2008/09 crash was a result of the unanticipated strength of responses by households, businesses and governments to global imbalances."

Understanding expectations

Prof Smit says the Economist of the Year competition forecasts published over the years have frequently been consulted by government institutions and business practitioners. The data has also served as foundation for a number of academic studies, some relating to forecasting accuracy, others to the more fundamental way of having been trying to understand how expectations about the future are formed and how they are adjusted as new information becomes available.

But after more than 20 years analysing forecasts, Prof Smit says that the world of economics and forecasting is a "puzzle", a "quandary", a "skein" or a "mess".

Prof Roux says companies (importers) can take forward cover against a weaker rand, but the rand could strengthen again when faith in the rand returns, and this is a "treatment" of investments returns. He warns against seeing the weaker rand as a means to enhance our international competitiveness (exports) because it may mean ignoring and failing to rectify fundamental problems.