FORECASTING US RECESSIONS WITH MACRO FACTORS

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ABSTRACT

Dynamic factors estimated from panels of macroeconomic indicators are used to predict future recessions using probit models. Three factors are considered: a bond and exchange rates factor, a stock market factor and a real activity factor. Three results emerge. First, models that use only financial indicators exhibit a large deterioration in fit after 2005. Second, models that use factors yield better fit than models that use indicators directly. Out-of-sample forecasting exercises confirm these results for 3-, 6- and 12-month horizons using both ex-post revised data and real-time data. Third, results show evidence that data revisions affect factors less than individual indicators.

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