

Pros and Cons of Alternatives Regarding Economic Forecasts for PJM's 2010 Load Forecast Report

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Summary of issue: PJM's long-term load forecasts, used for RTEP, RPM and other planning purposes, are documented each year in the PJM Load Forecast Report, finalized in January. Forecasts of future economic growth are very influential input assumptions to the peak load forecasting, and PJM uses Moody's Economy.com to generate forecasts of Gross Metropolitan Product (GMP) for various regions within the RTO footprint. In the past, the GMP values have always been based on Moody's "Baseline" macroeconomic (US GDP) scenario. This year, as a result of the economic recession, there is a wider range of views on future economic growth, and Moody's baseline scenario is one of the most optimistic with regard to the economic recovery. There is a proposal to request Moody's to base the GMP values this year on the "Blue Chip Consensus" view of economic growth rather than Moody's baseline.

Summary of logistics: Moody's states that it can prepare the GMP values based on the Blue Chip Consensus for \$15,000 and it would take about a week or less. The Blue Chip Consensus long-term forecast is published in October. The corresponding GMP values could be ready by the first week of November if not earlier.

The rationale for the Blue Chip Consensus alternative, and some logistical details, were explained in James Wilson's presentation at the August 12, 2009 Planning Committee meeting ("Wilson presentation"):

<http://www.pjm.com/committees-and-groups/committees/~media/committees-groups/committees/pc/20090812/20090812-item-05-lecg-load-forecast-proposal.ashx>

For those interested, a very accessible article describing why most economists do not expect a strong economic recovery (in contrast to Moody's view) ran on the front page of the Washington Post on Monday, August 17:

<http://www.washingtonpost.com/wp-dyn/content/article/2009/08/16/AR2009081602249.html>

At the August 12 Planning Committee meeting, the chair delegated to the Load Analysis Subcommittee the task of drafting Pros and Cons of the Blue Chip Consensus proposal relative to the status quo approach. The following table is my draft, which identifies the main considerations and assigns points based on the subjective importance of each consideration. The table suggests 10 points in favor of the Blue Chip Consensus proposal compared to 3 points against, for a net positive 7 points.

**Pros and Cons of the Proposal to use the Blue Chip Consensus
relative to the past approach, using Moody’s “Baseline” US GDP forecast**

Consideration	Pros and Cons of the Blue Chip Consensus Proposal relative to using Moody’s Baseline	Discussion of importance and rating (+3 =strong “Pro” for Blue Chip Proposal/strong “Con” for Moody’s Baseline, -3 = Strong “Con” for Blue Chip/strong “Pro” for Moody’s Baseline)	
		Discussion of importance	Rating (+3 ... - 3)
Consistency of the specific economic forecast with the views of a majority of professional forecasters; likely accuracy	By construction, the Blue Chip Consensus reflects the views of a majority of forecasters, while at present, Moody’s forecast of US GDP growth exceeds even the “Top Ten Average” of the Blue Chip forecasters for 2011, 2012, and 2013	Very important, as it gets to the key question of the likely accuracy of the economic forecast to be used in the peak load forecasting effort	+3
Anticipated accuracy of the economic forecast and resulting peak load forecast	Studies show that as a general matter, pooled forecasts such as the Blue Chip Consensus tend to be more accurate than those of individual forecasters (see Wilson presentation for citations)	Important, as it suggests that, as a general matter, use of a pooled forecast such as the Blue Chip will be superior to reliance on any individual forecaster’s scenario	+2
Risk of statistical bias (tendency toward optimism or pessimism) in the economic forecast	Studies show that pooled forecasts tend to be unbiased, or if there is any bias, it is weak and toward optimism; studies also show that individual forecasters’ forecasts may show statistical bias toward optimism or pessimism	Low; while the Moody’s forecasts have been optimistic since late 2007, Moody’s baseline was close to the Blue Chip Consensus in September 2007, so there would not appear to be much evidence of bias as a long-term characteristic	+1
Defensibility of the economic forecast and resulting peak load forecast	The Blue Chip Consensus is a highly regarded and oft-cited indicator of expected economic growth, and by pooling over 40 forecasts, will never be extreme; while Moody’s forecast at present is one of the most optimistic for the key time period (2012 and beyond)	Very important, as the RTEP, RPM, and many generation and transmission expansion plans rely on PJM’s peak load forecast	+3

Consideration	Pros and Cons of the Blue Chip Consensus Proposal relative to using Moody's Baseline	Discussion of importance and rating (+3 =strong "Pro" for Blue Chip Proposal/strong "Con" for Moody's Baseline, -3 = Strong "Con" for Blue Chip/strong "Pro" for Moody's Baseline)	
		Discussion of importance	Rating (+3 ... - 3)
Consistency with preparation of PJM's "median" or "50/50" peak load forecasts (underlying assumptions, such as the economic forecast, should in principle also be median or 50/50)	The Blue Chip Consensus is the mean, not median, of the 40+ point forecasts collected in each survey; however, review of past surveys shows that the mean is equal to or within 0.1 percentage points of the median of the forecasts; by contrast, Moody's baseline is explicitly a "most likely", not a median, forecast, and Moody's states that the risks are skewed to the downside, so a Moody's median forecast would be lower (see Wilson presentation for citations)	Medium importance; use of Moody's baseline would call into question whether the peak load values could legitimately be called median forecasts	+1
Effort to implement: technical issues	Implementation is by Moody's; the Blue Chip proposal does not require anything from PJM other than providing any guidance on preparing the alternate macroeconomic scenario	Low importance; determine any guidance to provide Moody's analysts regarding creation of the alternate macroeconomic scenario based on Blue Chip consensus	-1
Effort to implement: decision process with stakeholders	PJM would likely pursue a brief stakeholder process before deciding to implement the Blue Chip proposal, and to determine any guidance to provide on preparation of the Blue Chip scenario	Low importance relative to considerations such as likely accuracy, etc.	-1
Consistency with past forecasting	Past forecasts have implicitly relied on Moody's "baseline" US GDP scenario	Very low importance relative to considerations such as likely accuracy, defensibility	-1
Total Rating (> 0 shows overall advantage to Blue Chip proposal, < 0 would show advantage to Moody's Baseline)			+7 (+10 -3)