PART I

The Recognition Patterns
of Business Analysts

by RENDIGS FELS

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Introduction

This paper reports on an investigation into the problem of forecasting
and recognizing business cycle peaks and troughs. The word "recogniz-
ing" is used here to denote the pattern beginning with the vague early
warnings forecasters usually give that the cyclical situation may be
changing through the successive stages of increasing awareness until
they finally confirm that a turn has definitely occurred.[1] In a sense, the
entire process of recognition is one aspect of short-term business fore-
casting, though it is more usual to restrict the meaning of the phrase
"forecasting cyclical turns" to the part of the recognition pattern that
precedes the date of the peak or trough. The sooner a forecaster can
give warning of a turnabout, even if the warning comes after the event,
the more useful his forecasts will be. When he first gives warning, he may
think a turning point is not probable. As time goes by, evidence for or
against the hypothesis of a reversal builds up. In the case of a genuine
turn, the forecaster eventually becomes certain. Confirmation that a
turn has occurred can be useful for forecasting—is itself a forecast—if
it can be achieved within six months (or sometimes even longer) after
the peak or trough of the business cycle.[2]

[1] Terms like "recognition" and "recognition lag" are used in different senses
in the literature. Kareken and Solow in a study of the Federal Reserve System
defined recognition lag as the time between the need for action (viz., a cyclical
peak or trough) and the time the Federal Reserve actually took action. (They
assumed that the lag between recognition and decision was zero.) Brunner and
Meltzer more or less followed the same usage. In these and other studies, recog-
nition refers to a particular point in the recognition pattern rather than to the
pattern as a whole. See John Kareken and Robert M. Solow, "Lags in Monetary
Policy," in *Stabilization Policies,* prepared for the Commission on Money and
Credit, Englewood Cliffs, N. J., 1963, pp. 62–65; and Karl Brunner and Allan
H. Meltzer, *The Federal Reserve's Attachment to the Free Reserve Concept,*
Subcommittee on Domestic Finance, House of Representatives, 88th Congress,
2d Session, Washington, 1964, pp. 37–47.

[2] Under the definition used by the NBER, a business cycle (expansion plus
contraction) must last more than a year (Arthur F. Burns and Wesley C.
Mitchell, *Measuring Business Cycles,* New York: National Bureau of Economic
Research, 1946, p. 3). The shortest expansion on record lasted ten months, the

The purpose of this study is to describe and evaluate the recognition patterns of a representative group of business analysts. Following a review of a previous study for the 1920's by Garfield V. Cox, the paper discusses the forecasts of ten widely circulated publications, using a scoring system to evaluate their records in forecasting eight turning points since World War II. Though several different kinds of publications are represented, the ten do not constitute a random sample of forecasters. They have, however, put their analyses on record continuously for a substantial period of time, and their wide circulation suggests that they may have a significant influence on public opinion with respect to the state of the economy.

Geoffrey Moore, in discussing "the usual lag in recognizing revivals and recessions *that have already begun,*" has said, "this lag is clearly not negligible. If the user of statistical indicators could do no better than recognize contemporaneously the turns in general economic activity denoted by our reference dates, he would have a better record than most of his fellows." [3] This paper provides evidence bearing on Moore's hypothesis. It also throws some light on why recognition is difficult and on the comparative value of different forecasting methods.

Victor Zarnowitz has shown that one of the pervasive weaknesses of short-term business forecasting is its failure to predict changes in the direction of business activity (and sometimes its prediction of changes in direction that do not occur).[4] There evidently is no reliable way to forecast cyclical reversals even a few months in advance. This study shows that informed observers often do not know that a reversal is in the making until some months *after* the peak or trough.

shortest contraction seven months. The knowledge that a peak or trough has occurred leaves the domain of forecasting and enters that of historical fact perhaps half a year after the peak or trough itself, but this interval may be shorter or longer depending on economic developments, such as the rate of decline after the apparent peak or the vigor of recovery after the apparent trough. Before that time, confirmation implies a forecast of the direction and magnitude of change over the very short run.

The National Bureau has determined the dates of business cycle peaks and troughs historically for analytical purposes, often long after the fact. In the Department of Commerce monthly publication, *Business Cycle Developments,* which utilizes the National Bureau's dates, the position is taken that a peak or trough date will not be designated until at least six months after it has occurred (see p. 1 of each issue).

[3] Geoffrey H. Moore, *Business Cycle Indicators,* Princeton University Press for NBER, 1961, Vol. I, pp. 257–258 (Moore's italics).

[4] *An Appraisal of Short-Term Economic Forecasts,* Occasional Paper 104, National Bureau of Economic Research, New York, 1967, pp. 7 and 72–80.