Instructions. Please submit only one paper per group, via Blackboard. Please make sure that the printed output of your files is intelligible. Notice: the digital version of this document features active links to documents and webpages.

1. Predicting GDP growth. The spreadsheet hw4.xls contains quarterly data on GDP, the term spread, and the Conference Board Leading Indicator. GDP is Real Gross Domestic Product, expressed in billions of 2005 dollars, seasonally adjusted at annual rates (from Table 1.1.6. of NIPA). The term spread is the difference between the (annualized) yield on a 5–year zero–coupon Treasury Bond and the (annualized) yield on a 90–day T–Bill (5–year zero–coupon Treasuries do not exist, but we can construct artificial securities out of existing coupon bonds). Figures for the Leading Indicator are within–quarter simple averages of the actual monthly figures released by the Board.

(a) For the sake of simplicity, assume that it is the beginning of January 2013. Use the time series in the spreadsheet to estimate forecasting regressions for GDP growth over the next 12 months. Describe each regression and its properties (indicators used, $R^2$, root mean squared error). Hint: for simple methodological reasons (co–integration is the technical term), you cannot use the level of GDP as dependent variable. You must use the growth rate. (50 points)

(b) Most analysts forecast that in 2013 economic growth in the US will be moderate. Does your own work provide any support for these forecasts? Explain. (50 points)