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Some Possible Implications of Extraordinary Macro Uncertainty

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Six Extraordinary Aspects of the Current Situation (1)

1. The size and speed of the downturn: forecast errors equal to:
   - +6 standard deviations in March
   - +66 standard deviations in April
   - -17 standard deviations in May relative to the predictions from an AR(2)

2. The source of the shock
   - A deliberately induced coma for wide swaths of the economy
   - Not, for example, a monetary-policy induced recession to fight recession

3. The sectoral concentration of the shock
   - Focused on industries and occupations involving interpersonal contact
   - More service sector than, for example, durable goods

Six Extraordinary Aspects of the Current Situation (2)

4. The measurement uncertainty
   - How should misclassified individuals be handled?
   - Is the deterioration in response rate important?
   - What has happened since the middle of May?

5. The lack of clarity about the policy response
   - Not clear that monetary policy <u>can</u> do that much more
   - Not clear that fiscal policy <u>will</u> do that much more

6. The lack of clarity about the course of the disease
   - How long until a vaccine? Antiviral therapies?
   - How risk averse will individuals be?
   - Will there be a second wave in the fall/winter?

Some Implications of Extraordinary Uncertainty:
Three Lessons from Macro Policy

1. Distrust the models
    - They're never infallible, but are now operating outside the range of all prior experience
2. Take out more insurance; build up the safeguards
    - If a 500-year flood comes every ten years, build higher levees
3. Structure policies so they evolve as circumstances change
    - This is the beauty of "automatic stabilizers"

Do these lessons have analogues in the credit rating world?