The Upshot
EVERYDAY ECONOMICS

Deceptive Dip in G.D.P. Points to Perils of Election Forecasting

MAY 29, 2014

Justin Wolfers

An economic report issued this morning provides a good example of the hazards facing election forecasters. The Bureau of Economic Analysis reported that in the first quarter of this year, Gross Domestic Product, a broad indicator of the health of the economy, shrank at an annual rate of 1 percent. Even worse, an alternative and more accurate measure, called Gross Domestic Income, shrank at an annual rate of 2.3 percent. If that persisted, we'd call it a sharp recession.

But no one is using the R-word. Nor should they. Markets have taken the news in their stride, and few economists have changed their view that the economy is growing and will continue to through 2014. Likewise, consumers remain confident about their economic prospects. Their confidence rests partly on other indicators that suggested far better growth throughout the quarter, such as nonfarm payrolls, which grew by 569,000 over the same period.

And the economy motored along after that bad quarter ended, with employment growing strongly and unemployment falling in April, and new claims for unemployment insurance falling through May. Importantly, we know that the weakness in G.D.P. is partly due to one-off factors — it snowed heavily, keeping many of us indoors, rather than out making and buying stuff — and it partly reflects influences, like the inventory cycle, that don't have an enduring effect.

In any case, G.D.P. data are known to be noisy, and subject to a lot of later revision — so much so that the difference between the first and the final reading of G.D.P. growth is typically 1.3 percentage points. For all we know, the recent measured decline in output may be revised away.

But many election forecasters rely on quite mechanical models, linking their forecasts to a single economic indicator. The worst of these models assert that a single quarter's G.D.P. growth is sufficient; others average G.D.P. growth over several quarters, but they still put a lot of weight on very recent data. Because these computer models read the data so literally, they overreact to statistical noise. If the election were to be held next month, they would have no choice but to interpret this morning's data as evidence of a recession, leading them to forecast a huge swing against the president's party.

To such a computer model, the economy today looks as bad as it did in the days after Lehman collapsed. (In October 2008, government statisticians reported that G.D.P. had declined at a rate of 0.3 percent in the third quarter, a number since revised to a decline of 2 percent.) Such a judgment would be crazy.

The trick, to paraphrase our former colleague Nate Silver, is to distinguish the signal from the noise. It's always better to rely on a broader dashboard of economic indicators than to take any single number too literally. Today's data don't much change my view of the underlying signal: The economy remains damaged, but it is also healing. For each breathless headline between now and

Election Day, realize that no single economic statistic will much change the broader context within which the upcoming midterm elections will be fought. The economy changes slowly, even if our economic numbers jump around a lot.

Justin Wolfers is a senior fellow at the Brookings Institution and professor of economics and public policy at the University of Michigan. Follow him on Twitter at @justinwolfers.

The Upshot provides news, analysis and graphics about politics, policy and everyday life. Follow us on Facebook and Twitter.