

Abstract

Many recent theories postulate that economic and financial fluctuations result from changes in uncertainty, confidence, sentiment or the perceived probability of a disaster. One reason that belief-based theories have not eclipsed the standard paradigm is that, without direct evidence about what agents believe, many question whether beliefs fluctuate cyclically and why. This paper asks: What if agents form beliefs like a Bayesian econometrician? Each quarter, they use real-time RGDP data to re-estimate their forecasting model, forecast next quarter's growth, and estimate their forecast's standard deviation (uncertainty). When the forecasting model admits only normally-distributed outcomes, we find small, acyclical changes in uncertainty. But when agents can estimate a parameter that regulates skewness, uncertainty fluctuations become large and counter-cyclical. The reason is that small changes in estimated skewness whip around probabilities of unobserved tail events (black swans). The resulting forecasts resemble those of professional forecasters. Our real-time measure of GDP forecast uncertainty reveals that changes in the risk of a black swan explain most of the shocks to uncertainty.