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What's going on? Uncertain data and uncertain outcomes – a speech by Martin Weale

In a speech given at Liverpool University, Martin Weale discussed the uncertain nature of early data estimates and the challenge that poses to the Monetary Policy Committee (MPC) in making policy judgements and explaining the risks around its forecasts.

Martin noted that, while the MPC needs to make decisions "as things happen", most data become available only with a lag, meaning he and his colleagues need to estimate the current state of the economy. However, Martin identified a number of problems with using business surveys- one of the more common sources for up to date information on the economy. These include relatively small sample sizes, inconsistencies in how firms respond to them and the fact that they do not cover the public sector. While it might be possible to improve their performance as aggregate indicators, for example by specifying more precisely how firms should answer questions on output movements, these factors limited their ability to serve as good indicators of GDP growth.

Martin also explored the pattern of revisions to estimates of GDP from the ONS preliminary estimate to a final estimate produced about three years after the event. He noted that, while there was a clear tendency for low estimates to be revised up and high estimates to be revised down, and a simple model of revisions had performed well after the crisis, substantial uncertainty remained.

Turning to the question of forecast uncertainty, Martin compared the error spreads for the two-year growth and inflation forecasts with the distributions published by the MPC in the May *Inflation Report*. He noted that "although some have been wide of the mark, many of our growth and inflation forecasts are better than we think they are going to be."

Finally Martin addressed some of the challenges posed by the UK's referendum on EU membership, and the possibility that the uncertainty associated with it may be affecting economic activity. He suggested that the impact of aggregate uncertainty on household spending was likely to be fairly small. "The reason for this is that, for most people, uncertainty about future spending power arises mainly for idiosyncratic reasons, such as changes in family circumstances, rather than changes in the aggregate state of the economy." Thus it seemed that the main impact would be on investment spending.

The May forecast had noted an increase in uncertainty since late last year and he suggested that the component of it associated with the referendum was weighing on sterling and materially depressing GDP growth in the second quarter. Were the MPC to have over-estimated the degree to which the referendum has weighed on sterling, this would raise the prospect of inflation rising noticeably above target in two years or so. If at the same time economic growth remained weak, the MPC could, in the near term, have to trade-off limiting an overshoot of inflation against supporting economic growth.

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