

ABSTRACT

This study attempts to outline the practical steps which need to be undertaken to use autoregressive integrated moving average (ARIMA) time series models for forecasting Pakistan's inflation. A framework for ARIMA forecasting is drawn up. It considers two alternative approaches to the issue of identifying ARIMA models, the Box Jenkins approach and other selection criteria approach. On the basis of in-sample and out-of-sample forecast it can be concluded that the model has sufficient predictive powers and the findings are well in line with those of other studies.

Further, in this study, the main focus is to forecast the monthly inflation rate on short-term basis in order to provide policy makers a systematic forecast for the inflation rate which would be helpful whether you are an individual investor or simply someone who is trying to estimate future costs and spending and also State Bank of Pakistan (SBP) to take appropriate measures in deciding the changes that need to be made to the interest rates as well as by investors when trying to predict the future price of securities.

The aim is to determine the more accurate inflation rate predictions, for this purpose, different ARIMA models are used and better models are given. On the basis of different criteria two best (candidate) models are selected (with and without introducing dummy variable) for the short term forecasting of inflation.