

A MARKUP MODEL FOR FORECASTING INFLATION FOR THE EURO AREA

Bill Russell

Anindya Banerjee

ABSTRACT

We develop a small model for forecasting inflation for the Euro area using quarterly data over the period June 1973 to March 1999. The model is used to provide inflation forecasts from June 1999 to March 2002. We compare the forecasts from our model with those derived from six competing forecasting models, including autoregressions, vector autoregressions and Phillips-curve based models. A considerable gain in forecasting performance is demonstrated using a relative root mean squared error criterion and the Diebold-Mariano test to make forecast comparisons.

Keywords: Inflation, prices, markup, business cycle, cointegration, forecasting

JEL Classification: C22, C32, C52, D40, E31, E32