



PJM Interconnection

**Proposed: Replace Economy.com Baseline Forecast With Blue Chip Consensus U.S. GDP Forecast**

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<p>Blue Chip Consensus reflects the views of a majority of forecasters. <b>If one compares the list of forecasters participating in the Blue Chip Survey, the NABE survey and the Wall Street Journal survey of forecasters, there is very little overlap. Blue Chip does not include the views of a majority of forecasters. This statement is false.</b> As was noted in discussion, many of these forecasters do not use formalized models, they simply submit their newsletter write ups. As was noted by Mr. Cochran, many of these forecasts contain internal inconsistencies.</p>	<p>All referenced studies examining accuracy of consensus vs. individual forecasts consider only current year and next year forecasts. Studies do not measure relative accuracy of long-term forecasts (years 2-15).</p>
<p>MEDC's forecast of US GDP growth exceeds the "Top Ten Average" of the Blue Chip forecasters for 2011, 2012, and 2013 <b>It is very possible that Moodys will be correct. Even so, being right in one instance does not speak to the quality of the forecast. What should be of interest is how well Moodys has done over the past several decades, and how well the PJM Load Report has done over the past several decades. We submit that if such a study was done, the results would be surprisingly good (unbiased and efficient). We also believe such a study is a prerequisite to considering this proposal.</b></p>	<p>No PJM company or ISO/RTO has adopted a consensus forecast approach.</p>
<p>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 <b>2012 is 3 years in the future. The time horizon on the forecast is more than a decade. The literature on forecast accuracy with time horizons this long is almost non-existent. The proper approach is for PJM LAS to actually conduct such a study as a prerequisite to considering this proposal.</b></p>	<p>Blue Chip forecasts are not consistent with developing the 15year monthly load forecast needed by PJM planning (Blue Chip provides quarterly values for years 1 and 2, annual for years 3-5; 5-year average for years 6-15) <b>Blue Chip also says nothing at all about productivity growth. Because the sectoral growth rates in Blue Chip are averages, they imply that productivity behaves in strange ways. More important, Blue Chip says nothing about whether particular regions will grow faster or slower than the national average. This assignment will leave MEDC making assumptions for about 40 variables where the Blue Chip does not give guidance. Important examples include the price of oil and natural gas.</b></p>
<p>Studies show that pooled forecasts tend to be unbiased; studies also show that individual forecasters' forecasts may show statistical bias toward optimism or pessimism <b>Studies co-authored by Dr. Bock (BGE) and Dr. Farney (PHI) and published in Electric Light and Power show that utility forecasts and NERC regional forecasts are generally unbiased. Bias is not the critical forecasting problem. Forecast efficiency or precision is the forecasting challenge, and the subject is not being discussed.</b></p>	<p>Averaging growth rates (as Blue Chip does) will mask the detail of individual year-to-year growth, which is especially important at turning points.</p>
<p>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. <b>Being in the middle of the pack is not necessarily an advantage if the pack is wrong. This has been a real estate driven recession. Because of MEDC's great expertise in real estate economics, their work during this recession has been very insightful, contributing to lower forecast variances.</b></p>	<p>The proposal would ask MEDC to do something they have not done before (fix the dependent variable then determine independent variables). <b>In solving this problem, MEDC has no choice but to recycle the assumptions and biases that are embedded in their own forecast. The result will not be a Consensus forecast.</b></p>
<p>A median U.S. GDP growth forecast can be derived from the Blue Chip Consensus. MEDC's baseline is explicitly a "most likely", not a median, forecast. <b>MEDC's informed opinions have been very helpful during this recession. We believe that their insights have contributed to smaller forecast variances.</b></p>	<p>Proposal would result in an economic forecast that is not a consistent scenario; the underlying factors of GDP growth can not be explained to stakeholders, commissions, etc.</p>
<p>The Blue Chip consensus, as an average of many forecasts, will be a more stable forecast over time. <b>This is an empirical question that has not been investigated. LAS needs to do a study rather than rely on unproven assertions.</b></p>	<p>Having MEDC produce a customized forecast to replicate Blue Chip GDP forecast may potentially introduce inconsistencies among GDP drivers.</p>

<p>MEDC has been one of the least accurate, if not the least accurate, of all the forecasters participating in the Blue Chip survey, based on forecasts of 2009 growth produced in 2007-2008. This is another unproven assertion. Since the PJM forecast is based on GMP, it can't be answered, as the Blue Chip does not report GMP. The issues here are fundamental, such as whether the Mid-Atlantic will grow slower or faster than the US. MEDC has been having the Mid Atlantic grow more slowly, and they have been very close on a number of key indicators like employment. A study is needed.</p>	<p>Two month lead time needed to develop proposed customized forecast by MEDC. Multiple iterations between MEDC and PJM required, annually.</p>
<p>A majority of other forecasters assign very low probabilities to MEDC's forecast rates of growth for 2011 and 2012. For all of the reasons cited above, this is another unproven assertion. We do not know what those forecasters would think of MEDC's outlook for Chicago GMP, for example. Anyone who compares local GMP with national GDP will observe large differences in historical and forecast growth rates. We're not aware of any work that has been done on this subject – this is another unfounded assertion.</p>	<p>If MEDC is looking to PJM to develop inputs, PJM will be in the business of developing US macroeconomic forecasts.</p>
	<p>To use Blue Chip forecast, legal issues related to replicating their proprietary forecast must be addressed.</p>
	<p>LAS has an established practice of studying proposals before implementation. This proposal does not allow for that. PHI believes that this is the single most important issue.</p>
	<p>The proposal will lead to winners and losers at the regional level. Stakeholders will not have access to underlying data to validate the assumptions which determine this.</p>
	<p>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</p>
	<p>Past forecasts have used MEDC's baseline US GDP scenario. Continuing to do so would maintain consistency with past forecasting.</p>
	<p>Publishing multiple forecasts will contribute to "forecast shopping," where users of the forecast pick the forecast that is most favorable to their case.</p>