

Prediction of inflation based on high dimensional time series

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Abstract

Forecasting of macroeconomic variables has for many years been done by models with quite few variables. Today we have many different time series that can contain relevant information. In this paper we want to forecast one series using many predictor time series. We will do this by applying the dynamic factor model with the factors estimated by principal component analysis. To forecast the inflation in Sweden we use 39 yearly macroeconomic time series for 1991-2013. We find that three estimated factors can make a good prediction.

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