A first evaluation of AIR forecast for Norwegian core inflation, September 2006

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 Banks’s Inflation Reports. The forecasts are automatized, with a minimum of intervention after the specification of the forecasting mechanism is finished. Therefore the 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 bases on forecast errors for the period 2004q2-2006q2.

Figure 1 shows first that the bias for the annual rate of inflation in the AIR forecasts is less than 0.1 percentage point for 1 to 4 quarter forecasts. The average bias is somewhat larger for forecasts of length 5 and 6, and for the two longest horizons we have one large and one small bias (but only AIR 1/04 covers this horizon). The bias in Norges Bank’s forecasts is larger than the AIR biases, even for 1-period-ahead forecasts. For most of the other horizons, the IR biases are much bigger than the corresponding AIR biases.

*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](http://folk.uio.no/rnymoen/forecast_air_index.html)
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 AIRs are slightly worse than the IRs for 1 quarters ahead forecasts. However, for all other horizons also the MSFE favours the AIR as the more accurate set of forecasts.

This evaluation of AIR forecasts will be updated in October 2006.