Bayesian Forecast Combination for Inflation Using Rolling Windows: An Emerging Country Case

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AUTHOR OR EDITOR Luis Fernando Melo, Rubén Albeiro Loaiza AUTHORS AND/OR EDITORS Rubén Albeiro Loaiza

Typically, when forecasting inflation rates, there are a variety of individual models and a combination of several of these models. We implement a Bayesian shrinkage combination methodology to include information that is not captured by the individual models using expert forecasts as prior information. To take into account two common characteristics in emerging countries' economies, possible parameter instabilities and non-stationary dynamics, we use a rolling estimation windows technique for series integrated of order one. The empirical results of Colombian inflation show that the Bayesian forecast combination model outperforms the individual models and the random walk predictions for every evaluated forecast horizon. Moreover, these results outperform shrinkage forecasts that consider other priors as equal or zero weights.