Tomorrow's Affairs
Analysis of today
Assessment of tomorrow

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Why Do Forecasts Fail?

At the end of each year, financial institutions release their expectations for the next year. Personally, I tend to embrace the principle of "be patient and wait for things to become clearer" because I think it is not wise to generate ideas about the whole year before the first month of the year ends.

In my previous articles, I told you about the global risks and said that some of them have been around since the beginning of 2023 and do not seem like they will not go away soon. In this article, I will discuss the impacts of expectations on the global economy.

Last year's predictions for the US, Chinese and European economies, were quite inaccurate. There was constant talk of a recession in the US and the EU, and every report about China was the indication of an economic disaster, which led everyone to take their positions accordingly.

There is a conventional wisdom in economics that says when ex-ante expectations and ex-post outcomes differ from one another, volatility tends to increase.

In other words, when our positive or negative expectations do not match the realisations, pricing behaviour fails to remain stable and it becomes impossible to maintain balance in economic activities.

Sometimes leading organisations and market makers go through ebbs and flows just like the vehicles in traffic that decelerate and accelerate when the vehicle in front decelerates and accelerates, which is called the “accordion effect”.

But whether organisations speed up or slow down from time to time, they continue to perform.

Do not believe every report by international financial institutions

Supply chain bottlenecks, market slowdowns due to disruptions in consumer financing or logistics, and other conjunctural developments are among the main factors that lead to fluctuations in agricultural and non-agricultural commodity prices, causing critical decision makers to act rather cautiously.

This is also the reason behind excess hiring and layoffs, and unstable growth and profitability.

What I mean is you should not read too much into normal developments. Just be careful and do not believe every report by international financial institutions. Besides, they always get their projections on developing countries, sometimes developed ones, wrong.

Analysts with good mathematical skills often tend to base their approaches on algorithms they have memorised from memory and their computers, which have not changed much over the past two decades.

When calculating the real economic growth rate, we adjust nominal GDP for inflation, but we are not sure whether the inflation figure is accurate or not

For instance, their acceptance of the cliché notion that a nuclear family should consist of four people, their approach to population growth, immigration rates, basket of goods and services, marriage-divorce rates, unemployment rates, and even to sources of income are based on last-century thinking.

Gamers, Youtubers, artists, athletes, singers, and people who make money on platforms such as Spotify are not taken into account at all.

More interestingly, when calculating the real economic growth rate, we adjust nominal GDP for inflation, but we are not sure whether the inflation figure is accurate or not.

The truth is that real GDP rates are not accurate because inflation rates are not calculated correctly and they often can be deceptive (since they are manipulated by agencies responsible for their publication).

Obviously, economists ask, "If there is GDP growth, why is there unemployment?" This question alone proves that so many parameters are miscalculated.

Last-century thinking

With their last-century thinking, everyone defines growth as "producing more economic goods and services".

However, there are many countries in the world that are ridden with poverty despite their high GDP growth rates and the fact that they are producing billions of units of products.

Their poverty is simply reduced to the deduction that "they cannot develop". By the way, the production part of the GDP is calculated on a "lump sum" basis. No one goes to factories and other commercial establishments and inspects their produced units one by one.

Therefore, as economists, all we could do is to hope that the published figures are correct and true since we use them in our research and studies! What a tricky job we have indeed!

> Countries should stop wasting their time bragging about their real growth rates

Actually, it is all about kg/value calculation. Businesses that produce fewer yet more valuable goods have a low growth rate but do not suffer from financial distress. Just look at the agricultural production and exports of a small country like the Netherlands.

Countries should stop wasting their time bragging about their real growth rates, and start doing things that matter such as "producing high added value products and services".

And to do that, they will need to focus on improving design, branding, digital transformation, finance, logistics and marketing while providing a strong training for their human resources.

Often, economists do not tend to take these matters seriously since they happen to be in the area of business management. Economists will bring their own end unless they start taking an interest in these issues and stop being "macro blind".

The driving effect of new activities

At Topkapı University, we employ economists with different fields of specialisation, from labour economics to foreign trade, and together we analyse the contribution of each activity, especially new ones, to the economy.

If we ignore the driving effect of new activities, we might risk forming faulty approaches to parameters such as the country's current account and budget balance.

For example, a current account deficit to GDP ratio exceeding 5% was considered a leading indicator of the economic crisis in the early 2000s.

However, since crises did occur in countries running current account surpluses, such as Argentina, it was understood that there has to be more than one cause triggering crises.

It also turned out that, when managed correctly, even "twin deficits", which means having both a fiscal deficit and a current account deficit, could not lead to a serious crisis, as long as governments remain aware that running a current account deficit and a budget deficit are harmful to a country’s economy therefore they should not exceed the tolerance limit.

> Monetary policies are no longer independent and national in any country except the US and the EU

Another fact is that monetary policies are no longer independent and national in any country except the US and the EU, whereas central banks are supposed to be autonomous entities.

There are no more boundaries in finance hence every step taken to restrict money movements disrupts the free market economy, fluctuates interest and exchange rates, and distorts pricing behaviour.

Central Banks, already keen on intervention, see that their efforts do not produce the intended result and they get keener and keener on intervening in the markets, but the outcome is always disappointment and wasted time.

But their incompetence should never lead a government to resort to harmful solutions such as exchange controls.

The Nobel Prizes for Economics is a propaganda tool

Honestly, international financial institutions cannot know all the details of a country's economy, and therefore, it is not possible for them to make a spot-on forecast on the global economy. So expectations are revised constantly, causing an ongoing turmoil in the markets.

As the gap between expectations and reality broadens, attaining feasibility becomes more difficult. Therefore, those who are in charge of the economy tend to focus more on sector-specific market dynamics and price developments in those markets, rather than the macroeconomic factors in the country.

Calculate your own inflation instead of trusting the official data - Emre Alkin

That’s why I say at every conference, "Calculate your own inflation instead of trusting the official data." Because none of the figures published by the government is correct or true, neither the GDP growth nor the CPI.

If unemployment was that high, wouldn't we be seeing different developments now? Does anyone actually and accurately calculate the number of unregistered and illegal workers? Is there a government agency that investigates the effects of cryptocurrencies on the economy? Can anyone explain the reason for the high net errors and omissions in the balance of payments?

Reaching conclusions based on the macroeconomic data alone is flawed, confusing, and outdated, and definitely not scientific.

But, it will not be possible to make radical changes before the scientific community is ready for it, since new ideas would replace old ones, accepted for generations.

Therefore, in my opinion, the Nobel Prizes for Economics is a propaganda tool that serves established policies. To some winners, they say "take ithis and shut up"; to others they say "keep going on just like this".