

OPTIMAL COMBINATION OF FORECASTS

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ABSTRACT

The combination of two competing forecasts is recommended as an alternative to choosing one and discarding the other. Optimality of the combined forecast in terms of unbiasedness and minimum mean square error of prediction is discussed. Estimation of the optimal combined forecast is done for the case when the competing forecasts are generated by regression models and for the case when the models generating the competing forecasts are unknown. The combination of quarterly and monthly forecasts is considered as a special case. Data analyses involving forecasting Consumer Price Index in the Philippines are used to numerically illustrate the advantage of using combined forecasts.