

ASSESSING THE IMPACT OF SHORT-TERM SHOCKS TO INFLATION FORECASTS

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Abstract

The accuracy and reliability of forecasting models are fundamental to policymaking. However, unexpected and extraordinary events may occur at certain time points which can exert a degree of influence to the forecast. Thus, it is important to identify these shocks and account properly their effects on the underlying structure of the data. We fit appropriate structural and nonstructural models with pulse function to account for random shocks. We also used the robust estimation procedure for time series models in the presence of structural change developed by Campano and Barrios (2011). Model fit and forecast accuracy improved when the impact of the temporary shock is taken into account. The robust estimation procedure generates forecasts that are comparable to intervention models but allows forecasting without *a priori* knowledge on the time of the occurrence of temporary shock. The robust estimation procedure further yield superior out-of-sample predictive ability.

Keywords: inflation forecasts, time series, intervention models, AR-sieve bootstrap, robust estimation procedure