Economic Forecasting and why we should remain optimistic

As we all know, before the 2016 EU referendum took place a series of projections on the likely impact of a Leave vote were made by the UK Treasury, the Bank of England, the OECD, the IMF and others. Almost without exception, they forecasted dire results. The Treasury predicted that in short order there would be a 500,000 increase in unemployment, whereas actually unemployment fell and the total number of people in work rose by 400,000. We were told that the UK economy might experience a 3.6% drop in output– as much as the fall in 2008. Actually, the UK economy grew by 1.9% in 2016 and by 1.7% in 2017.

It was not, however, just prestigious organisations which got their predictions so wrong. It was also the bulk of professional economists. No doubt there was some interaction here between their pre-conceived predominantly Remain views and their belief that the economy would falter if there was a Leave vote. Because they generally favoured Remain rather than Leave, most economists seem to have been predisposed towards believing – perhaps almost hoping – that the economic consequences of a Leave vote would be a disaster.

Why, however, even allowing for this, did such big mistakes get made? Economic forecasts are notoriously unreliable, but if you stick your neck out and make them, you need to try to get them right. The explanation for what went wrong, which in turn has a substantial bearing on what we can reasonably expect the outcome of Brexit to be, is that nearly all the gloomy forecasts almost certainly had a built-in bias towards being much too negative.

Why did this happen? It is because economists are used to using data from the past to predict what is going to happen in future. The problem with the Brexit vote was that it took everyone into unchartered territory. No-one had relevant past data on which to rely when forecasting what the economic impact of a Leave vote would be. All sorts of assumptions therefore had to be made which could not be supported by relevant past econometric data.

This is when a crucial bias then crept in. It was much easier for economists to identify what downside problems there might be than it was to foresee what new opportunities might be created. The result was a tendency for all projections to be too pessimistic. This was because the result of feeding in the costs of all the problems which it was relatively easy to anticipate, while leaving out the relatively unknowable benefits of new opportunities, was bound to tend to conclusions which were too gloomy.

It is, however, not just economists who seem to be suffering from this bias. It appears that many businesses may be caught up with the same syndrome, reinforced by the relatively negative projections coming from organisations such as the CBI. What is actually happening, however, is that new opportunities are materialising as quickly as new costs are incurred, which is why the economy is holding up so much better than the experts predicted it would.

What this tells us is that the UK economy will very probably continue to expand, albeit relatively slowly, whatever the result of the Brexit negotiations. There are side-effects to be expected from both a soft Brexit or a clean break but, absent a last-minute breakdown for which inadequate preparations have been made, a significant deviation from current trends seems unlikely. Businesses should then plan accordingly and those who voted Leave and who support Brexit as the negotiations proceed should be thankful that they have not been swayed by the bad advice provided by those who might have been expected to know better.

Forecasts always depend on the assumptions fed into the models used to provide them. If you only see problems ahead, but not opportunities, your guesses at the way the future unfold are not likely to be right – as indeed we saw, Rubbish in – rubbish out – and this is why those of us who take an optimistic view of Brexit are much more likely to turn out to be right than those who predict doom and gloom.

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