Working Paper No. 853

Keep in mind

The series Working Papers on Economics is published by the Office for Economic Studies at the *Banco de la República* (Central Bank of *Colombia*). It contributes to the dissemination and promotion of the work by researchers from the institution. This series is indexed at Research Papers in Economics (RePEc).

On multiple occasions, these works have been the result of collaborative work with individuals from other national or international institutions. The works published are provisional, and their authors are fully responsible for the opinions expressed in them, as well as for possible mistakes. The opinions expressed herein are those of the authors and do not necessarily reflect the views of Banco de la República or its Board of Directors.

AUTHORS AND/OR EDITORS

Melo-Velandia, Luis Fernando

Rubén A. Loaiza

Villamizar-Villegas, Mauricio

Typically, central banks use a variety of individual models (or a combination of models) when forecasting inflation rates. Most of these require excessive amounts of data, time, and computational power; all of which are scarce when monetary authorities meet to decide over policy interventions. In this paper we use a rolling Bayesian combination technique that considers inflation estimates by the staff of the Central Bank of Colombia during 2002-2011 as prior information. Our results show that: 1) the accuracy of individual models is improved by using a Bayesian shrinkage methodology, and 2) priors consisting of staff's estimates outperform all other priors that comprise equal or zero-vector weights. Consequently, our model provides readily available forecasts that exceed all individual models in terms of forecasting accuracy at every evaluated horizon.