

"Assessing the Probability of an Inflation Target Breach with DSGE and VAR Models"

Kirdan Lees, Reserve Bank of New Zealand;
James Mitchell, National Institute of Economic and Social Research;
Shaun Vahey, Norges Bank and Reserve Bank of New Zealand

In this paper, we analyze and compare the forecasting performance of DSGE and VAR models. We evaluate out-of-sample forecasts from the perspective of a monetary policymaker interested in the probability of an inflation target breach. We show that model combination based on out-of-sample forecast performance provides reasonable post-data probabilities using real-time New Zealand data.