

Preface

The story of this book began with my difficult transition from teaching international economics and econometrics in Economics Ph.D. programs at Harvard and UCLA to teaching in the MBA programs at the Anderson School at UCLA. On the basis of 20 years of apparent teaching success in Ph.D. education, I arrived at the Anderson School in 1990 with a self-image as a star teacher, but I was greeted with highly disturbing mediocre teaching evaluations. Faced with a data set that was inconsistent with my view of reality, I did what analysts usually do – I formulated a theory why the data were misleading.

Here is how I thought about it. Two aspects of the course – content and amusement – drive numerical course evaluations. If you rank courses by the average of the content score and the amusement score, then the component that can be measured most accurately will determine the ranking. Do you understand why? It is what averaging does: it eliminates the noise. Suppose, for example, that a student cannot tell anything about the content, and the content score is simply a random number, varying from student to student. Those random numbers will average out across students to about the same number for each course. As the average course content score is about the same for every course, it is the amusement score that will drive the rankings. Thus the difference between my success in economics and my failure in the business school reflected the differences in the student populations – the Ph.D. students could detect content differences across courses, while the business school students did not have a clue. Gosh, those thoughts made me feel better. But it did not last long. I cannot imagine a more distressing way to spend one's life than to be an unappreciated teacher except for being a despised teacher. It was a very tough mountain to climb, but after nine times teaching the course, and improving, I was awarded the Executive MBA teaching award in 2001 and 2002. How satisfying was that!

I am not writing an autobiography here, so why bother with this information? Because, first it introduces the central idea of the book: patterns and stories (the teaching evaluation data and the story I told myself). Second, it reveals the bad news and the good news. The bad news is that I am not a macroeconomist and thus cannot claim an expert's knowledge of the theory of the field. The good news is that

I am not a macroeconomist, and I do not carry the heavy intellectual baggage that most macroeconomists lug around.

The fields in which I have made academic contributions are first econometric methodology and then the analysis of international microeconomics data. When I moved to the Anderson School of Management at UCLA in 1990, I fished around for something to teach that would make me happy and the students too. That is a rare double combination of desires. I decided that I would teach the students how to turn numbers into knowledge, using macroeconomic data as the case.

After teaching the lessons of macro data for ten years, I was ready when the Dean called to ask me to be the Director of the UCLA Anderson Forecast, which is one of the most long-lived and prominent macroeconomics forecasts, included in the Wall Street Journal panel of forecasters, the Livingston Survey and the Blue Chip Forecasts. But, it should be admitted, forecasting the economy is an enterprise held in low repute among academic economists. I see it differently. Making a quarterly forecast, telling the story that lies behind it, and discovering when you are right and when you are wrong is a powerful way to learn what is important and what is not. I think I have learned a lot, and I have tried to pack the lessons into this book. Whether that is useful or not is for you to judge.

In the midst of this teaching and forecasting, I heard on NPR that “humans are pattern-seeking story-telling animals,” which sums up with great rhetorical accuracy what economists do. I am going to show you some patterns, and then tell causal stories about them.

Causal stories are the right way of saying it. We should be very wary of drawing causal conclusions from the nonexperimental macroeconomic data we will be exploring. I know more than most that correlations are in the data but causation is in the mind of the observer. I know that temporal orderings (first the lighting of the match, and then the fire) do not by themselves reveal causality (weather forecasts, which come first, do not “cause” the weather), even though Clive Granger has christened the *post hoc ergo propter hoc* fallacy with the name “Granger Causality.” I know it is impossible to find a scientifically validated causal chain connecting monetary policy with housing with the economy overall. But that will not stop me, as it has not stopped other economists from drawing firm causal conclusions mostly from a war-chest of thought experiments conducted strictly in their heads. In contrast to most, I am going to go to great lengths to collect the basic facts about the US economy, and use those facts to influence my opinions.

That said, I offer the surprising patterns that I see and the interesting stories that come to mind. I think you will be amazed by the patterns and amused by the stories.

Pedagogical Goals

There are two pedagogical goals of this book. One goal is to describe the most important features of the macroeconomy in a readable, organized, and informative way.

The other goal is to demonstrate how people can learn from numbers, by seeking patterns and telling stories.

Both of these goals are or should be part of the core teaching mission of every MBA program because of the following:

1. MBAs need to talk the talk: Most managers at the highest levels of business firms are conversant in the lore of the business cycle – how much growth in sales is likely, where interest rates are going, what will happen to the housing market, etc. If we expect our MBAs to rise to the highest levels of management, they will need to have well-formed opinions based on real evidence about the nature of the business cycle. If we get them interested, and give them the tools to decode the countless articles in the business press about the latest macroeconomic data, we should be able to capture their interest, and set them off on a life-long learning journey.

If we decide not to teach macroeconomics, the next most important skill is golf.

2. MBAs need ways of finding insights: A personal computer and the Internet provide managers access to virtually unlimited textual and numerical data. That enormous data set is completely worthless unless it is transformed into knowledge through some form of filtering. Ability to transform the Internet data first into knowledge and then into insights should be one of the core skills that MBA training provides. A study of macroeconomic data and the business cycle is a great way of making this point. Students who begin a 10-week course with virtually no knowledge of macroeconomics, self-conscious and unsure, by the end of a course of pattern-seeking and story-telling become self-confident “experts,” capable of making their own discoveries and confident enough to see the flaws in the opinions of others that they read in the *Wall Street Journal*, the *New York Times* and the *Financial Times*.

Features

Chapters cover the behavior of every major US macroeconomic variable including GDP, employment, unemployment, inflation, interest rates, and exchange rates. After explaining what these variables are and how they are measured, attention turns to understanding the recessions: what are their symptoms, how frequently do they occur, which businesses suffer and which prosper in recessions, and what helps to predict the next one? Then comes discussion of longer-term issues, including savings and investment, the Federal deficit and the external deficit, and housing as an asset to support us in our retirements.

I show what the US business cycle is like: It is not a business cycle at all. It is really a consumer cycle in the sense that the first expenditure component to turn down prior to a recession is usually consumer spending on homes, then consumer durables, and only when the recession is fully upon us does business spending on equipment and software weaken, and last are the longest lived business assets: factories and office building. Not always, but eight times out of ten.

This and thousands of other facts can be found in this book, delivered in what I hope to be a provocative and entertaining style.

There is little traditional macroeconomic theory in this book, though there are several “stories” about unemployment and the business cycle. The traditional macro theory is great for economics majors but it leaves no lasting impression on most other students and not much even on economics majors. (How many readers of the *Wall Street Journal* can remember the IS-LM model they studied in college? How many of the journalists who write those articles have even the slightest awareness of the IS-LM model or any other macro model?) I rely much more heavily on the data to help students form their own point of view. I try to bring the reader along with me on this journey to understanding. Because visual displays are much more memorable than any table of numbers, the argument is highly graphical and uses a minimum amount of numerical statistical analysis.

Exercises

Updated images, review exercises, and homeworks can be found on the Internet at:

<http://www.anderson.ucla.edu/faculty/edward.leamer/>

The homeworks parallel the book.

- What is GDP?
- How do the four key macro variables behave? (growth, interest rates, inflation and unemployment)
- Is your job at risk in recessions?
- What helps to predict an oncoming recession?
- What can cure a recession?
- Is there a housing bubble?
- How can the US external deficit be closed?
- Is the US on a new productivity trend?

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8 February 2007

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<http://www.springer.com/978-3-540-46388-7>

Macroeconomic Patterns and Stories

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2009, XVI, 360 p., Hardcover

ISBN: 978-3-540-46388-7