

### BOX C: DECOMPOSITION OF FORECAST ERRORS (AN UPDATE)

Understanding deviations between Government forecasts of the macroeconomy and actual outturns forms an essential part of the endorsement process within the Council's mandate and its role in assessing macroeconomic projections.

The *April 2013 FAR* (Box A) highlighted a clear systematic tendency for Department of Finance forecasts to overestimate domestic demand – which is more tax-rich in nature – in preceding years, with the reverse true for net exports. This Box updates the analysis, using the latest available data for 2007-14, documenting the sources of real GDP forecast errors at different horizons (Figures C1–C3).

For the earlier crisis years, the Department's systematic tendency to over-estimate domestic demand is still evident – though this tendency appears to have lessened of late. A more sluggish than expected export performance in 2012 and 2013 coincided with specific developments in the multinational-dominated sectors of the economy. In particular, underestimation of the pharmaceutical patent cliff and declines in the gross value added from ICT-related sectors (Nov 2014 FAR, Box C) likely prompted large forecast errors on the contribution of net exports to real GDP growth. By comparison, 2014 real GDP growth over-performed on all fronts relative to earlier expectations as a broadening recovery surprised most forecasters.

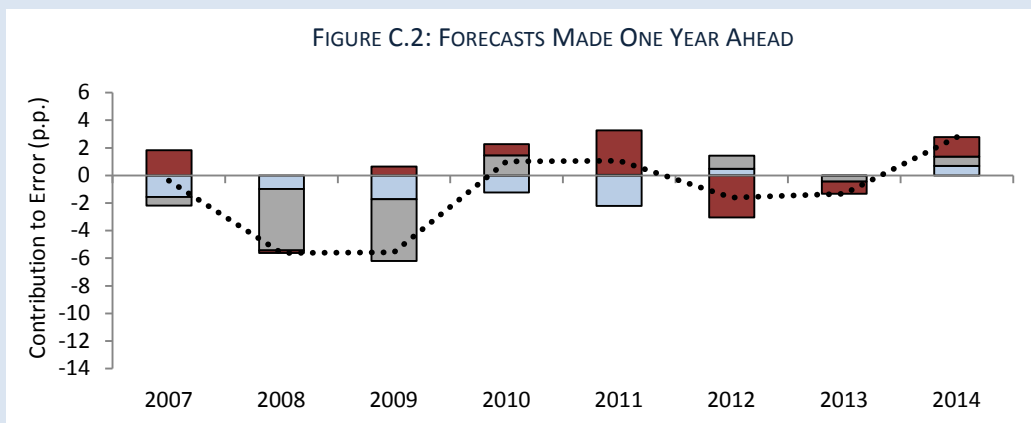
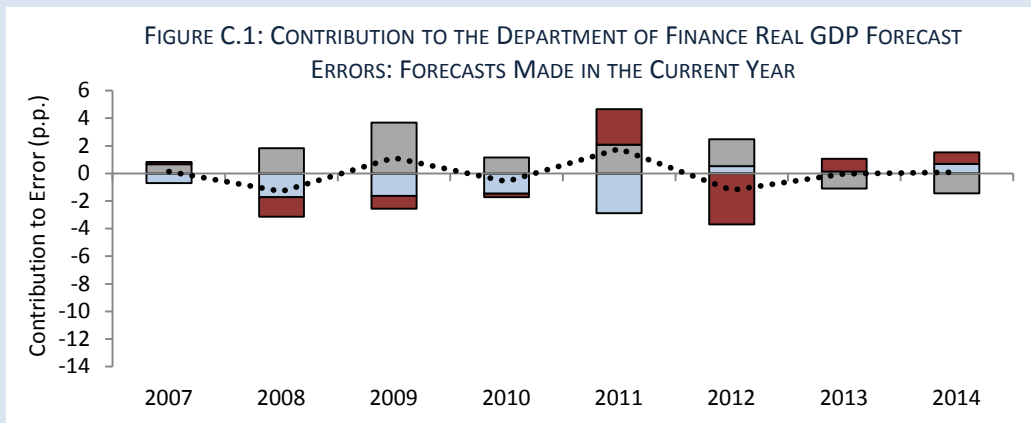
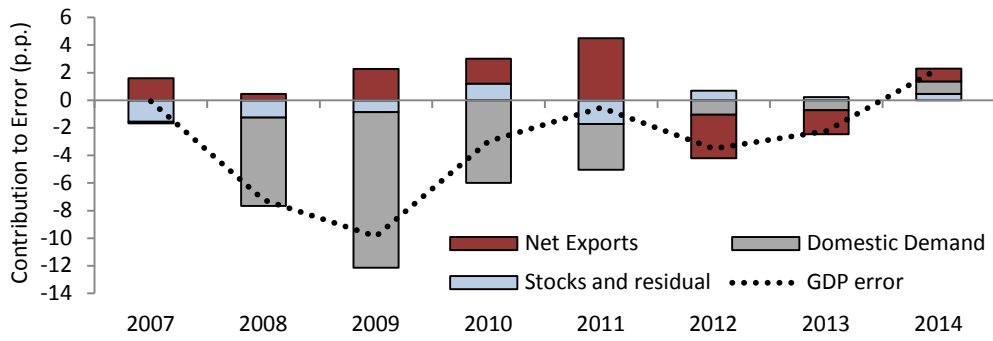


FIGURE C.3: FORECASTS MADE TWO YEARS AHEAD



Sources: Department of Finance (Budget/SPU documents); internal IFAC calculations.