Chaos of 2008 causes havoc for predictions

The credit crunch and swings in commodity prices wrong-footed economists. **David Smith** finds out whose forecasts were best

So what a horrible year that was. A full-blown credit crunch, of the kind I have never witnessed before, alongside a nasty commodity-price shock. One was the worst since the 1930s, the other the biggest since the 1970s.

The commodity shock is over but the credit crunch is still very much with us. Economists, unsurprisingly, found it a tough year to predict. That was partly because of the nature of the crunch itself.

At the start of this year we had seen two phases of the crisis, the initial August-September 2007 turbulence in the markets that did for Northern Rock and a secondary shock in December, as banks scrambled for liquidity.

But it was reasonable to think that markets would gradually thaw during 2008. That was the view of central banks and finance ministers when they gathered for the IMF's autumn 2007 annual meetings.

Instead, things turned out gloomier than even the pessimists expected. A third phase of dislocation in the money markets came in March, claiming the scalp of Bear Stearns, and worse was to come six months later with the failure of Lehman Brothers. It was in March that the real squeeze on lending started to hit Britain's economy.

It did not necessarily have to be like this. There were a number of ways the crisis could have played out. The route it ended up taking was close to the worst.

Forecasters always find it difficult to predict turning points in economic activity but there were other reasons why 2008 was an unusually hard year to pin down. Imagine, a year ago, somebody had told you the oil price would have collapsed from $100 to $40 a barrel, the economy would be in recession, Bank rate would be just 2% and then invited you to guess at Britain's inflation rate in those circumstances. I would have said 1%, not the 4% (though falling) we have at present.

So any economist getting it right during 2008 would have required mystical powers of prediction. Small wonder, as I look at my annual forecasting league table, most got it wrong.

A word about the rules of engagement. Economic data get revised all the time and just before Christmas we had new figures for gross domestic product and the balance of payments; the latter suggesting that the current-account deficit is coming down sharply.

But there has to be a cut-off point and mine, as in previous years, is the December forecasting consensus for growth (0.8% for the calendar year) and the current account (a deficit of just below £40 billion). I have used the actual end-year Bank rate, and November's inflation and unemployment figures. One or two forecasters have been slightly harmed by the use of this cut-off but nobody has been seriously wronged.

Banks have had a torrid time and have justifiably seen their reputations slide. So it is odd, then, that after a year most forecasters would prefer to forget, banks top my annual forecasting league table. Standard Chartered, whose chief economist is Gerard Lyons, was gloomier than most a year ago, predicting just 1.2% growth at a time when forecasters were clustered around 2%.

His forecast was too low on inflation — most people expected an end-year figure of 2% — but right to pick up on the downward risks to growth. Standard Chartered is downbeat on growth for 2009 — it expects the economy to contract by 2.3% before edging up by 0.6% in 2010. The fact that policy has responded quickly and commodity prices have plunged leads it to suggest a recession on the scale of the early 1990s but not as bad as the deep downturn of the early 1980s. Even so, Sarah Hewin, Standard's UK economist, thinks the Labour Force Survey measure of unemployment will eventually hit 3.5m.

Alongside Standard Chartered, but just slightly further away from what looks like the 2008 outturn, was HSBC. Both these banks got a creditable 5 out of 10. My forecasts scored only two points.

Next in the table, intriguingly, is Lehman Brothers, whose demise caused so much trouble. Its economists had a credible story to tell about a "downward spiral" of activity hitting Britain's economy from early in the year. The economic view was a lot more credible than some of the other things Lehman was up to.

After a year like that, how should we judge what economists are saying about 2009? Once the economy has turned into recession, forecasters are on firmer ground. They know what history tells us about the length of past "big" post-war recessions — an average length of about five quarters, though with a tendency to slip back temporarily during a weak recovery phase.

The big unknown remains the continuing impact of the credit crunch and the effect on an economy of a sudden shrinking of banking capacity.

Many economists think forecasting should not be part of their game. Others warn that precise-number forecasts will invariably be wrong and that all economists can do is lay out broad trends.

Even that, as the Bank of England has discovered with its famous fan charts, is easier said than done when things change so dramatically. And it would be a dull world if economists — and economic journalists — did not put their heads on the block and offer views on the outlook. I know some of my readers would lose their purpose in life if I deprived them of the opportunity to point out when I had been wrong.

A year ago, just about the gloomiest forecast for house prices you could find among economists was for a fall of 5% in 2008. Data from the main lenders, Halifax and Nationwide, point to a fall about three times that, though the FT-Acadametrics index is down by a more modest 8%.

In some ways it was easy to predict a house-price fall a year ago, because it had begun the previous autumn. But there had been false dusks for housing before. The savagery of the crunch-induced mortgage famine, however, meant this one was real.

Housing also eventually obeyed the normal rules. I had always argued that you needed a shock big enough to push the economy into recession to produce a big fall in house prices, and so it was. In the late 1980s it was a 15% Bank rate. This time it was the crunch. In some respects at least, the normal rules apply.

PS: **Anyway, that is how the professionals fared. Now it is your turn to take part in my seasonal competition. So over the next two weeks please submit your predictions for the five variables I use to measure forecasting performance — calendar-year growth (2009's average GDP compared with 2008); the current-account deficit/surplus; and end-year consumer price inflation, Bank rate and claimant unemployment.**

If you want to add in the stock market, house prices or anything else, feel free to do so, though they will not count towards the scoring.

The trouble with this is that it means a very slow-burn competition, which will not see its denouement for 12 months. So there is also a chance for some short-term gratification for the two people who offer the most interesting and entertaining vision of 2009. I can't promise a DVD of my favourite piece of Christmas kitsch — the Panorama biopic of Robert Peston — but there'll be something.

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THE YEAR'S BEST FORECASTERS

		GDP growth %	Inflation Q4 %	Current account £bn	Jobless Q4 m	Bank rate %	Score out of 10
	Outturn	0.8	4.1	-39	1.07	2	10
1	Standard Chartered	1.2	1.0	-50		4.25	5
2	HSBC	1.5	2.0	-50	1.02	4.5	5
3	Lehman Brothers	1.7	2.7	-50	0.87	5.0	4
4	Economic Perspectives	-0.1	2.3	-33	1.05	4.5	4
5	Daiwa Institute	1.8	2.0	-39.7	0.95	5.0	4
6	ING Financial Markets	1.6	1.8	-49	0.92	4.75	4
7	MacroEcon.Com	3.0	3.2	-41.7	0.81	6.25	4
8	Lombard Street	1.4	2.2	-52.3	0.93	4.25	3
9	Ingenious Securities	1.8	2.5	-70.7	0.91	5.25	3
10	BNP Paribas	1.6	2.2	-65	0.88	4.5	3
11	ABN Amro	1.9	2.2	-55.7	*1.89	5.0	3
12	Deutsche Bank	1.8	2.1	-43.7	0.9	5.0	3
13	Hermes	2.0	2.2	-42	0.9	4.75	3
14	Barclays Capital	2.0	2.1	-45.7	0.81	5.0	3
15	Dresdner Kleinwort	1.9	2.0	-39		5.0	3
16	Beacon Econ Forecasting	2.1	2.8	-74.1	0.8	5.2	2
17	Experian	1.7	2.3	-80.1	0.87	5.0	2
18	Goldman Sachs	1.7	2.3	-50.5	*1.64		2
19	CBI	2.0	2.4	-40.2	0.81	5.25	2
20	Citigroup	1.8	2.2	-64.3	0.8	4.25	2
21	CSFB	2.0	2.4	-60		4.75	2
22	UBS	1.8	2.2	-51	0.86	4.5	2
23	Global Insight	1.8	2.1	-52	0.91	4.5	2
24	Morgan Stanley	1.8	2.1			5.25	2
25	Commerzbank	1.8	2.1	-55.1	0.84	4.75	2
26	Ernst & Young Item Club	1.8	2.0	-65	0.89	4.5	2
27	Liverpool Macroeconomics	2.1	**2.3	-50.9	1.23	5.4	2
28	OECD	2.0	2.2				2
29	Bank of America	1.8	1.9	-73.9		4.5	2
30	Capital Economics	2.0	2.1	-75	0.87	4.5	2
31	CEBR	1.7	1.7	-62.4	0.96	4.5	2
32	European Commission	2.2	2.0	-49.9	*1.74		2
33	Moody's Economy	1.7	1.5	-27.7	0.97	5.25	2
34	Oxford Economics	1.9	1.9	-52.1	0.92	5.0	1
35	Cambridge Econometrics	2.1	1.9	-36.9	0.9	5.4	1
36	NIESR	2.2	2.0	-47.7	0.9	5.4	1
37	Treasury	2.25	2.0	-45			1
38	EIU	2.3	2.0	-45.1	0.89	5.0	1
39	RBS Financial Markets	2.1	2.1	-58.9	0.89	5.0	0
40	Fortis Bank	2.1	1.9	-58	0.89	5.0	0
41	Daiwa Securities	2.3	2.0			5.5	0
42	IMF	2.3	2.0	-52.5			0

SCORING SYSTEM **GDP growth:** 3 points for 0.4%-1.2%; 2 points for 0%-1.6%; 1 point for -0.4%-2%. **Inflation:** 3 points for 3.5% or above; 2 points for 3% or above; 1 point for 2.5% or above. **Current account:** 1 point for a deficit between £30 billion and £50 billion. **Unemployment:** 1 point for 0.95m or above. **Bank rate:** 1 point for 3% or below. Bonus point for inflation exceeding growth.
Where scores are equal, forecasters are ranked by their proximity to the growth and inflation outturns.
Key: * Labour Force Survey unemployment; ** RPIX inflation