An evaluation of AIR forecast for Norwegian core inflation for the period 2004(2)-2006(3).

Automatized econometric inflation forecasts have been published two times a year, starting in July 2004. The purpose is to provide an econometrically based alternative to the official forecasts in Norges Bank’s Inflation Reports. The forecasts are automatized, with a minimum of intervention after the econometric specification of the forecasting mechanism is finished. Therefore these econometrically based forecasts have been dubbed Automatized Inflation Reports forecasts (AIR for short).

Nymoen (2005) gives an evaluation of how the forecasting model underlying AIR performs relative to Norges Bank’s inflation forecasts in 2002 and 2003. Here, we evaluate the true ex-ante forecasts based on forecast errors for the period 2004(2)-2006(3).

Figure 1, upper panel, shows that the bias of the AIR one quarter ahead forecasts is small and practically identical to the IR forecasts. The average AIR biases are also low for 2, 3 and 4 quarters ahead forecasts. In comparison, Norges Bank’s IR forecasts are markedly biased---the 4 quarter forecast are on average 0.75 percentage points too high compared to actual inflation in the period 2004(2)-2006(3).

Figure 1: First panel: Mean forecast errors, MFE, for core inflation (annual rate of change in CPI-ATE). Inflation report forecast in red, and AIR forecast in blue. Second panel: Mean squared forecast errors, MSFE. Source: Inflation Reports 2/04 - 2/06 and AIRs published at http://folk.uio.no/rnymoen/forecast_air_index.html
The biases of the AIR forecasts become markedly bigger for forecasts of length 5 and 6, and for the two longest horizons we have one large and one small bias. The biases in Norges Bank’s forecasts are larger than the AIR biases, with the exception of the 7 quarter horizon where the two biases are identical.

The second panel shows the mean squared forecast errors, MSFE, to which large forecast errors contribute relatively more than small errors. Based on this measure, the AIR are slightly worse than the IR for 1 quarter ahead forecasts. For the other horizons, the picture is more or less the same as in the first panel.

This evaluation of AIR forecasts will be updated in January 2007.

Earlier evaluation of AIR: September.