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# FORECASTING

## PRINCIPLES AND PRACTICE

A comprehensive introduction to the latest forecasting methods using R. Learn to improve your forecast accuracy using dozens of real data examples.



3RD EDITION

 **OTexts**  
Open Texts Publishing

## 7. Time series regression models

### 7.8 Correlation, causation and forecasting

[OTexts.org/fpp3/](http://OTexts.org/fpp3/)

# Correlation is not causation

- When  $x$  is useful for predicting  $y$ , it is not necessarily causing  $y$ .
- e.g., predict number of drownings  $y$  using number of ice-creams sold  $x$ .
- Correlations are useful for forecasting, even when there is no causality.
- Better models usually involve causal relationships (e.g., temperature  $x$  and people  $z$  to predict drownings  $y$ ).

# Multicollinearity

In regression analysis, multicollinearity occurs when:

- Two predictors are highly correlated (i.e., the correlation between them is close to  $\pm 1$ ).
- A linear combination of some of the predictors is highly correlated with another predictor.
- A linear combination of one subset of predictors is highly correlated with a linear combination of another subset of predictors.

# Multicollinearity

If multicollinearity exists...

- the numerical estimates of coefficients may be wrong (worse in Excel than in a statistics package)
- don't rely on the  $p$ -values to determine significance.
- there is no problem with model *predictions* provided the predictors used for forecasting are within the range used for fitting.
- omitting variables can help.
- combining variables can help.