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What is Not Known about the Economy

by Richard W. Rahn

How much will the stock market rise this year? As an economist, I frequently get variations of that question. If I am honest and say "I have no idea," the questioner most often walks away with a disappointed look. If I say something like "10.4 percent," the questioner will often be satisfied, even though I have given a random number with no basis in fact.

One of the many contributions of the great 20th-century economist and philosopher F.A. Hayek was his work on the limits of knowledge. There are many things that cannot be known by one individual but can be known by a market through the price discovery process.

One of mankind's greatest inventions was "futures markets," where one can bet on the future price of all major physical commodities from gold to wheat, or financial instruments, such as government bonds or the relative value of currencies. The beauty of the futures market is that the price forecast (i.e., the price for whatever month in the future) is set by people around the globe who are willing to put their money behind their mouth, rather than some guy sitting at bar with a beer in his hand, or some prissy professor trying to impress his students with how smart he is.

An old friend, Steve Moore, a columnist for The Washington Times, has been nominated by the president to serve as one of the Federal Reserve Bank's governors. One of the raps against Steve is that he has been wrong several times in his forecasts for the economy resulting from tax changes. There may be arguments as to why Steve should not get the post, but being an imperfect forecaster is not one of them. During the Obama years, both the Fed and the International Monetary Fund (IMF) greatly overestimated economic growth year by year — and they both had huge teams of establishment economists and the best economic models money could buy. Some of the media critics of the appointment (e.g., The New York Times) employ some of the worst economic commentators/forecasters (e.g., Nobel Laureate Paul Krugman).

We economists can look at the worldwide buildup of government debt and correctly say that it is not sustainable — but we cannot tell when the day of reckoning will occur and the form of that reckoning. On the positive side, we can also say, based on more than a century of history, a well-balanced portfolio of common stocks will outperform bonds and inflation if held long enough.

There was a very good piece of news this last month that I did not see reported anywhere: The U.S. government has a drought monitor that shows the amount and extent of drought at any given time in the United States. The western part of the United States, and particularly California, had been suffering from an extended multi-year drought. As late as this past October, government climate experts forecast that California would again have a warmer and drier winter and the drought situation would get worse. A month later, the rains started — record rains — not only in California, but throughout the whole Lower 48. Los Angeles set an all-time record in February by not having a temperature above 70 degrees (measurements going back well over a hundred years).

The bad news is that the government climate forecasters were totally and undeniably wrong. The good news is there is no remaining drought in California — the reservoirs are full, and many of the snow packs are at record levels. And, in fact, there is almost no area of the Lower 48 suffering from drought — which is a record in itself. Remember, many of the climate scientists told us that global warming would mean more drought and crop failures.

This past week, there was even more bad news for the climate doomsday crowd. In its annual (2018) State of the Climate Report, published by the Global Warming Policy Foundation, the author concluded, "After the warm year of 2016, temperatures last year continued to fall back to levels of the so-called warming 'pause' of 2000-2015. There is no sign of any acceleration in global temperature, hurricane, or sea-level rise."

Political forecasters have of late been even more wrong than economists and climate scientists. The shock of the Trump win is still not over. Many of the PC political forecasters had convinced themselves that the Mueller report would show that the president's team colluded with the Russians. Unlike the forecast mistakes made by economists and climate scientists which are often due to inadequate and/or poorly analyzed data, those made by political forecasters are often due to laziness and fear of learning what they don't want to know.

Former CIA director John Brennan seems to have been the source of much of the misinformation about the Mueller report and Russian spying. Some basic due diligence on the part of the political press could have quickly led them to understand that much of Mr. Brennan's "misinformation" was in fact of Russian origin.

The good news is that markets work even when it comes to forecasters. People increasingly ignore those who all too often give bad economic, climate or political forecasts — which in part explains why MSNBC and CNN are losing market share to more balanced FoxNews.

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