

The role of survey data in the construction of short-term GDP growth forecasts*

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Executive Summary

The aim of this paper is to investigate the role of Business and Consumer Survey (BCS) data published by the European Commission, in the construction of short-term GDP growth forecasts. A pseudo out-of-sample forecasting exercise is conducted in which the availability of data mimics real-time releases. A sequence of GDP growth estimates is computed starting 5-5.5 months prior to the publication of GDP growth and ending about 10 days before the release of the actual figure. The focus of the analysis is on Cyprus and some of its key trading partners, namely the European Union, the euro area, the United Kingdom and Greece. Due to the openness of the Cypriot economy, timely information on the expected economic performance of Cyprus's main trading partners is crucial to the assessment of domestic prospects and challenges.

The pseudo out-of-sample forecasts are constructed over the period 2006q2-2015q3. Therefore, the evaluation of the BCS data covers a turbulent period for both the domestic and the European economy. The analysis for Cyprus reveals that the use of survey data improves the accuracy of GDP growth estimates, but the forecasting gains are not always statistically significant. The improvements in forecast accuracy from the use of survey data are larger and more significant for the euro area, the European Union and Greece compared to those for Cyprus, while survey predictors were not found to enhance the precision of GDP growth estimates for the United Kingdom. Thus, the BCS indicators for the European Union and the euro area as a whole, as well as for Greece, can be used by practitioners in order to extract reliable signals for the short-term growth prospects of these economies and identify risks to the outlook for the Cypriot economy. The BCS data for Cyprus resulted in large forecasting gains over the benchmark during the international financial crisis and its aftermath and predicted the depth of the recession in 2009 and 2013 fairly accurately. Nevertheless, the relative benefits from the use of survey data began diminishing at the onset of the domestic economic crisis. The analysis also shows that survey information correctly signalled the moderation of the recession in Cyprus in 2013 - 2014.

The BCS data provide early and useful information for monitoring movements in economic activity, enabling policy-makers to react timely. However, additional domestic and foreign leading indicators should also be employed to gain even more reliable and complete insight into the outlook for the Cypriot economy.

* The Economics Research Centre of the University of Cyprus acknowledges funding from the European Commission and the Ministry of Finance for conducting the Business and Consumer Survey Project in Cyprus. This paper reflects only the authors' views and the European Commission is not responsible for any use that may be made of the information it contains.