

#35 Topic: The role of market beliefs in macroeconomic fluctuations

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Expectations play a central role in economics. Traditionally, they have been modelled as rational and homogeneous. However, this way of modelling expectations has come under increasing criticism. This is one of the reasons why economists have been making better use of data from surveys that ask professional forecasters for their economic predictions. This survey expectations data comprises forecasts for various economic variables over different horizons, and conditional on changing fundamentals. In this Science Jam, I will discuss a research idea to extract from such data a few time-varying belief indices, which summarize deviations of expectations from the forecasts implied by economic fundamentals. Together, these indices define the state of market beliefs. First, I propose to construct a large dataset that reflects all relevant features of the economy at the time that the professional forecasters form their expectations. Second, I intend to use this dataset to generate benchmark forecasts, adopting econometric techniques designed for large datasets. Third, I plan to use principal component analysis to extract the belief indices from the differences between the reported and benchmark forecasts. Finally, I aim to investigate the role of market beliefs in macroeconomic fluctuations, and to find ways to model/forecast the dynamics of its distribution.