

Macroeconomic Nowcasting Using Google Probabilities*

Gary Koop, University of Strathclyde[†]

Luca Onorante, European Central Bank[‡]

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Abstract: Many recent papers have investigated whether data from internet search engines such as Google can help improve nowcasts or short-term forecasts of macroeconomic variables. These papers construct variables based on Google searches and use them as explanatory variables in regression models. We add to this literature by nowcasting using dynamic model selection (DMS) methods which allow for model switching between time-varying parameter regression models. This is potentially useful in an environment of coefficient instability and over-parameterization which can arise when forecasting with Google variables. We extend the DMS methodology by allowing for the model switching to be controlled by the Google variables through what we call Google probabilities. That is, instead of using Google variables as regressors, we allow them to determine which nowcasting model should be used at each point in time. In an empirical exercise involving nine major monthly US macroeconomic variables, we find DMS methods to provide large improvements in nowcasting. Our use of Google model probabilities within DMS often performs better than conventional DMS.

Keywords: internet search data, nowcasting, dynamic model averaging, state space model

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[†]This research was supported by the ESRC under grant RES-062-23-2646. Gary Koop is a Fellow at the Rimini Centre for Economic Analysis. Address for correspondence: Gary Koop, Department of Economics, University of Strathclyde, 130 Rottenrow, Glasgow G4 0GE, UK. Email: Gary.Koop@strath.ac.uk

[‡]Currently on leave to the Central Bank of Ireland

1 Introduction

Macroeconomic data are typically published with a time lag. This has led to a growing body of research on nowcasting. Nowcasting uses currently available data to provide timely estimates of macroeconomic variables weeks or even months before their initial estimates are produced. The availability of internet search data has provided a new resource for researchers interested in nowcasts or short-term forecasts of macroeconomic variables. Google search data, available since January 2004, is a particularly popular source. Pioneering papers such as Choi and Varian (2009, 2011) have led to an explosion of nowcasting work using Google data including, among many others, Artola and Galan (2012), Askitas and Zimmermann (2009), Carriere-Swallow and Labbe (2011), Chamberlin (2010), D'Amuri and Marcucci (2009), Hellerstein and Middeldorp (2012), Kholodilin, Podstawski and Siliverstovs (2010), McLaren and Shanbhoge (2011), Scott and Varian (2012), Schmidt and Vosen (2009), Suhoj (2009) and Wu and Brynjolfsson (2010).¹

These papers report a variety of findings for a range of variables, but a few general themes emerge. First, Google data is potentially useful in nowcasting or short-term forecasting, but there is little evidence that it can be successfully used for long-term forecasting. Second, Google data is only rarely found to be useful for broad macroeconomic variables (e.g. inflation, industrial production, etc.)² and is more commonly used to nowcast specific variables relating to consumption, housing or labor markets. For instance, Choi and Varian (2011) successfully nowcast the variables motor vehicles and car parts, initial claims for unemployment benefits and tourist arrivals in Hong Kong. Third, the existing literature uses linear regression methods.

The present paper deals with the second and third of these points. We nowcast a variety of conventional US monthly macroeconomic variables and see if Google variables provide additional nowcasting power beyond a conventional set of predictors. It is common (see, among many others, Giannone, Lenza, Momferatou and Onorante, 2010) to forecast inflation using a variety of macro predictors such as unemployment, the term spread, wage inflation, oil price inflation, etc.. We use Google variables in different ways as additional information and check whether their inclusion can improve nowcasting power. We do this for nine different macroeconomic variables.

The main innovations in our approach relate to the manner in which we include the Google variables in our regression models. The first is that we use Dynamic model averaging and model selection (DMA and DMS) methods with time-varying parameter (TVP) regressions. DMA methods for TVP regression models were developed in Raftery et al (2010) and have been used them successfully in several applications (e.g., among others, Dangl and Halling, 2012, Koop and Korobilis, 2012, Koop and Onorante, 2012, Koop and Tole, 2013, Nicoletti

¹This list of papers uses Google data for macroeconomic forecasting. Google data is also being used for nowcasting in other fields such as finance and epidemiology.

²A notable exception is the nowcasting of U.S. unemployment in D'Amuri and Marcucci (2009).

and Passaro, 2012).

Initially we implement DMA and DMS in a conventional manner, using Google variables as additional predictors in TVP regressions. This represents a useful extension over existing nowcasting methods, such as Choi and Varian (2009, 2011), who use linear regression methods with constant coefficients. The second innovative aspect of the paper is that we extend the DMA methodology to use the Google data in a different manner. Instead of simply using a Google variable as an explanatory variable in a regression, we develop a method which allows for the inclusion probability of each macro explanatory variable to depend on the Google data. This motivates the terminology used in the title of this paper: “Google probabilities”. The rationale behind our approach is that some of the existing literature (e.g. Choi and Varian, 2011) suggests that Google variables might not be good linear predictors. However, they may be good at signalling turning points or other forms of change or model switching. In particular, we hypothesize that Google searches are able to collect “collective wisdom” and be informative about which macro variables are important in the model at different points in time, either directly or by influencing the outcomes through expectations. For example, a surge in searches about oil prices may not say much per se on whether oil prices are increasing or decreasing, but may indicate that the variable should be relevant in modelling. This should trigger a switch towards nowcasting models including the oil price as explanatory variable.

In an empirical exercise involving monthly US data on nine macroeconomic variables, we find DMS methods to nowcast well, regardless of whether they involve Google model probabilities or not. In particular, DMS tends to nowcast slightly better than DMA and much better than standard benchmarks using OLS methods. The use of Google probabilities to influence model switching often leads to further improvements in nowcast performance.

2 Macroeconomic Nowcasting and Google Data

Table 1 lists the macroeconomic variables we are interested in nowcasting. We use monthly US data from January 1973 through July 2012. Note that, as is commonly done, all of our variables are transformed so as to be rates (e.g. inflation rate, unemployment rate, etc.). All data are taken from the BIS Macroeconomic series databases, OECD Main Economic Indicators (OECD), Hamburg World Economic Archive and the Federal Reserve Bank of Chicago.

| Variable | Raw Variable (w_t) |
|-----------------------|--|
| Inflation | Consumer price index, all items |
| Wage inflation | Ave. hourly earnings in manuf. |
| Unemployment | Unemployment rate, all employees |
| Term spread | Long minus short 10 yr. Treasury minus Fed funds rate |
| FCI | Financial Conditions Index We use the one produced by the Chicago Fed who ca |
| Comm. price inflation | Price Index, food and energy |
| Industrial production | Total industrial production excluding construction |
| Oil price inflation | Crude oil price (USD per barrel) |
| Money supply growth | Money supply (M3) |

We use the one produced by the Chicago Fed who calibrate this variable to have an average value of zero and a standard deviation of one. Positive/negative numbers indicate tighter/looser than average financial conditions.

The end result is a data set involving 18 variables. These are the 9 variables listed in Table 1 and, corresponding to each, the average Google search variable reflecting internet search activity relating to the underlying macroeconomic concept.

3 Models

Each of our models involves using one of the macroeconomic variables as a dependent variable, y_t , with the remainder of the macroeconomic variables being included as potential explanatory variables, X_t . The Google variables corresponding to X_t will be labelled Z_t . The Google variables are available weekly, whereas the macroeconomic variables are available monthly. In our empirical work, we use the Google data from the last week of month t and, thus, Z_t is data which will be available at the end of the last week of month t . Of course, other timing conventions are possible depending on when nowcasts are desired. For instance, if we used first week of the month Google data we could provide nowcasts after this first week.

3.1 Our Baseline: Regressions with Constant Coefficients

A standard, one-step ahead regression model for forecasting y_t (e.g., among many others, Koop and Korobilis, 2012) would be:

$$y_t = X'_{t-1}\beta + \varepsilon_t. \quad (1)$$

Typically, the model would also include lags of the dependent variable and an intercept. All models and all the empirical results in this paper include these (with a lag length of 2), but for notational simplicity we will not explicitly note this in the formulae in this section.

We then add the Google regressors. We assume the following timing convention: At the end of month t or early in month $t + 1$, we assume y_t has not been observed and, hence, we are interested in nowcasts of it. The Google search data for the last week of month t , Z_t , becomes available. The other macroeconomic variables are released with a time lag so that X_{t-1} is available, but not X_t . With these assumptions about timing, the following regression can be used for nowcasting y_t early in month $t + 1$

$$y_t = X_{t-1}'\beta + Z_t'\gamma + \varepsilon_t. \quad (2)$$

The results in this paper adopt this timing convention, but other timing conventions (e.g. nowcasting in the middle of a month) can be accommodated with minor alterations of the preceding equation (depending on the release date of the variables in X_t).

3.2 TVP Regression Models, Model Averaging and Model Switching with Google regressors

The regressions in the preceding sub-section have two potential problems: i) they assume coefficients are constant over time which, for many macroeconomic time series, is rejected by the data (see, among many other, Stock and Watson, 1996) and ii) they may be over-parameterized since the regressions potentially have many explanatory variables and the time span of the data may be short.

An obvious way to surmount the first problem is to use a TVP regression model. TVP regression models (or multivariate extensions) are increasingly popular in macroeconomics (see, among many others, Canova, 1993, Cogley and Sargent, 2001, 2005, Primiceri, 2005, Canova and Gambetti, 2009, Canova and Ciccarelli, 2009, and Koop, Leon-Gonzalez and Strachan, 2009, and Chan et al, 2012). Our TVP regression model is specified as:

$$\begin{aligned} y_t &= W_t'\theta_t + \varepsilon_t \\ \theta_{t+1} &= \theta_t + \eta_t, \end{aligned} \quad (3)$$

where, in our empirical work, we consider both $W_t = X_{t-1}$ and $W_t = [X_{t-1}', Z_t']'$. Note that W_t defined in this way includes all information available for nowcasting y_t at the end of month t . We also wish to allow for time variation in the error variance and, thus, ε_t is assumed to be i.i.d. $N(0, \sigma_t^2)$, where σ_t^2 is replaced by an Exponentially Weighted Moving Average (EWMA) estimate (see RiskMetrics, 1996 and West and Harrison, 1997 and note that EWMA is a special case of a GARCH model):

$$\hat{\sigma}_t = \kappa \hat{\sigma}_{t-1} + (1 - \kappa) \hat{\varepsilon}_t \hat{\varepsilon}_t', \quad (4)$$

where $\hat{\varepsilon}_t$ are the estimated regression errors. We set the decay factor, $\kappa = 0.96$ following suggestions in Riskmetrics (1996). Furthermore, η_t are independent $N(0, Q_t)$ random variables (also independent of ε_t). An advantage of such models is that they are state space models and, thus, standard methods for estimating them exist (e.g. involving the Kalman filter). However, a possible disadvantage is they can be over-parameterized, exacerbating the second problem noted above.

Due to over-parametrization concerns, there is a growing literature which uses model averaging or selection methods in TVP regressions. That is, instead of working with one large over-parameterized model, parsimony can be achieved by averaging over (or selecting between) smaller models. Thus, model averaging or model selection methods can be used to ensure shrinkage in over-parameterized models. With TVP models, it is often desirable to do this in a time-varying fashion and, thus, DMA or DMS methods can be used (see, e.g., Koop and Korobilis, 2012). These allow for a different model to be selected at each point in time (with DMS) or different weights used in model averaging at each point in time (with DMA). For instance, in light of Choi and Varian (2011)'s finding that Google variables predict better at some points in time than others, one may wish to include the Google variables at some times but not others. DMS allows for this. It can switch between models which include Google variables and models which do not, as necessary.

The pioneering paper which developed methods for DMA and DMS was Raftery et al (2010). Since this paper describes (and provides motivation for) the DMA algorithm used in this paper, we will not provide complete details here. Instead we just describe the model space under consideration and the general ideas involved in the algorithm.

Instead of working with the single regression of the form (??), we have $j = 1, \dots, J$ TVP regression models, each of the form:

$$\begin{aligned} y_t &= W_t^{(j)} \theta_t^{(j)} + \varepsilon_t^{(j)} \\ \theta_{t+1}^{(j)} &= \theta_t^{(j)} + \eta_t^{(j)}, \end{aligned} \tag{5}$$

where $\varepsilon_t^{(j)}$ is $N(0, \sigma_t^{2(j)})$ and $\eta_t^{(j)}$ is $N(0, Q_t^{(j)})$. The $W_t^{(j)}$ contain different sub-sets of the complete set W_t of potential explanatory variables. If we denote S as the number of explanatory variables in W_t (e.g. in TVP regressions which do not include Google variables, then $S = 8$ since one of the macroeconomic variables in Table 1 will be the dependent variable and the remaining 8 will enter in lagged form as explanatory variables), then there are $J = 2^S$ possible TVP regressions involving every possible combination of the S explanatory variables. Unless S is small, it can be seen that the model space is huge. As discussed in Koop and Korobilis (2012), exact Bayesian estimation of this many TVP regression models using Markov Chain Monte Carlo (MCMC) is computationally infeasible which motivates our use of EWMA and forgetting factor methods.

Within a single TVP regression model we estimate $\sigma_t^{2(j)}$ using EWMA meth-

ods (as described above) and $Q_t^{(j)}$ using forgetting factor methods. Forgetting factors have long been used in the state space literature to simplify estimation. Sources such as Raftery et al (2010) and West and Harrison (1997) describe forgetting factor estimation of state space models and we will not repeat this material here. Suffice it to note that they involve choice of a scalar forgetting factor $\lambda \in [0, 1]$ and lead to estimates of $\theta_t^{(j)}$ where observations j periods in the past have weight λ^j . An alternative way of interpreting λ is to note that it implies an effective window size of $\frac{1}{1-\lambda}$. With EWMA and forgetting factor methods used to estimate $\sigma_t^{2(j)}$ and $Q_t^{(j)}$, all that is required is the use of the Kalman filter in order to provide estimates of the states and, crucially for our purposes, the predictive density, $p_j(y_t|W_{1:t}, y_{1:t-1})$, where $W_{1:t} = (W_1, \dots, W_t)$ and $y_{1:t-1} = (y_1, \dots, y_{t-1})$.

DMA and DMS involve a recursive updating scheme using quantities which we label $q_{t|t,j}$ and $q_{t|t-1,j}$. The latter is the key quantity: it is the probability that model j is the model used for nowcasting y_t , at time t , using data available at time $t-1$. The former updates $q_{t|t-1,j}$ using data available at time t . DMS involves selecting the single model with the highest value for $q_{t|t-1,j}$ and using it for forecasting y_t . Note that DMS allows for model switching: at each point in time it is possible that a different model is used for forecasting. DMA uses forecasts which average over all $j = 1, \dots, J$ models using $q_{t|t-1,j}$ as weights. Note that DMA is dynamic since these weights can vary over time.

Raftery et al (2010) derive the following model updating equation:

$$q_{t|t,j} = \frac{q_{t|t-1,j} p_j(y_t|W_{1:t}, y_{1:t-1})}{\sum_{l=1}^J q_{t|t-1,l} p_l(y_t|W_{1:t}, y_{1:t-1})} \quad (6)$$

where $p_j(y_t|W_{1:t}, y_{1:t-1})$ is the predictive likelihood (i.e. the predictive density for y_t produced by the Kalman filter run for model j evaluated at the realized value for y_t). The algorithm then uses a forgetting factor, α , set to 0.99 following Raftery et al (2010), to produce a model prediction equation:

$$q_{t|t-1,j} = \frac{q_{t-1|t-1,j}^\alpha}{\sum_{l=1}^J q_{t-1|t-1,l}^\alpha}. \quad (7)$$

Thus, starting with $q_{0|0,j}$ (for which we use the noninformative choice of $q_{0|0,j} = \frac{1}{J}$ for $j = 1, \dots, J$) we can recursively calculate the key elements of DMA: $q_{t|t,j}$ and $q_{t|t-1,j}$ for $j = 1, \dots, J$.

3.3 DMA and DMS with Google Model Probabilities

Our third and most original contribution consists of using the Google variables not directly as regressors, but as providing information to determine which macroeconomic variables should be included at each point in time. The underlying intuition is that the search volume might show the relevance of a certain variable for nowcasting at one point in time rather than a precise and signed cause-effect relationship. Therefore even those Google searches showing little

direct forecasting power as explanatory variables in a regression might be useful in selecting the explanatory variables of most use for nowcasting at any given point in time. Motivated by these considerations, we propose to modify the conventional DMA/DMS methodology as follows.

Let $Z_t = (Z_{1t}, \dots, Z_{kt})'$ be the vector of Google variables and remember that we construct our data set so that each macroeconomic variable is matched up with one Google variable. Z_{it} is standardized by Google to be a number between 0 and 100. Conveniently re-sized, this number can be interpreted as a probability.

Consider the same model space as before, defined in (??), with $W_t = X_{t-1}$. For each of these models and for each time t we define $p_{t,j}$, which we call a Google probability:

$$p_{t,j} = \sum_{s \in I^j} Z_{st} \sum_{s \in I^{\sim j}} (1 - Z_{st}).$$

where I^j indicates which variables are in model j . For instance, if model j is the TVP regression model which contains lags of the third and seventh explanatory variables then $I^j = \{3, 7\}$. In a similar fashion, we denote the explanatory variables which are excluded from model j by $I^{\sim j}$. It can be seen that $\sum_{j=1}^J p_{t,j} = 1$ and that each Google model probability reflects increases or decreases in internet searches. In our example where $I^j = \{3, 7\}$, $p_{t,j}$ will be large in times when internet searches on terms relating to the third and seventh explanatory variables are unusually high and it will be low when such searches are unusually low.

Our modified version of DMA and DMS with Google model probabilities involves implementing the algorithm of Raftery et al (2010), except with the time varying model probabilities altered to reflect the Google model probabilities as:

$$q_{t|t-1,j} = \omega \frac{q_{t-1|t-1,j}^\alpha}{\sum_{l=1}^J q_{t-1|t-1,l}^\alpha} + (1 - \omega) p_{t,j} \quad (8)$$

where ω can be selected by the researcher and $0 \leq \omega \leq 1$. If $\omega = 1$ we are back in conventional DMA or DMS as done by Raftery et al (2010), if $\omega = 0$ then $p_{t,s}$ replaces $q_{t|t-1,s}$ in the algorithm (and, hence, the Google model probabilities are driving model switching). Intermediate values of ω will combine the information in the Google internet searches with the Raftery et al (2010) data-based model probabilities.

4 Nowcasting Using DMS and DMA with Google Model Probabilities

4.1 Overview

In this section, we present evidence on the nowcasting performance of various implementations of DMA and DMS using the data set described in Section 2.

For each of the nine variables in Table 1, we carry out a nowcasting exercise using several different approaches most of which are either DMA or DMS using (??). In particular, we consider $\omega = 0, \frac{1}{2}, 1$. We also categorize our approaches depending on whether Google variables are used as regressors as in (??), used in the DMA model probabilities as in (??) or not used at all as in (??). We stress that all of our DMA and DMS approaches involve TVP regression models. As benchmarks we also present recursive OLS nowcasts using all of the relevant explanatory variables, recursive nowcasts using an AR(2) model and “No change” nowcasts which use the most recently available observation on the dependent variable as its nowcast.

We use mean squared forecast errors (MSFEs) to evaluate the quality of point forecasts and sums of log predictive likelihoods to evaluate the quality of the predictive densities produced by the various methods. Remember though, that our macroeconomic data is available from January 1973 through July 2012, but the Google data only exists since January 2004. In light of this mismatch in sample span, we estimate all our models in two different ways. First, we simply discard all pre-2004 data for all variables and estimate our models using this relatively short sample. Second, we use data back to 1973 for the macroeconomic variables, but pre-2004 we do not use versions of the models involving the unavailable Google data. For instance, when doing DMA with $\omega = \frac{1}{2}$ we proceed as follows: Pre-2004 we do conventional DMA as implemented in Raftery et al (2010) so that $q_{t|t-1,j}$ is defined using (??). As of January 2004, however, $q_{t|t-1,j}$ is defined using (??).³ Results using post-2004 data are given in Table 2 with results using data since 1973 being in Table 3. In the former case, the nowcast evaluation period begins in September 2005, in the latter case in January 2004. In both cases, the nowcast evaluation period ends in July 2012. Our OLS and No change benchmark approaches involve only one model and do not produce predictive likelihoods. Hence, only MSFEs are provided for these benchmarks which are put in the column labelled DMA in the tables.

4.2 Discussion of Empirical Results

With 9 variables, two different forecast metrics and two different sample spans, there are 36 different dimensions in which our approaches can be compared. Not surprisingly, we are not finding one approach which nowcasts best in every case. However, there is a strong tendency to find that DMA and DMS methods nowcast better than standard benchmarks and there are many cases where the inclusion of Google data improves nowcast performance relative to the comparable approach excluding the Google data. Inclusion of Google data in the form of model probabilities is typically (although not always) the best way of including Google data. It is typically the case that DMS nowcasts better than the comparable DMA algorithm, presumably since the ability of DMS to switch quickly between different parsimonious models helps improve nowcasts.

³For the case where the Google variables are included as regressors, we only use post-2004 data.

The remainder of this sub-section elaborates on these points, going through one macroeconomic variable at a time.

Inflation. For inflation, we find DMS with $\omega = 0$ or $\omega = \frac{1}{2}$ to produce the best nowcasts, regardless of data span or forecast metric. Note that both of these approaches uses Google probabilities. Doing DMS using Google variables as regressors leads to a worse nowcast performance. For instance, Table 2a shows that doing DMS using Google probabilities yields an MSFE of 19.13 but if DMS is done in the conventional manner using Google variables as regressors, the MSFE is 21.08, which is a fairly substantial deterioration. If the Google variables are simply used as regressors in a recursive OLS exercise, the MSFE deteriorates massively to 37.23. Similar results, where relevant, hold for the predictive likelihoods. In Table 2a, the best MSFE for an OLS benchmark model is 24.22 which also is much worse than DMS using Google probabilities.

Industrial Production: As with inflation, there is strong evidence that DMS leads to nowcast improvements over benchmark OLS methods. However, evidence conflicts on the best way to include Google variables. If we use only the post-2004 data, the MSFEs indicate the Google variables are best used as regressors (along with DMS methods). However, predictive likelihoods indicate that DMS with Google model probabilities nowcasts best. However, if we use data since 1973, MSFEs and predictive likelihoods both indicate that simply doing DMS using the macroeconomic variables nowcasts best. Hence, we are finding strong support for the use of DMS, but a less clear story on how or whether Google variables should be used with DMS.

Unemployment: With the post-2004 data, MSFEs indicate support for our DMS approach using Google probabilities, but predictive likelihoods indicate a preference for using the Google variables as regressors (or not at all). When using the post-1973 sample, predictive likelihoods also indicate support for DMS using Google probabilities. However, MSFEs indicate omitting the Google variables leads to the best nowcasts, with conventional DMS and recursive OLS being the winning approaches according to this metric.

Wage inflation: This is a variable for which MSFE and predictive likelihood results are in accordance. For the post-2004 sample they indicate conventional DMS, using the Google variables as regressors, is to be preferred. However, for the post-1973 sample, they indicate DMS using Google probabilities nowcasts best.

Money: The different measures of nowcast performance and sample spans also lead to a consistent story for money supply growth. In particular, DMS with Google probabilities nowcasts best, although there is some disagreement over whether $\omega = 0$ or $\frac{1}{2}$.

Financial Conditions Index: Using MSFEs, both sample spans indicate that DMS with Google data nowcasts best. Predictive likelihoods, though, show a conflict between whether the Google variables should be used as regressors (post-2004 data) or not included at all (post-1973 data).

Oil Price Inflation: For this variable, both nowcast metrics and data spans indicate DMS with $\omega = 0$ nowcasts best. This is the version of DMS which let the Google model probabilities entirely determine which model is selected at

each point in time.

Commodity Price Inflation: Using the post-2004 sample, we find the best performance using DMS with the Google variables being used as regressors. However, using the post-1973 sample we find the approaches including the Google model probabilities (either with $\omega = 0$ or $\frac{1}{2}$) to nowcast best.

Term Spread: Using the smaller post-2004 sample, we are finding that DMS using Google variables as regressors narrowly beats approaches using Google probabilities to be the best nowcasting model. However, in the longer sample, approaches which use the Google probabilities nowcast best. We note also that this is one of the few variables where a benchmark approach does well. In particular, using the post-2004 sample, an AR(2) model nowcasts quite well (although it does not beat our DMS approach).

| | LogPL | | MSFE | |
|----------------|--------------------------------------|---------|--------|--------|
| | DMA | DMS | DMA | DMS |
| | Inflation | | | |
| | Google Variables Not Used | | | |
| $\omega = 1$ | -236.73 | -235.38 | 24.95 | 23.28 |
| Rec. OLS | - | - | 30.75 | - |
| Rec. AR(2) | - | - | 24.22 | - |
| No change | - | - | 31.20 | - |
| | Google Variables Used in Model Probs | | | |
| $\omega = 0.5$ | -239.41 | -232.29 | 24.69 | 19.35 |
| $\omega = 0$ | -239.48 | -232.36 | 24.75 | 19.13 |
| | Google Variables Used as Regressors | | | |
| $\omega = 1$ | -237.64 | -233.23 | 26.28 | 21.08 |
| Rec. OLS | - | - | 37.23 | - |
| | Industrial Production | | | |
| | Google Variables Not Used | | | |
| $\omega = 1$ | -289.10 | -287.78 | 107.04 | 104.46 |
| Rec. OLS | - | - | 165.51 | - |
| Rec. AR(2) | - | - | 114.13 | - |
| No change | - | - | 113.83 | - |
| | Google Variables Used in Model Probs | | | |
| $\omega = 0.5$ | -291.74 | -286.46 | 116.96 | 110.12 |
| $\omega = 0$ | -291.94 | -284.42 | 117.49 | 109.74 |
| | Google Variables Used as Regressors | | | |
| $\omega = 1$ | -288.28 | -284.98 | 102.88 | 95.90 |
| Rec. OLS | - | - | 158.12 | - |

| Table 2b: Nowcast Performance (post-2004 data) | | | | |
|--|--------------------------------------|---------|-------|-------|
| | LogPL | | MSFE | |
| | DMA | DMS | DMA | DMS |
| | Unemployment | | | |
| | Google Variables Not Used | | | |
| $\omega = 1$ | -124.10 | -123.04 | 0.033 | 0.033 |
| Rec. OLS | - | - | 0.036 | - |
| Rec. AR(2) | - | - | 0.038 | - |
| No change | - | - | 5.44 | - |
| | Google Variables Used in Model Probs | | | |
| $\omega = 0.5$ | -133.75 | -127.30 | 0.032 | 0.033 |
| $\omega = 0$ | -134.41 | -128.38 | 0.032 | 0.035 |
| | Google Variables Used as Regressors | | | |
| $\omega = 1$ | -127.91 | -123.04 | 0.034 | 0.033 |
| Rec. OLS | - | - | 0.047 | - |
| | Wage Inflation | | | |
| | Google Variables Not Used | | | |
| $\omega = 1$ | -192.95 | -190.10 | 6.52 | 5.77 |
| Rec. OLS | - | - | 9.78 | - |
| Rec. AR(2) | - | - | 6.83 | - |
| No change | - | - | 6.15 | - |
| | Google Variables Used in Model Probs | | | |
| $\omega = 0.5$ | -197.80 | -194.11 | 7.16 | 5.71 |
| $\omega = 0$ | -198.02 | -194.49 | 7.17 | 5.89 |
| | Google Variables Used as Regressors | | | |
| $\omega = 1$ | -195.25 | -189.50 | 6.72 | 5.53 |
| Rec. OLS | - | - | 11.48 | - |

| Table 2c: Nowcast Performance (post-2004 data) | | | | |
|--|--------------------------------------|---------|-------|-------|
| | LogPL | | MSFE | |
| | DMA | DMS | DMA | DMS |
| | Money | | | |
| | Google Variables Not Used | | | |
| $\omega = 1$ | -245.69 | -244.53 | 30.02 | 29.71 |
| Rec. OLS | - | - | 33.50 | - |
| Rec. AR(2) | - | - | 28.99 | - |
| No change | - | - | 28.69 | - |
| | Google Variables Used in Model Probs | | | |
| $\omega = 0.5$ | -249.97 | -242.72 | 29.28 | 27.34 |
| $\omega = 0$ | -250.81 | -243.97 | 29.75 | 26.07 |
| | Google Variables Used as Regressors | | | |
| $\omega = 1$ | -247.07 | -242.90 | 31.20 | 28.12 |
| Rec. OLS | - | - | 42.77 | - |
| | FCI | | | |
| | Google Variables Not Used | | | |
| $\omega = 1$ | -53.22 | -53.64 | 0.29 | 0.29 |
| Rec. OLS | - | - | 0.30 | - |
| Rec. AR(2) | - | - | 0.32 | - |
| No change | - | - | 0.45 | - |
| | Google Variables Used in Model Probs | | | |
| $\omega = 0.5$ | -58.92 | -53.29 | 0.28 | 0.21 |
| $\omega = 0$ | -59.56 | -54.56 | 0.28 | 0.21 |
| | Google Variables Used as Regressors | | | |
| $\omega = 1$ | -55.51 | -51.56 | 0.32 | 0.26 |
| Rec. OLS | - | - | 0.48 | - |

| Table 2d: Nowcast Performance (post-2004 data) | | | | |
|--|---------|---------|--------|--------|
| | LogPL | | MSFE | |
| | DMA | DMS | DMA | DMS |
| Oil Price Inflation | | | | |
| Google Variables Not Used | | | | |
| $\omega = 1$ | -484.51 | -479.54 | 13,219 | 10,407 |
| Rec. OLS | - | - | 17,465 | - |
| Rec. AR(2) | - | - | 11,253 | - |
| No change | - | - | 12,185 | - |
| Google Variables Used in Model Probs | | | | |
| $\omega = 0.5$ | -481.39 | -475.00 | 11,678 | 8,961 |
| $\omega = 0$ | -481.60 | -474.71 | 11,857 | 8,555 |
| Google Variables Used as Regressors | | | | |
| $\omega = 1$ | -484.63 | -479.72 | 13,241 | 10,415 |
| Rec. OLS | - | - | 29,333 | - |
| Commodity Price Inflation | | | | |
| Google Variables Not Used | | | | |
| $\omega = 1$ | -429.24 | -425.50 | 3,115 | 2,706 |
| Rec. OLS | - | - | 3,925 | - |
| Rec. AR(2) | - | - | 2,950 | - |
| No change | - | - | 3,254 | - |
| Google Variables Used in Model Probs | | | | |
| $\omega = 0.5$ | -429.74 | -427.97 | 3,169 | 2,964 |
| $\omega = 0$ | -429.85 | -428.49 | 3,168 | 2,986 |
| Google Variables Used as Regressors | | | | |
| $\omega = 1$ | -429.23 | -424.71 | 3,120 | 2,635 |
| Rec. OLS | - | - | 5,193 | - |
| Table 2e: Nowcast Performance (post-2004 data) | | | | |
| | LogPL | | MSFE | |
| | DMA | DMS | DMA | DMS |
| Term Spread | | | | |
| Google Variables Not Used | | | | |
| $\omega = 1$ | -87.68 | -86.67 | 0.072 | 0.072 |
| Rec. OLS | - | - | 0.092 | - |
| Rec. AR(2) | - | - | 0.068 | - |
| No change | - | - | 1.476 | - |
| Google Variables Used in Model Probs | | | | |
| $\omega = 0.5$ | -99.42 | -91.28 | 0.069 | 0.081 |
| $\omega = 0$ | -100.53 | -93.32 | 0.069 | 0.091 |
| Google Variables Used as Regressors | | | | |
| $\omega = 1$ | -91.44 | -86.67 | 0.068 | 0.072 |
| Rec. OLS | - | - | 0.103 | - |

| Table 3a: Nowcast Performance (data since 1973) | | | | |
|---|--------------------------------------|---------|--------|-------|
| | LogPL | | MSFE | |
| | DMA | DMS | DMA | DMS |
| | Inflation | | | |
| | Google Variables Not Used | | | |
| $\omega = 1$ | -293.11 | -291.56 | 20.39 | 19.39 |
| Rec. OLS | - | - | 22.80 | - |
| Rec. AR(2) | - | - | 24.16 | - |
| No change | - | - | 34.10 | - |
| | Google Variables Used in Model Probs | | | |
| $\omega = 0.5$ | -293.71 | -290.95 | 20.42 | 18.74 |
| $\omega = 0$ | -293.73 | -291.71 | 20.42 | 19.09 |
| | Industrial Production | | | |
| | Google Variables Not Used | | | |
| $\omega = 1$ | -363.09 | -360.27 | 94.88 | 88.38 |
| Rec. OLS | - | - | 90.43 | - |
| Rec. AR(2) | - | - | 90.38 | - |
| No change | - | - | 104.35 | - |
| | Google Variables Used in Model Probs | | | |
| $\omega = 0.5$ | -362.54 | -361.41 | 94.79 | 93.11 |
| $\omega = 0$ | -362.59 | -361.04 | 94.92 | 92.61 |
| Table 3b: Nowcast Performance (data since 1973) | | | | |
| | LogPL | | MSFE | |
| | DMA | DMS | DMA | DMS |
| | Unemployment | | | |
| | Google Variables Not Used | | | |
| $\omega = 1$ | 48.28 | 50.83 | 0.027 | 0.025 |
| Rec. OLS | - | - | 0.025 | - |
| Rec. AR(2) | - | - | 0.030 | - |
| No change | - | - | 4.408 | - |
| | Google Variables Used in Model Probs | | | |
| $\omega = 0.5$ | 45.85 | 46.19 | 0.029 | 0.028 |
| $\omega = 0$ | 45.51 | 46.15 | 0.029 | 0.028 |
| | Wage Inflation | | | |
| | Google Variables Not Used | | | |
| $\omega = 1$ | -232.99 | -229.57 | 6.06 | 5.44 |
| Rec. OLS | - | - | 9.30 | - |
| Rec. AR(2) | - | - | 7.71 | - |
| No change | - | - | 10.41 | - |
| | Google Variables Used in Model Probs | | | |
| $\omega = 0.5$ | -233.69 | -230.94 | 6.16 | 5.42 |
| $\omega = 0$ | -233.77 | -230.37 | 6.13 | 5.39 |

| Table 3c: Nowcast Performance (post-2004 data) | | | | |
|--|--------------------------------------|---------|--------|-------|
| | LogPL | | MSFE | |
| | DMA | DMS | DMA | DMS |
| | Money | | | |
| | Google Variables Not Used | | | |
| $\omega = 1$ | -294.56 | -293.57 | 23.46 | 22.73 |
| Rec. OLS | - | - | 23.02 | - |
| Rec. AR(2) | - | - | 23.34 | - |
| No change | - | - | 24.16 | - |
| | Google Variables Used in Model Probs | | | |
| $\omega = 0.5$ | -293.99 | -290.76 | 22.97 | 20.38 |
| $\omega = 0$ | -294.11 | -291.24 | 23.07 | 20.92 |
| | FCI | | | |
| | Google Variables Not Used | | | |
| $\omega = 1$ | -28.63 | -28.02 | 0.17 | 0.17 |
| Rec. OLS | - | - | 0.18 | - |
| Rec. AR(2) | - | - | 0.20 | - |
| No change | - | - | 0.36 | - |
| | Google Variables Used in Model Probs | | | |
| $\omega = 0.5$ | -31.71 | -31.17 | 0.18 | 0.16 |
| $\omega = 0$ | -31.70 | -31.15 | 0.18 | 0.16 |
| Table 3d: Nowcast Performance (post-2004 data) | | | | |
| | LogPL | | MSFE | |
| | DMA | DMS | DMA | DMS |
| | Oil Price Inflation | | | |
| | Google Variables Not Used | | | |
| $\omega = 1$ | -610.18 | -608.20 | 10,443 | 9,836 |
| Rec. OLS | - | - | 10,468 | - |
| Rec. AR(2) | - | - | 9,740 | - |
| No change | - | - | 10,957 | - |
| | Google Variables Used in Model Probs | | | |
| $\omega = 0.5$ | -609.54 | -607.24 | 10,210 | 9,269 |
| $\omega = 0$ | -609.63 | -606.73 | 10,230 | 9,064 |
| | Commodity Price Inflation | | | |
| | Google Variables Not Used | | | |
| $\omega = 1$ | -531.01 | -528.20 | 2,230 | 2,080 |
| Rec. OLS | - | - | 2,198 | - |
| Rec. AR(2) | - | - | 2,200 | - |
| No change | - | - | 2,710 | - |
| | Google Variables Used in Model Probs | | | |
| $\omega = 0.5$ | -529.57 | -528.19 | 2,230 | 2,079 |
| $\omega = 0$ | -529.64 | -527.63 | 2,235 | 2,084 |

| | LogPL | | MSFE | |
|----------------|--------------------------------------|-------|-------|-------|
| | DMA | DMS | DMA | DMS |
| | Term Spread | | | |
| | Google Variables Not Used | | | |
| $\omega = 1$ | 2.980 | 6.239 | 0.062 | 0.056 |
| Rec. OLS | - | - | 0.109 | - |
| Rec. AR(2) | - | - | 0.083 | - |
| No change | - | - | 1.382 | - |
| | Google Variables Used in Model Probs | | | |
| $\omega = 0.5$ | 2.374 | 6.785 | 0.062 | 0.053 |
| $\omega = 0$ | 2.484 | 6.754 | 0.061 | 0.052 |

5 Further Discussion and Conclusions

The preceding discussion reveals a wide variety of findings. The following main conclusions emerge:

- First, the inclusion of Google data leads to sizeable improvements in nowcast performance. This result complements the existing literature by showing that Google search variables are not only useful when dealing with specific disaggregate variables, but can be used to improve nowcasting of broad macroeconomic aggregates.
- Second, and despite the crude procedure we adopted to create the Google variables, we also find that it is often (albeit not invariably) the case that the information in the Google variables is best included in the form of model probabilities as opposed to simply including Google variables as regressors. The intuition that Google search volumes may provide the econometrician with useful information about which variable is important at each point in time opens the way to a new and more extensive use of this vast database.
- Finally, Google probabilities make sense in a context where the economy is not constant, and are therefore particularly suited to deal with the recent crisis. However, their potential must be exploited with opportune techniques allowing for model change and parsimony. We compared different techniques responding to such requirements. DMS proved to be a particularly good method for improving nowcast performance in the models we are dealing with, leading to substantial improvements over common benchmarks. It is also worth noting that DMS is a strategy which often nowcasts best, but even when it does not it does not go too far wrong. Our simple benchmarks, using OLS methods, sometimes also provide reasonable nowcasts but occasionally produce very bad nowcasts.

This is a first and so far successful attempt to use Google variables to improve macroeconomic nowcasting. We proposed two different uses of these variables,

one of which, to our knowledge, completely new and close to the spirit (“what are people concerned about?”) in which these variables are collected. Additional research will be needed to make these results more robust. Our construction of the Google variables, in particular, is extremely simple, and it is not unlikely that a more accurate choice in the searches or a different method of averaging may lead to further improvements in their use.

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Appendix: Google Search Terms

The following tables list the google search terms we use along with the macroeconomic variable each corresponds to.

| Table A1: Categorization of Google Search Terms | |
|--|----------------------------|
| Google search term | Category |
| steel price | Commodity Price Inflation |
| food price | Commodity Price Inflation |
| copper price | Commodity Price Inflation |
| stock compensation | Financial Conditions Index |
| investment banking | Financial Conditions Index |
| growth equity | Financial Conditions Index |
| goldman sachs | Financial Conditions Index |
| equity compensation | Financial Conditions Index |
| us gdp growth | Industrial Production |
| urban growth | Industrial Production |
| the great depression | Industrial Production |
| tax calculator | Industrial Production |
| small business growth | Industrial Production |
| sales growth | Industrial Production |
| sales compensation | Industrial Production |
| revenue growth | Industrial Production |
| recession | Industrial Production |
| recession inflation | Industrial Production |
| market growth | Industrial Production |
| growth | Industrial Production |
| growth industries | Industrial Production |
| growth financial | Industrial Production |
| growth company | Industrial Production |
| growth companies | Industrial Production |
| great depression | Industrial Production |
| great depression deflation | Industrial Production |
| gdp growth | Industrial Production |
| economy | Industrial Production |

| Table A2: Categorization of Google Search Terms | |
|--|-----------------------|
| Google search term | Category |
| economic growth | Industrial Production |
| cycle | Industrial Production |
| crisis | Industrial Production |
| business growth | Industrial Production |
| business cycle | Industrial Production |
| what is inflation | Inflation |
| what is deflation | Inflation |
| us inflation | Inflation |
| us inflation rates | Inflation |
| us inflation rate | Inflation |
| us inflation index | Inflation |
| us deflation | Inflation |
| united states inflation | Inflation |
| u.s. inflation | Inflation |
| real inflation | Inflation |
| rate of inflation | Inflation |
| price inflation | Inflation |
| price index | Inflation |
| national inflation | Inflation |
| investing deflation | Inflation |
| inflation | Inflation |
| inflation usa | Inflation |
| inflation stocks | Inflation |
| inflation rates | Inflation |
| inflation rate | Inflation |
| inflation or deflation | Inflation |
| inflation money | Inflation |
| inflation index | Inflation |

| Table A3: Categorization of Google Search Terms | |
|--|-----------------|
| Google search term | Category |
| inflation in us | Inflation |
| inflation graph | Inflation |
| inflation forecast | Inflation |
| inflation deflation | Inflation |
| inflation definition | Inflation |
| inflation data | Inflation |
| inflation chart | Inflation |
| inflation calculator | Inflation |
| inflation and deflation | Inflation |
| india inflation | Inflation |
| historical inflation | Inflation |
| high inflation | Inflation |
| fed deflation | Inflation |
| economic inflation | Inflation |
| economic deflation | Inflation |
| depression deflation | Inflation |
| deflation | Inflation |
| deflation rate | Inflation |
| deflation interest rates | Inflation |
| deflation in us | Inflation |
| deflation gold | Inflation |
| deflation economy | Inflation |
| definition inflation | Inflation |
| definition deflation | Inflation |
| define inflation | Inflation |
| debt deflation | Inflation |
| current inflation | Inflation |
| current inflation rate | Inflation |

| Google search term | Category |
|---------------------------|-----------------------|
| cpi | Inflation |
| cpi index | Inflation |
| cost of inflation | Inflation |
| consumer price index | Inflation |
| money | Money Supply |
| money deflation | Money Supply |
| monetary policy | Money Supply |
| monetary deflation | Money Supply |
| oil production | Oil Price Inflation |
| oil prices | Oil Price Inflation |
| oil price | Oil Price Inflation |
| gasoline price | Oil Price Inflation |
| gas price | Oil Price Inflation |
| energy production | Oil Price Inflation |
| energy price | Oil Price Inflation |
| electricity price | Oil Price Inflation |
| diesel price | Oil Price Inflation |
| production | Industrial Production |
| production jobs | Industrial Production |
| production company | Industrial Production |
| production companies | Industrial Production |
| us interest rate | Term Spread |
| the fed | Term Spread |
| real interest rate | Term Spread |
| prime rate | Term Spread |
| prime interest rate | Term Spread |
| mortgage rate | Term Spread |
| mortgage interest rates | Term Spread |

| Google search term | Category |
|---------------------------|-----------------|
| lower interest rate | Term Spread |
| libor | Term Spread |
| libor rate | Term Spread |
| libor interest rate | Term Spread |
| interest rates | Term Spread |
| interest rates inflation | Term Spread |
| interest rate | Term Spread |
| interest rate trends | Term Spread |
| interest rate risk | Term Spread |
| interest rate reduction | Term Spread |
| interest rate predictions | Term Spread |
| interest rate news | Term Spread |
| interest rate mortgage | Term Spread |
| interest rate model | Term Spread |
| interest rate inflation | Term Spread |
| interest rate history | Term Spread |
| interest rate forecast | Term Spread |
| interest rate fed | Term Spread |
| interest rate drop | Term Spread |
| interest rate cuts | Term Spread |
| interest rate cut | Term Spread |
| interest rate chart | Term Spread |
| interest rate calculator | Term Spread |
| feds interest rate | Term Spread |
| federal reserve | Term Spread |
| federal interest rate | Term Spread |
| fed | Term Spread |
| fed rates | Term Spread |

| Google search term | Category |
|-------------------------------|-------------------|
| fed rate | Term Spread |
| fed rate cut | Term Spread |
| fed interest rates | Term Spread |
| fed interest rate | Term Spread |
| fed cut | Term Spread |
| discount rate | Term Spread |
| current interest rate | Term Spread |
| washington unemployment | Unemployment Rate |
| us unemployment | Unemployment Rate |
| us unemployment rate | Unemployment Rate |
| unemployment | Unemployment Rate |
| unemployment statistics | Unemployment Rate |
| unemployment rates | Unemployment Rate |
| unemployment rate | Unemployment Rate |
| unemployment pa | Unemployment Rate |
| unemployment office | Unemployment Rate |
| unemployment michigan | Unemployment Rate |
| unemployment insurance | Unemployment Rate |
| unemployment great depression | Unemployment Rate |
| unemployment extension | Unemployment Rate |
| unemployment depression | Unemployment Rate |
| unemployment checks | Unemployment Rate |
| unemployment check | Unemployment Rate |
| unemployment benefits | Unemployment Rate |
| texas unemployment | Unemployment Rate |
| subsidies | Unemployment Rate |
| state compensation fund | Unemployment Rate |
| oregon unemployment | Unemployment Rate |

| Table A7: Categorization of Google Search Terms | |
|--|-------------------|
| Google search term | Category |
| ohio unemployment | Unemployment Rate |
| ny unemployment | Unemployment Rate |
| nj unemployment | Unemployment Rate |
| new york unemployment | Unemployment Rate |
| michigan works | Unemployment Rate |
| michigan works unemployment | Unemployment Rate |
| michigan state unemployment | Unemployment Rate |
| marvin unemployment | Unemployment Rate |
| marvin michigan unemployment | Unemployment Rate |
| job growth | Unemployment Rate |
| florida unemployment | Unemployment Rate |
| federal unemployment | Unemployment Rate |
| employee benefits | Unemployment Rate |
| depression unemployment rate | Unemployment Rate |
| compensation packages | Unemployment Rate |
| compensation package | Unemployment Rate |
| california unemployment | Unemployment Rate |
| workers compensation | Wage Inflation |
| workers compensation ohio | Wage Inflation |
| workers compensation insurance | Wage Inflation |
| what is compensation | Wage Inflation |
| walmart wages | Wage Inflation |
| wages | Wage Inflation |
| wages calculator | Wage Inflation |
| wage | Wage Inflation |
| wage inflation | Wage Inflation |
| vice president salary | Wage Inflation |
| us wages | Wage Inflation |

#

| Google search term | Category |
|---------------------------|-----------------|
| unpaid wages | Wage Inflation |
| union wages | Wage Inflation |
| total compensation | Wage Inflation |
| state wages | Wage Inflation |
| state employee wages | Wage Inflation |
| salary | Wage Inflation |
| salary tax calculator | Wage Inflation |
| salary survey | Wage Inflation |
| salary schedule | Wage Inflation |
| salary requirements | Wage Inflation |
| salary raise | Wage Inflation |
| salary grade | Wage Inflation |
| salary comparison | Wage Inflation |
| salary calculator hourly | Wage Inflation |
| salaries | Wage Inflation |
| real wages | Wage Inflation |
| project manager salary | Wage Inflation |
| pilot salary | Wage Inflation |
| paycheck calculator | Wage Inflation |
| nfl salary | Wage Inflation |
| nfl minimum salary | Wage Inflation |
| minimum wages | Wage Inflation |
| labor wages | Wage Inflation |
| labor and wages | Wage Inflation |
| job wages | Wage Inflation |
| investment banking salary | Wage Inflation |
| incentive compensation | Wage Inflation |
| human resources salary | Wage Inflation |

| Table A9: Categorization of Google Search Terms | |
|--|-----------------|
| Google search term | Category |
| human resources compensation | Wage Inflation |
| hr compensation | Wage Inflation |
| hourly wages | Wage Inflation |
| gross wages | Wage Inflation |
| gross salary | Wage Inflation |
| federal wages | Wage Inflation |
| federal salary | Wage Inflation |
| executive compensation | Wage Inflation |
| employment wages | Wage Inflation |
| employee wages | Wage Inflation |
| employee compensation | Wage Inflation |
| director compensation | Wage Inflation |
| deferred compensation | Wage Inflation |
| compensation | Wage Inflation |
| compensation time | Wage Inflation |
| compensation system | Wage Inflation |
| compensation structure | Wage Inflation |
| compensation resources | Wage Inflation |
| compensation plans | Wage Inflation |
| compensation plan | Wage Inflation |
| compensation manager | Wage Inflation |
| compensation consulting | Wage Inflation |
| compensation analyst | Wage Inflation |
| china wages | Wage Inflation |
| ceo salary | Wage Inflation |
| ceo compensation | Wage Inflation |
| calculate salary | Wage Inflation |
| bonus compensation | Wage Inflation |
| benefits and compensation | Wage Inflation |
| average wages | Wage Inflation |
| average salary | Wage Inflation |
| average nfl salary | Wage Inflation |
| annual compensation | Wage Inflation |