Contents

Preface xiii

Acknowledgments xvii

Chapter 1 Creating Harmony Out of Noisy Data 1
   Effective Decision Making: Characterize the Data 2

Chapter 2 First, Understand the Data 27
   Growth: How Is the Economy Doing Overall? 30
   Personal Consumption 31
   Gross Private Domestic Investment 33
   Government Purchases 35
   Net Exports of Goods and Services 36
   Real Final Sales and Gross Domestic Purchases 37
   The Labor Market: Always a Core Issue 37
   Establishment Survey 39
   Data Revision: A Special Consideration 42
   The Household Survey 43
   Marrying the Labor Market Indicators Together 48
   Jobless Claims 48
   Inflation 49
   Consumer Price Index: A Society's Inflation Benchmark 50
   Producer Price Index 53
   Personal Consumption Expenditure Deflator: The Inflation Benchmark
      for Monetary Policy 55
   Interest Rates: Price of Credit 56
   The Dollar and Exchange Rates: The United States in a
      Global Economy 58
   Corporate Profits 60
   Summary 62

Chapter 3 Financial Ratios 63
   Profitability Ratios 64
   Summary 73

Chapter 4 Characterizing a Time Series 75
   Why Characterize a Time Series? 76
   How to Characterize a Time Series 77
   Application: Judging Economic Volatility 101
   Summary 109

Chapter 5 Characterizing a Relationship between Time Series 111
   Important Test Statistics in Identifying Statistically
      Significant Relationships 115
Simple Econometric Techniques to Determine a Statistical Relationship 119
Advanced Econometric Techniques to Determine a Statistical Relationship 120
Summary 126
Additional Reading 127

Chapter 6 Characterizing a Time Series Using SAS Software 129
Tips for SAS Users 130
The DATA Step 131
The PROC Step 135
Summary 156

Chapter 7 Testing for a Unit Root and Structural Break Using SAS Software 157
Testing a Unit Root in a Time Series: A Case Study of the U.S. CPI 158
Identifying a Structural Change in a Time Series 162
The Application of the HP Filter 169
Application: Benchmarking the Housing Bust, Bear Stearns, and Lehman Brothers 172
Summary 177

Chapter 8 Characterizing a Relationship Using SAS 179
Useful Tips for an Applied Time Series Analysis 179
Converting a Dataset from One Frequency to Another 182
Application: Did the Great Recession Alter Credit Benchmarks? 215
Summary 221

Chapter 9 The 10 Commandments of Applied Time Series Forecasting for Business and Economics 223
Commandment 1: Know What You Are Forecasting 224
Commandment 2: Understand the Purpose of Forecasting 226
Commandment 3: Acknowledge the Cost of the Forecast Error 226
Commandment 4: Rationalize the Forecast Horizon 229
Commandment 5: Understand the Choice of Variables 231
Commandment 6: Rationalize the Forecasting Model Used 232
Commandment 7: Know How to Present the Results 234
Commandment 8: Know How to Decipher the Forecast Results 235
Commandment 9: Understand the Importance of Recursive Methods 238
Commandment 10: Understand Forecasting Models Evolve over Time 239
Summary 240

Chapter 10 A Single-Equation Approach to Model-Based Forecasting 241
The Unconditional (Atheoretical) Approach 242
The Conditional (Theoretical) Approach 251
Recession Forecast Using a Probit Model 257
Summary 261

Chapter 11 A Multiple-Equations Approach to Model-Based Forecasting 263
The Importance of the Real-Time Short-Term Forecasting 265
The Individual Forecast versus Consensus Forecast: Is There an Advantage? 266
The Econometrics of Real-Time Short-Term Forecasting: The BVAR Approach 268
Forecasting in Real Time: Issues Related to the Data and the Model Selection 275
Case Study: WFC versus Bloomberg 280
Summary 288
Appendix 11A: List of Variables 289

Chapter 12 A Multiple-Equations Approach to Long-Term Forecasting 291
The Unconditional Long-Term Forecasting: The BVAR Model 293
The BVAR Model with Housing Starts 296
The Model without Oil Price Shock 298
The Model with Oil Price Shock 304
Summary 306

Chapter 13 The Risks of Model-Based Forecasting: Modeling, Assessing, and Remodeling 307
Risks to Short-Term Forecasting: There Is No Magic Bullet 308
Risks of Long-Term Forecasting: Black Swan versus a Group of Black Swans 310
Model-Based Forecasting and the Great Recession/Financial Crisis: Worst-Case Scenario versus Panic 314
Summary 315

Chapter 14 Putting the Analysis to Work in the Twenty-First-Century Economy 317
Benchmarking Economic Growth 318
Industrial Production: Another Case of Stationary Behavior 322
Employment: Jobs in the Twenty-First Century 324
Inflation 331
Interest Rates 337
Imbalances between Bond Yields and Equity Earnings 338
A Note of Caution on Patterns of Interest Rates 345
Business Credit: Patterns Reminiscent of Cyclical Recovery 347
Profits 348
Financial Market Volatility: Assessing Risk 349
Dollar 351
The Long-Term Deficit Bias and Its Economic Implications 358
Summary 362

Appendix: Useful References for SAS Users 365

About the Authors 367

Index 369