

ETC3550/ETC5550

Applied forecasting

Ch9. ARIMA models

OTexts.org/fpp3/



Outline

- 1 Stationarity and differencing
- 2 Non-seasonal ARIMA models
- 3 Estimation and order selection
- 4 ARIMA modelling in R
- 5 Forecasting
- 6 Seasonal ARIMA models
- 7 ARIMA vs ETS

ARIMA models

AR: autoregressive (lagged observations as inputs)

I: integrated (differencing to make series stationary)

MA: moving average (lagged errors as inputs)

ARIMA models

AR: autoregressive (lagged observations as inputs)

I: integrated (differencing to make series stationary)

MA: moving average (lagged errors as inputs)

An ARIMA model is rarely interpretable in terms of visible data structures like trend and seasonality. But it can capture a huge range of time series patterns.

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Stationarity

Definition

If $\{y_t\}$ is a stationary time series, then for all s , the distribution of (y_t, \dots, y_{t+s}) does not depend on t .

Stationarity

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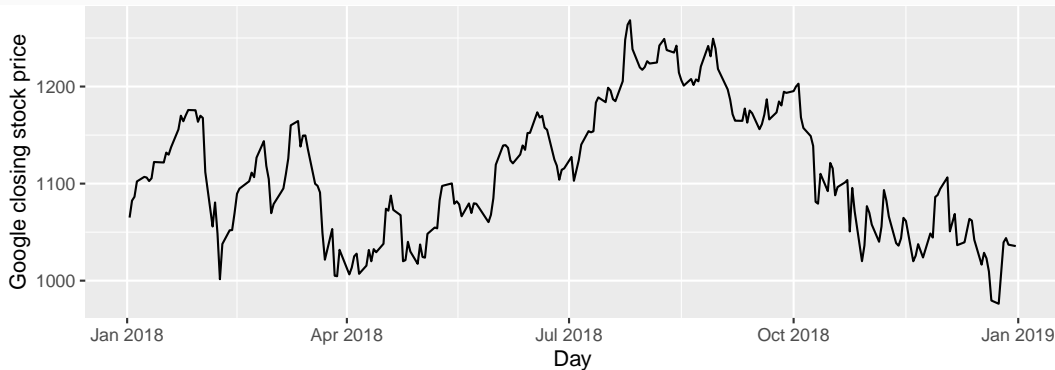
If $\{y_t\}$ is a stationary time series, then for all s , the distribution of (y_t, \dots, y_{t+s}) does not depend on t .

A **stationary series** is:

- roughly horizontal
- constant variance
- no patterns predictable in the long-term

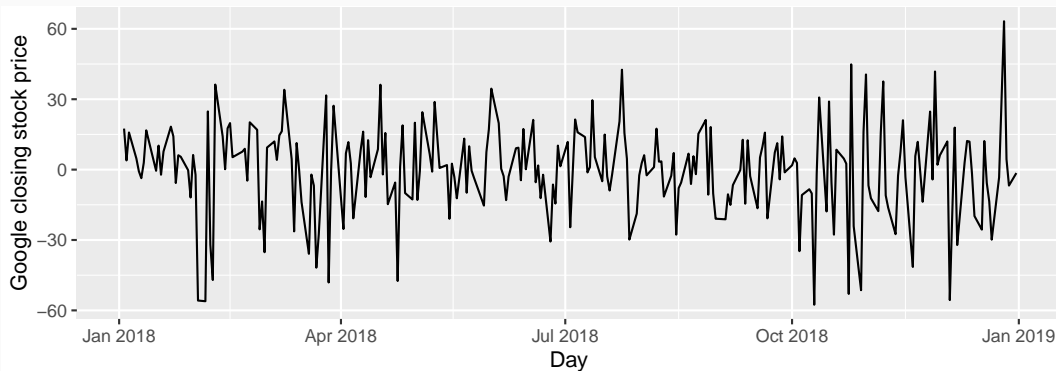
Stationary?

```
gafa_stock %>%  
  filter(Symbol == "GOOG", year(Date) == 2018) %>%  
  autoplot(Close) +  
  labs(y = "Google closing stock price", x = "Day")
```



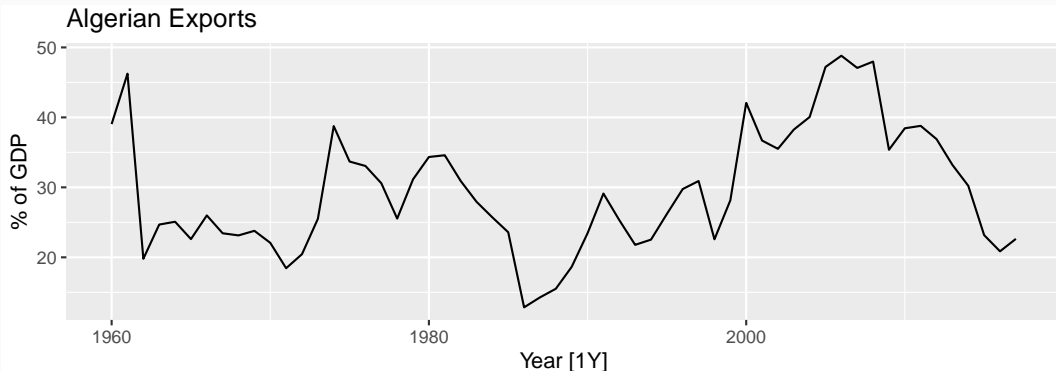
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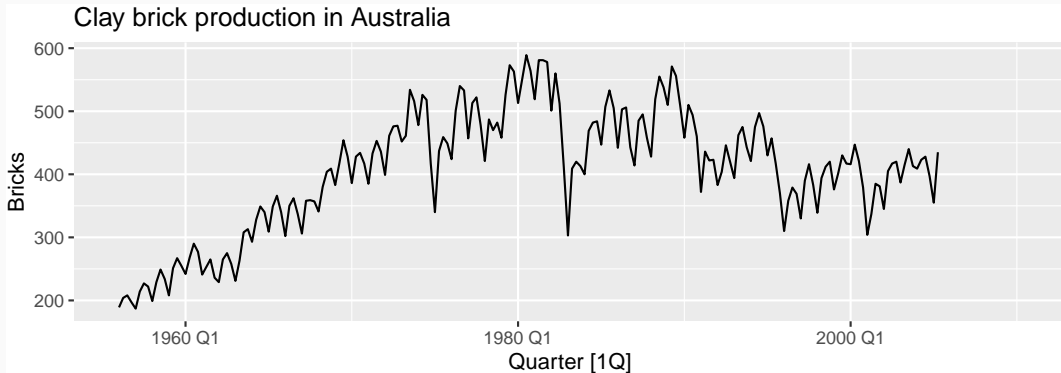
Stationary?

```
global_economy %>%  
  filter(Country == "Algeria") %>%  
  autoplot(Exports) +  
  labs(y = "% of GDP", title = "Algerian Exports")
```



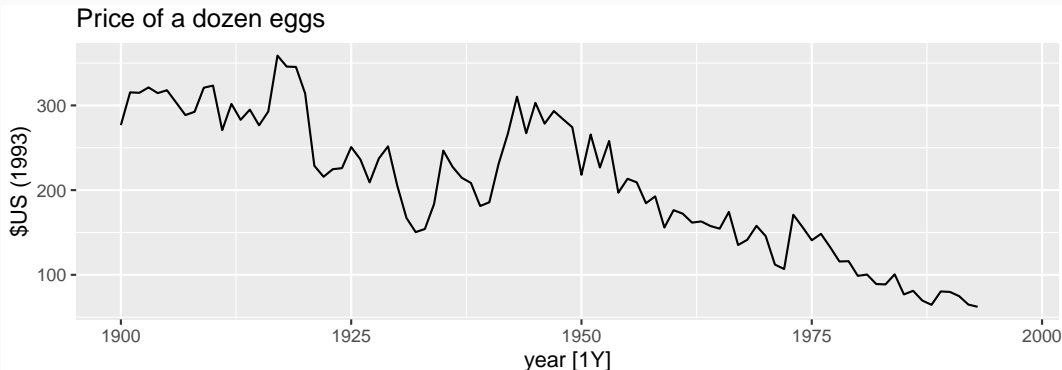
Stationary?

```
aus_production %>%  
  autoplot(Bricks) +  
  labs(title = "Clay brick production in Australia")
```



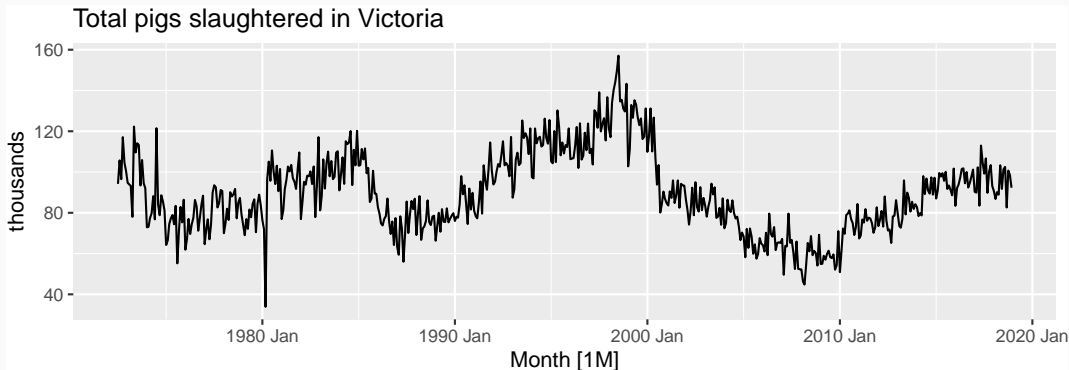
Stationary?

```
prices %>%  
  filter(year >= 1900) %>%  
  autoplot(eggs) +  
  labs(y="$US (1993)", title="Price of a dozen eggs")
```



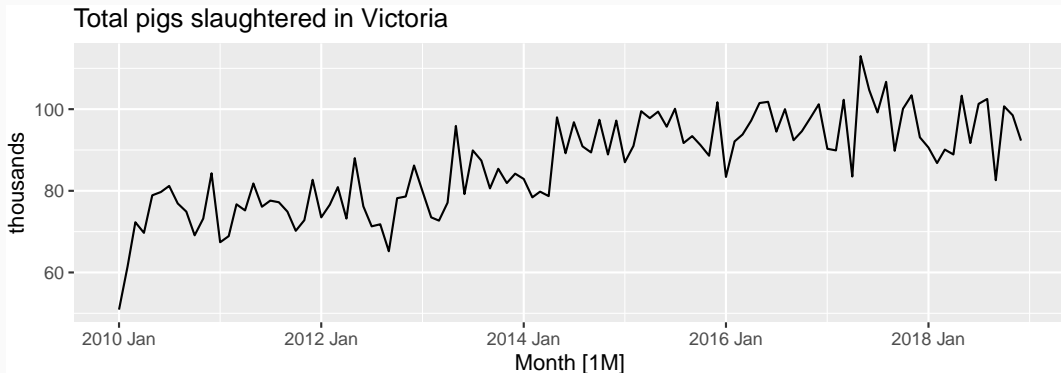
Stationary?

```
aus_livestock %>%  
  filter(Animal == "Pigs", State == "Victoria") %>%  
  autoplot(Count/1e3) +  
  labs(y = "thousands", title = "Total pigs slaughtered in Victoria")
```



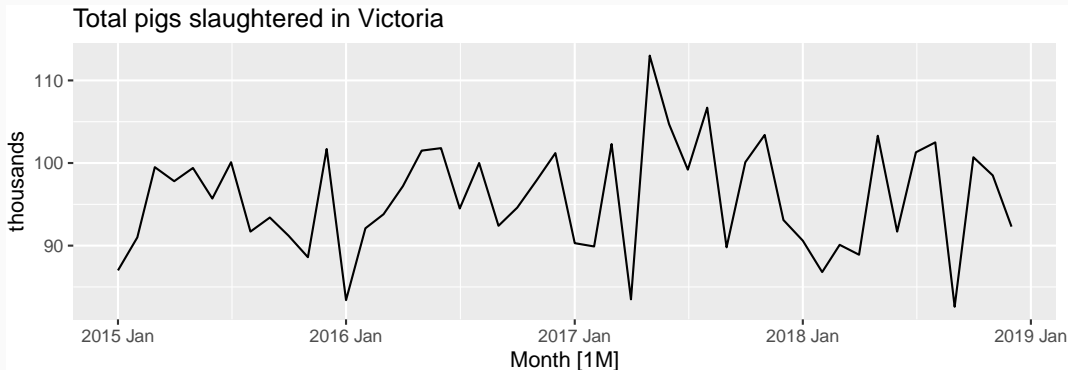
Stationary?

```
aus_livestock %>%  
  filter(Animal == "Pigs", State == "Victoria", year(Month) >= 2010) %>%  
  autoplot(Count/1e3) +  
  labs(y = "thousands", title = "Total pigs slaughtered in Victoria")
```



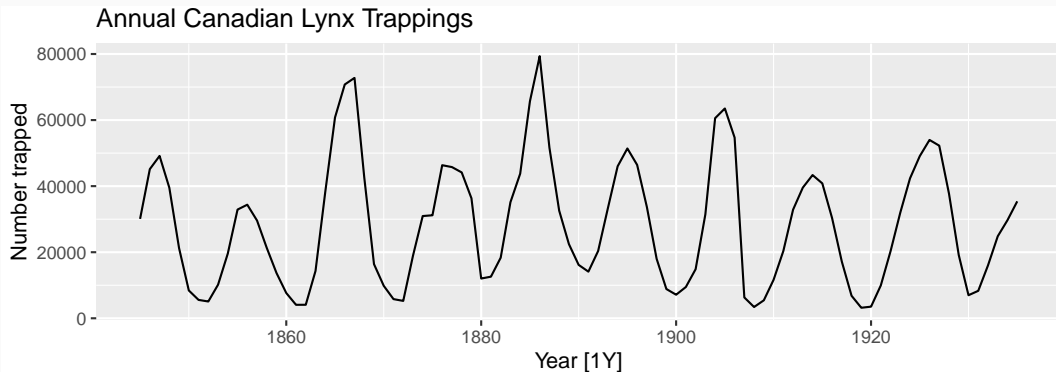
Stationary?

```
aus_livestock %>%  
  filter(Animal == "Pigs", State == "Victoria", year(Month) >= 2015) %>%  
  autoplot(Count/1e3) +  
  labs(y = "thousands", title = "Total pigs slaughtered in Victoria")
```



Stationary?

```
pelt %>%  
  autoplot(Lynx) +  
  labs(y = "Number trapped", title = "Annual Canadian Lynx Trappings")
```



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Transformations help to **stabilize the variance**.

For ARIMA modelling, we also need to **stabilize the mean**.

Non-stationarity in the mean

Identifying non-stationary series

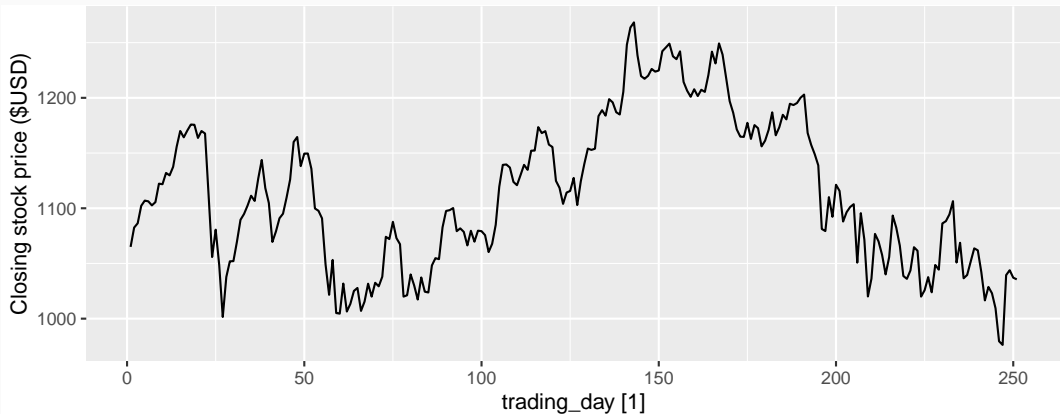
- time plot.
- The ACF of stationary data drops to zero relatively quickly
- The ACF of non-stationary data decreases slowly.
- For non-stationary data, the value of r_1 is often large and positive.

Example: Google stock price

```
google_2018 <- gafa_stock %>%  
  filter(Symbol == "GOOG", year(Date) == 2018)
```

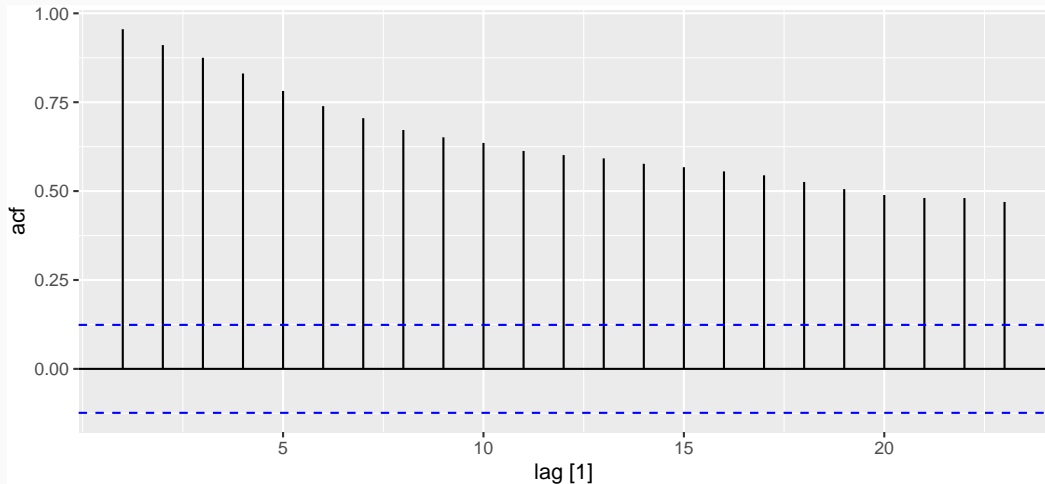
Example: Google stock price

```
google_2018 %>%  
  autoplot(Close) +  
  labs(y = "Closing stock price ($USD)")
```



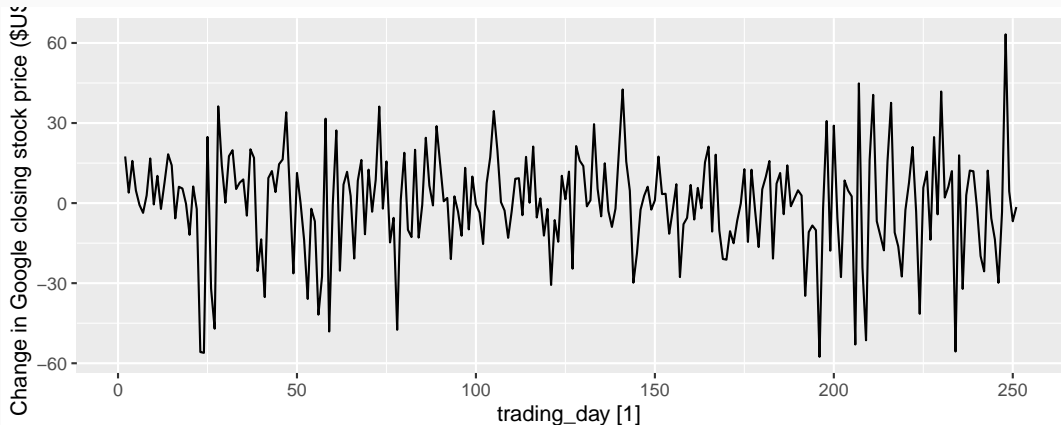
Example: Google stock price

```
google_2018 %>% ACF(Close) %>% autoplot()
```



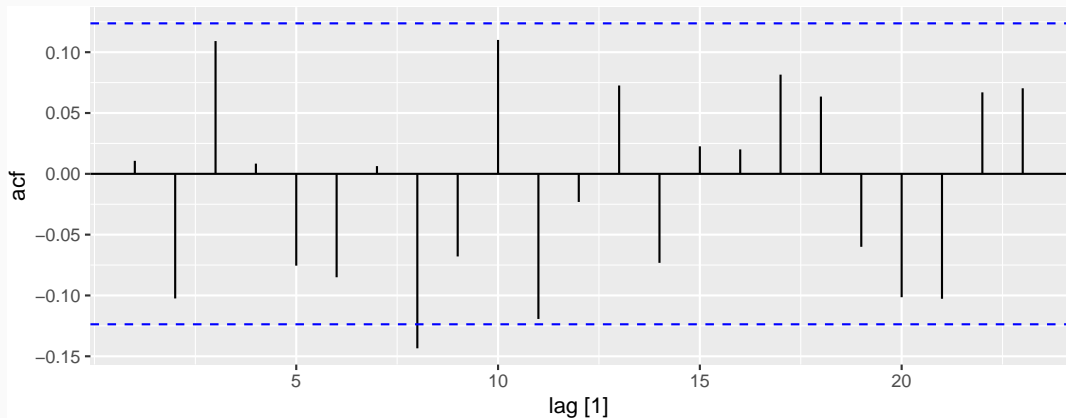
Example: Google stock price

```
google_2018 %>%  
  autoplot(difference(Close)) +  
  labs(y = "Change in Google closing stock price ($USD)")
```



Example: Google stock price

```
google_2018 %>% ACF(difference(Close)) %>% autoplot()
```



Differencing

- Differencing helps to **stabilize the mean**.
- The differenced series is the *change* between each observation in the original series: $y'_t = y_t - y_{t-1}$.
- The differenced series will have only $T - 1$ values since it is not possible to calculate a difference y'_1 for the first observation.

Second-order differencing

Occasionally the differenced data will not appear stationary and it may be necessary to difference the data a second time:

Second-order differencing

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$$\begin{aligned}y_t'' &= y_t' - y_{t-1}' \\&= (y_t - y_{t-1}) - (y_{t-1} - y_{t-2}) \\&= y_t - 2y_{t-1} + y_{t-2}.\end{aligned}$$

Second-order differencing

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$$\begin{aligned}y_t'' &= y_t' - y_{t-1}' \\&= (y_t - y_{t-1}) - (y_{t-1} - y_{t-2}) \\&= y_t - 2y_{t-1} + y_{t-2}.\end{aligned}$$

- y_t'' will have $T - 2$ values.
- In practice, it is almost never necessary to go beyond second-order differences.

Seasonal differencing

A seasonal difference is the difference between an observation and the corresponding observation from the previous year.

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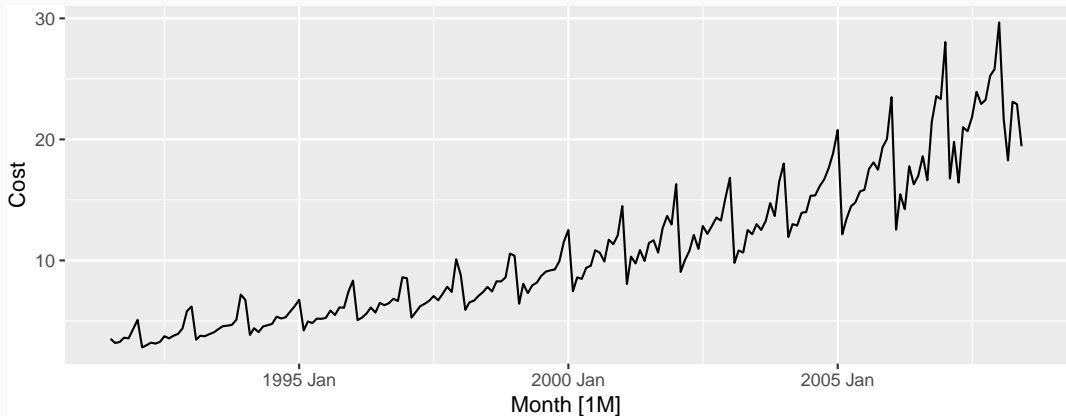
- For monthly data $m = 12$.
- For quarterly data $m = 4$.

Antidiabetic drug sales

```
a10 <- PBS %>%  
  filter(ATC2 == "A10") %>%  
  summarise(Cost = sum(Cost)/1e6)
```

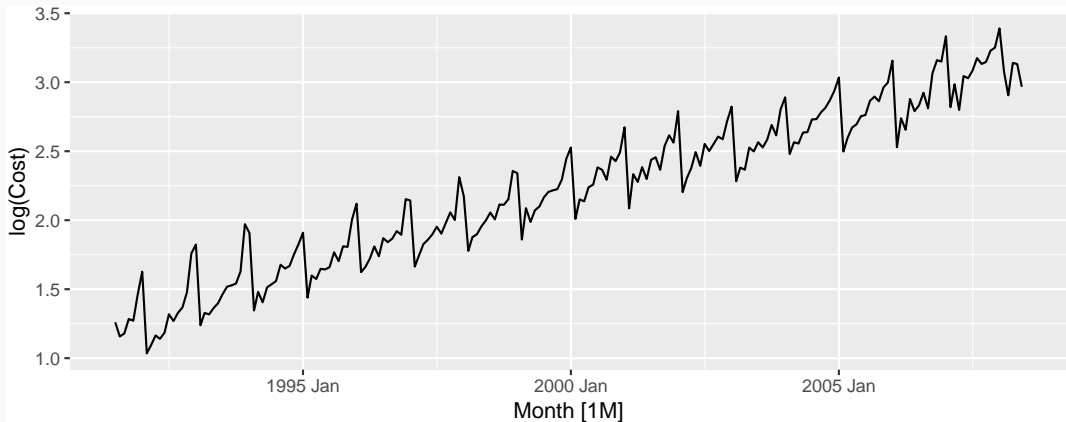

Antidiabetic drug sales

```
a10 %>% autoplot(  
  Cost  
)
```



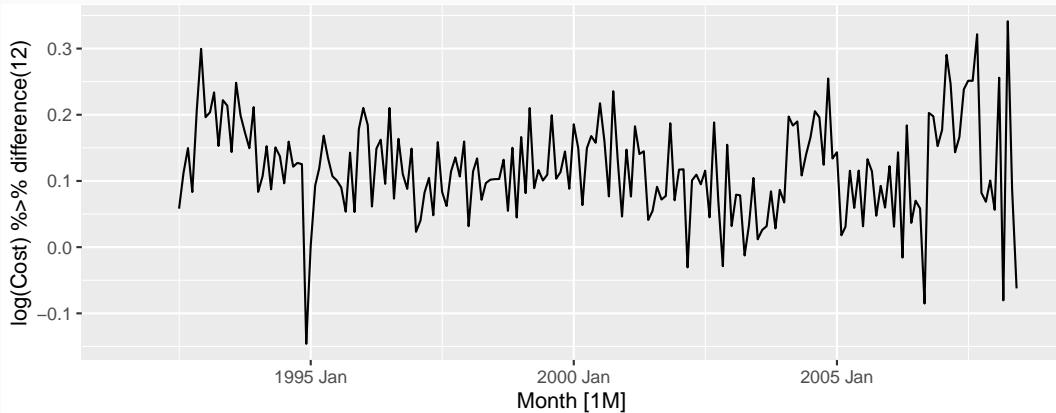
Antidiabetic drug sales

```
a10 %>% autoplot(  
  log(Cost)  
)
```



Antidiabetic drug sales

```
a10 %>% autoplot(  
  log(Cost) %>% difference(12)  
)
```

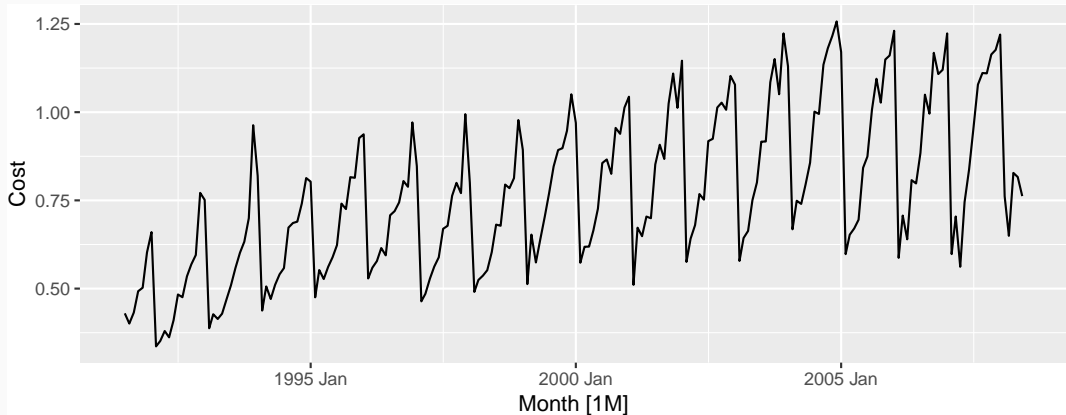


Corticosteroid drug sales

```
h02 <- PBS %>%  
  filter(ATC2 == "H02") %>%  
  summarise(Cost = sum(Cost)/1e6)
```

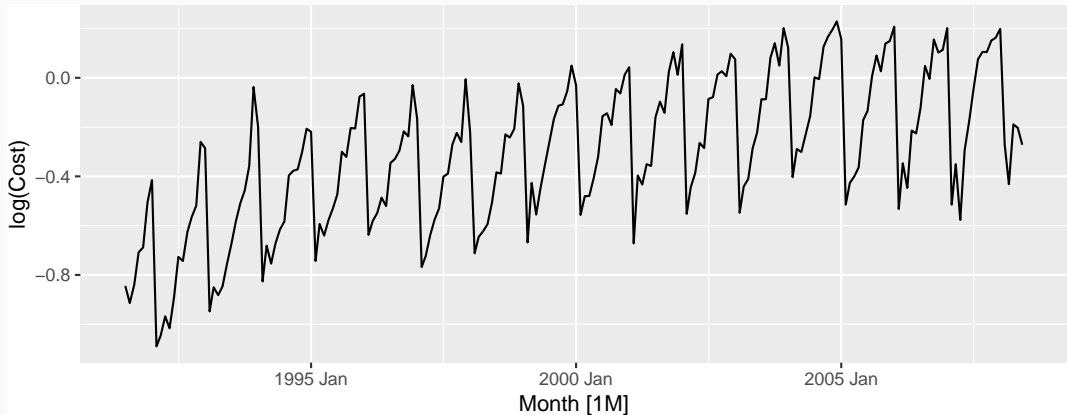
Corticosteroid drug sales

```
h02 %>% autoplot(  
  Cost  
)
```



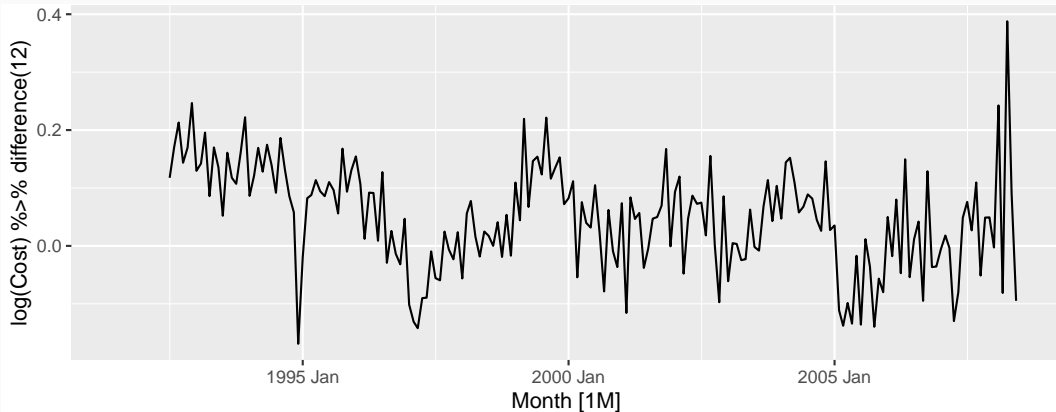
Corticosteroid drug sales

```
h02 %>% autoplot(  
  log(Cost)  
)
```



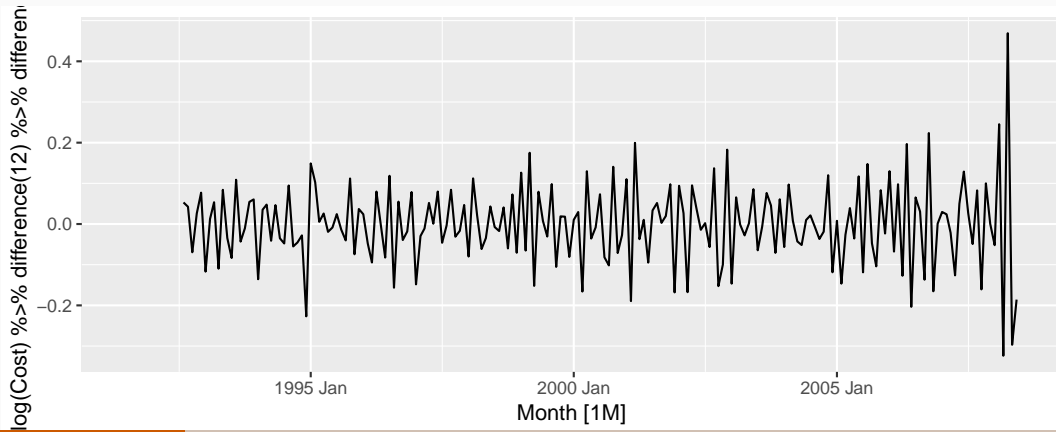
Corticosteroid drug sales

```
h02 %>% autoplot(  
  log(Cost) %>% difference(12)  
)
```



Corticosteroid drug sales

```
h02 %>% autoplot(  
  log(Cost) %>% difference(12) %>% difference(1)  
)
```



Corticosteroid drug sales

- Seasonally differenced series is closer to being stationary.
- Remaining non-stationarity can be removed with further first difference.

If $y'_t = y_t - y_{t-12}$ denotes seasonally differenced series, then twice-differenced series is

$$\begin{aligned}y_t^* &= y'_t - y'_{t-1} \\&= (y_t - y_{t-12}) - (y_{t-1} - y_{t-13}) \\&= y_t - y_{t-1} - y_{t-12} + y_{t-13} .\end{aligned}$$

Seasonal differencing

When both seasonal and first differences are applied...

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- it makes no difference which is done first—the result will be the same.
- If seasonality is strong, we recommend that seasonal differencing be done first because sometimes the resulting series will be stationary and there will be no need for further first difference.

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It is important that if differencing is used, the differences are interpretable.

Interpretation of differencing

- first differences are the change between **one observation and the next**;
- seasonal differences are the change between **one year to the next**.

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But taking lag 3 differences for yearly data, for example, results in a model which cannot be sensibly interpreted.

Unit root tests

Statistical tests to determine the required order of differencing.

- 1 Augmented Dickey Fuller test: null hypothesis is that the data are non-stationary and non-seasonal.
- 2 Kwiatkowski-Phillips-Schmidt-Shin (KPSS) test: null hypothesis is that the data are stationary and non-seasonal.
- 3 Other tests available for seasonal data.

KPSS test

```
google_2018 %>%  
  features(Close, unitroot_kpss)
```

```
## # A tibble: 1 x 3  
##   Symbol kpss_stat kpss_pvalue  
##   <chr>      <dbl>      <dbl>  
## 1 GOOG      0.573      0.0252
```


KPSS test

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##   <chr>      <dbl>      <dbl>  
## 1 GOOG      0.573      0.0252
```

```
google_2018 %>%  
  features(Close, unitroot_ndiffs)
```

```
## # A tibble: 1 x 2  
##   Symbol ndiffs  
##   <chr>   <int>  
## 1 GOOG     1
```

Automatically selecting differences

STL decomposition: $y_t = T_t + S_t + R_t$

Seasonal strength $F_s = \max\left(0, 1 - \frac{\text{Var}(R_t)}{\text{Var}(S_t + R_t)}\right)$

If $F_s > 0.64$, do one seasonal difference.

```
h02 %>% mutate(log_sales = log(Cost)) %>%  
  features(log_sales, list(unitroot_nsdiffs, feat_stl))
```

```
## # A tibble: 1 x 10  
##   nsdiffs trend_strength seasonal_streng~ seasonal_peak_y~ seasonal_trough~  
##   <int>         <dbl>         <dbl>         <dbl>         <dbl>  
## 1       1       0.957       0.955           6           8  
## # ... with 5 more variables: spikiness <dbl>, linearity <dbl>,  
## #   curvature <dbl>, stl_e_acf1 <dbl>, stl_e_acf10 <dbl>
```

Automatically selecting differences

```
h02 %>% mutate(log_sales = log(Cost)) %>%  
  features(log_sales, unitroot_nsdiffs)
```

```
## # A tibble: 1 x 1  
##   nsdiffs  
##   <int>  
## 1      1
```

```
h02 %>% mutate(d_log_sales = difference(log(Cost), 12)) %>%  
  features(d_log_sales, unitroot_ndiffs)
```

```
## # A tibble: 1 x 1  
##   ndiffs  
##   <int>  
## 1      1
```

Backshift notation

A very useful notational device is the backward shift operator, B , which is used as follows:

$$By_t = y_{t-1}$$

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In other words, B , operating on y_t , has the effect of **shifting the data back one period**. Two applications of B to y_t **shifts the data back two periods**:

$$B(By_t) = B^2y_t = y_{t-2}$$

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$$B(By_t) = B^2y_t = y_{t-2}$$

For monthly data, if we wish to shift attention to “the same month last year”, then B^{12} is used, and the notation is $B^{12}y_t = y_{t-12}$.

Backshift notation

The backward shift operator is convenient for describing the process of *differencing*.

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Note that a first difference is represented by $(1 - B)$.

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$$y'_t = y_t - y_{t-1} = y_t - By_t = (1 - B)y_t$$

Note that a first difference is represented by $(1 - B)$.

Similarly, if second-order differences (i.e., first differences of first differences) have to be computed, then:

$$y''_t = y_t - 2y_{t-1} + y_{t-2} = (1 - B)^2 y_t$$

Backshift notation

- Second-order difference is denoted $(1 - B)^2$.
- *Second-order difference* is not the same as a *second difference*, which would be denoted $1 - B^2$;
- In general, a d th-order difference can be written as

$$(1 - B)^d y_t$$

- A seasonal difference followed by a first difference can be written as

$$(1 - B)(1 - B^m)y_t$$

Backshift notation

The “backshift” notation is convenient because the terms can be multiplied together to see the combined effect.

$$\begin{aligned}(1 - B)(1 - B^m)y_t &= (1 - B - B^m + B^{m+1})y_t \\ &= y_t - y_{t-1} - y_{t-m} + y_{t-m-1}.\end{aligned}$$

Backshift notation

The “backshift” notation is convenient because the terms can be multiplied together to see the combined effect.

$$\begin{aligned}(1 - B)(1 - B^m)y_t &= (1 - B - B^m + B^{m+1})y_t \\ &= y_t - y_{t-1} - y_{t-m} + y_{t-m-1}.\end{aligned}$$

For monthly data, $m = 12$ and we obtain the same result as earlier.

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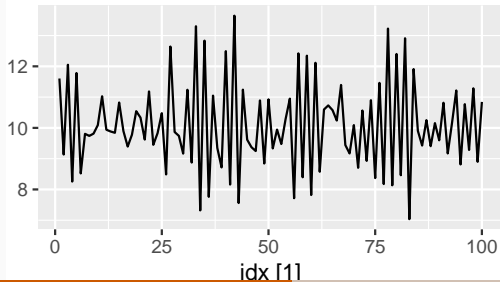
Autoregressive models

Autoregressive (AR) models:

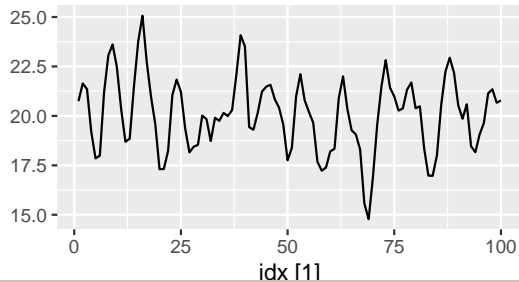
$$y_t = c + \phi_1 y_{t-1} + \phi_2 y_{t-2} + \cdots + \phi_p y_{t-p} + \varepsilon_t,$$

where ε_t is white noise. This is a multiple regression with **lagged values** of y_t as predictors.

AR(1)



AR(2)

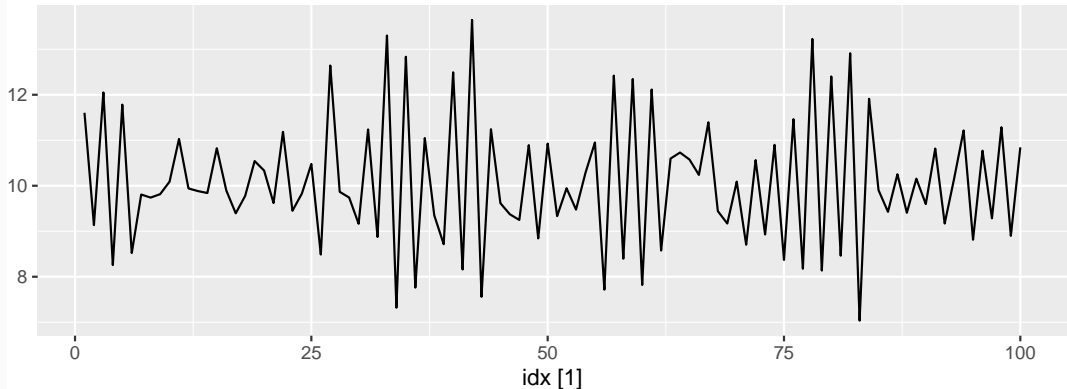


AR(1) model

$$y_t = 18 - 0.8y_{t-1} + \varepsilon_t$$

$$\varepsilon_t \sim N(0, 1), \quad T = 100.$$

AR(1)



AR(1) model

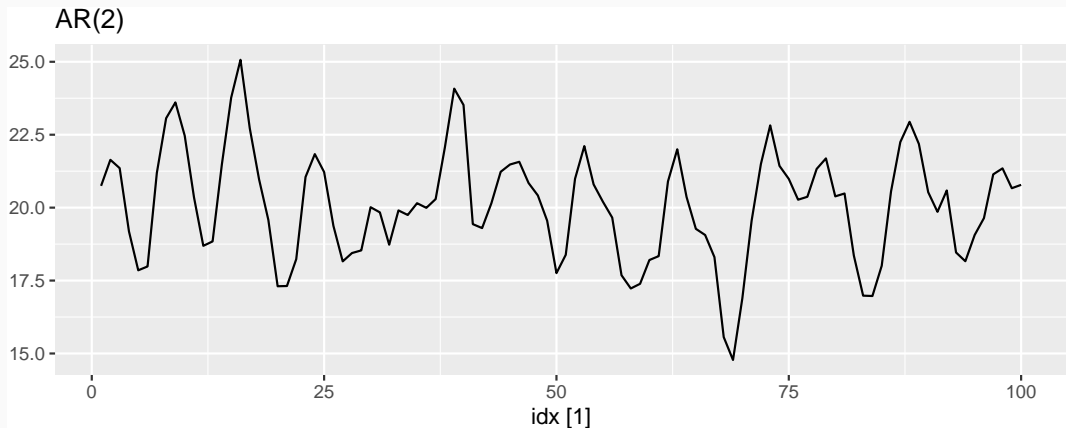
$$y_t = c + \phi_1 y_{t-1} + \varepsilon_t$$

- When $\phi_1 = 0$, y_t is **equivalent to WN**
- When $\phi_1 = 1$ and $c = 0$, y_t is **equivalent to a RW**
- When $\phi_1 = 1$ and $c \neq 0$, y_t is **equivalent to a RW with drift**
- When $\phi_1 < 0$, y_t tends to **oscillate between positive and negative values.**

AR(2) model

$$y_t = 8 + 1.3y_{t-1} - 0.7y_{t-2} + \varepsilon_t$$

$$\varepsilon_t \sim N(0, 1), \quad T = 100.$$



Stationarity conditions

We normally restrict autoregressive models to stationary data, and then some constraints on the values of the parameters are required.

General condition for stationarity

Complex roots of $1 - \phi_1 z - \phi_2 z^2 - \dots - \phi_p z^p$ lie outside the unit circle on the complex plane.

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We normally restrict autoregressive models to stationary data, and then some constraints on the values of the parameters are required.

General condition for stationarity

Complex roots of $1 - \phi_1 z - \phi_2 z^2 - \dots - \phi_p z^p$ lie outside the unit circle on the complex plane.

- For $p = 1$: $-1 < \phi_1 < 1$.
- For $p = 2$:
 $-1 < \phi_2 < 1$ $\phi_2 + \phi_1 < 1$ $\phi_2 - \phi_1 < 1$.
- More complicated conditions hold for $p \geq 3$.
- Estimation software takes care of this.

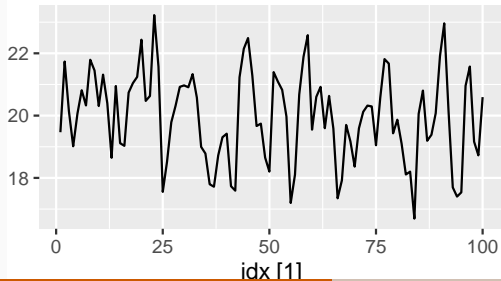
Moving Average (MA) models

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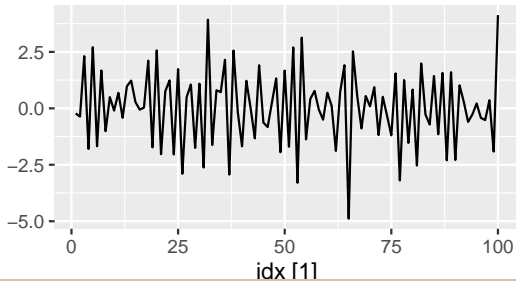
$$y_t = c + \varepsilon_t + \theta_1 \varepsilon_{t-1} + \theta_2 \varepsilon_{t-2} + \cdots + \theta_q \varepsilon_{t-q},$$

where ε_t is white noise. This is a multiple regression with **past errors** as predictors. *Don't confuse this with moving average smoothing!*

MA(1)



MA(2)

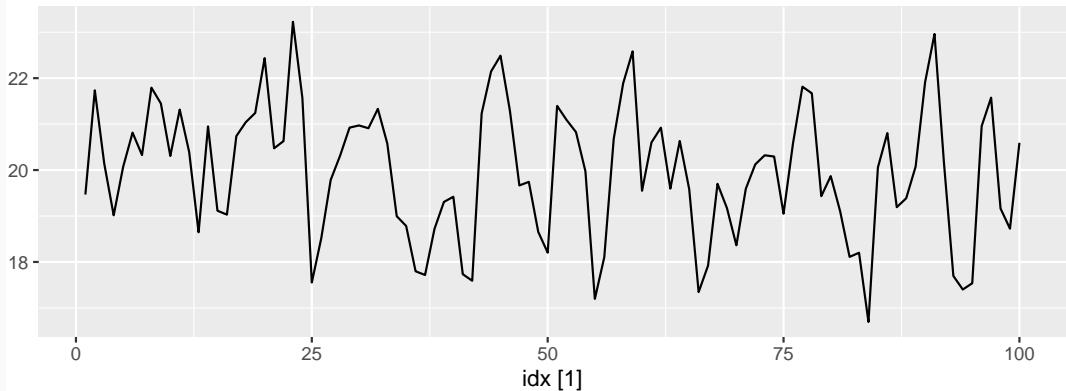


MA(1) model

$$y_t = 20 + \varepsilon_t + 0.8\varepsilon_{t-1}$$

$$\varepsilon_t \sim N(0, 1), \quad T = 100.$$

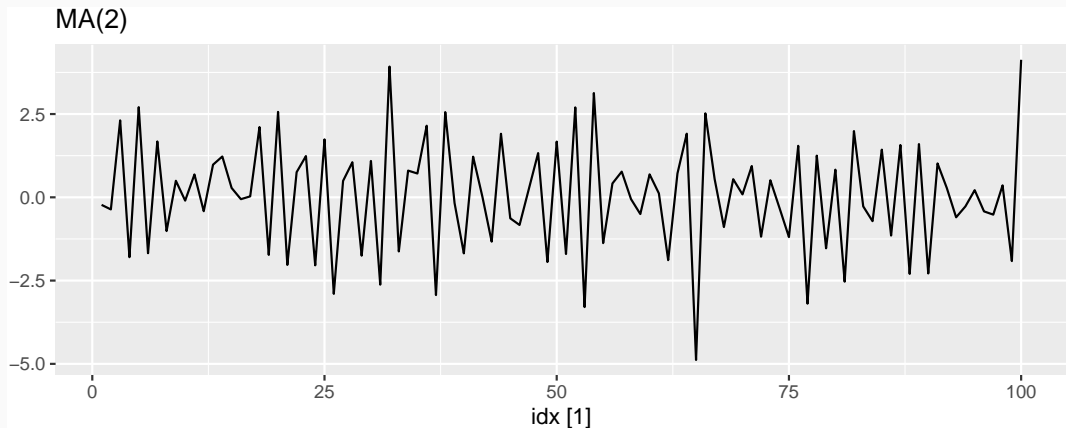
MA(1)



MA(2) model

$$y_t = \varepsilon_t - \varepsilon_{t-1} + 0.8\varepsilon_{t-2}$$

$$\varepsilon_t \sim N(0, 1), \quad T = 100.$$



MA(∞) models

It is possible to write any stationary AR(p) process as an MA(∞) process.

Example: AR(1)

$$\begin{aligned}y_t &= \phi_1 y_{t-1} + \varepsilon_t \\&= \phi_1(\phi_1 y_{t-2} + \varepsilon_{t-1}) + \varepsilon_t \\&= \phi_1^2 y_{t-2} + \phi_1 \varepsilon_{t-1} + \varepsilon_t \\&= \phi_1^3 y_{t-3} + \phi_1^2 \varepsilon_{t-2} + \phi_1 \varepsilon_{t-1} + \varepsilon_t \\&\dots\end{aligned}$$

MA(∞) models

It is possible to write any stationary AR(p) process as an MA(∞) process.

Example: AR(1)

$$\begin{aligned}y_t &= \phi_1 y_{t-1} + \varepsilon_t \\&= \phi_1(\phi_1 y_{t-2} + \varepsilon_{t-1}) + \varepsilon_t \\&= \phi_1^2 y_{t-2} + \phi_1 \varepsilon_{t-1} + \varepsilon_t \\&= \phi_1^3 y_{t-3} + \phi_1^2 \varepsilon_{t-2} + \phi_1 \varepsilon_{t-1} + \varepsilon_t \\&\dots\end{aligned}$$

provided $-1 < \phi_1 < 1$.

Invertibility

- Any $MA(q)$ process can be written as an $AR(\infty)$ process if we impose some constraints on the MA parameters.
- Then the MA model is called “invertible”.
- Invertible models have some mathematical properties that make them easier to use in practice.
- Invertibility of an ARIMA model is equivalent to forecastability of an ETS model.

Invertibility

General condition for invertibility

Complex roots of $1 + \theta_1 z + \theta_2 z^2 + \dots + \theta_q z^q$ lie outside the unit circle on the complex plane.

Invertibility

General condition for invertibility

Complex roots of $1 + \theta_1 z + \theta_2 z^2 + \dots + \theta_q z^q$ lie outside the unit circle on the complex plane.

- For $q = 1$: $-1 < \theta_1 < 1$.
- For $q = 2$:
 $-1 < \theta_2 < 1 \quad \theta_2 + \theta_1 > -1 \quad \theta_1 - \theta_2 < 1$.
- More complicated conditions hold for $q \geq 3$.
- Estimation software takes care of this.

ARIMA models

Autoregressive Moving Average models:

$$y_t = c + \phi_1 y_{t-1} + \cdots + \phi_p y_{t-p} \\ + \theta_1 \varepsilon_{t-1} + \cdots + \theta_q \varepsilon_{t-q} + \varepsilon_t.$$

ARIMA models

Autoregressive Moving Average models:

$$y_t = c + \phi_1 y_{t-1} + \cdots + \phi_p y_{t-p} \\ + \theta_1 \varepsilon_{t-1} + \cdots + \theta_q \varepsilon_{t-q} + \varepsilon_t.$$

- Predictors include both **lagged values of y_t and lagged errors.**
- Conditions on coefficients ensure stationarity.
- Conditions on coefficients ensure invertibility.

ARIMA models

Autoregressive Moving Average models:

$$y_t = c + \phi_1 y_{t-1} + \cdots + \phi_p y_{t-p} \\ + \theta_1 \varepsilon_{t-1} + \cdots + \theta_q \varepsilon_{t-q} + \varepsilon_t.$$

- Predictors include both **lagged values of y_t and lagged errors.**
- Conditions on coefficients ensure stationarity.
- Conditions on coefficients ensure invertibility.

Autoregressive Integrated Moving Average models

- Combine ARMA model with **differencing.**
- $(1 - B)^d y_t$ follows an ARMA model.

ARIMA models

Autoregressive Integrated Moving Average models

ARIMA(p, d, q) model

AR: p = order of the autoregressive part

I: d = degree of first differencing involved

MA: q = order of the moving average part.

- White noise model: ARIMA(0,0,0)
- Random walk: ARIMA(0,1,0) with no constant
- Random walk with drift: ARIMA(0,1,0) with const.
- AR(p): ARIMA($p,0,0$)
- MA(q): ARIMA(0,0, q)

Backshift notation for ARIMA

■ ARMA model:

$$y_t = c + \phi_1 B y_t + \dots + \phi_p B^p y_t + \varepsilon_t + \theta_1 B \varepsilon_t + \dots + \theta_q B^q \varepsilon_t$$

or $(1 - \phi_1 B - \dots - \phi_p B^p) y_t = c + (1 + \theta_1 B + \dots + \theta_q B^q) \varepsilon_t$

■ ARIMA(1,1,1) model:

$$\begin{array}{ccccc} (1 - \phi_1 B) & (1 - B) y_t & = & c + (1 + \theta_1 B) \varepsilon_t \\ \uparrow & \uparrow & & \uparrow \\ \text{AR}(1) & \text{First} & & \text{MA}(1) \\ & \text{difference} & & \end{array}$$

Backshift notation for ARIMA

■ ARMA model:

$$y_t = c + \phi_1 B y_t + \dots + \phi_p B^p y_t + \varepsilon_t + \theta_1 B \varepsilon_t + \dots + \theta_q B^q \varepsilon_t$$

or $(1 - \phi_1 B - \dots - \phi_p B^p) y_t = c + (1 + \theta_1 B + \dots + \theta_q B^q) \varepsilon_t$

■ ARIMA(1,1,1) model:

$$\begin{array}{ccccc} (1 - \phi_1 B) & (1 - B) y_t & = & c + (1 + \theta_1 B) \varepsilon_t \\ \uparrow & \uparrow & & \uparrow \\ \text{AR(1)} & \text{First} & & \text{MA(1)} \\ & \text{difference} & & \end{array}$$

Expand: $y_t = c + y_{t-1} + \phi_1 y_{t-1} - \phi_1 y_{t-2} + \theta_1 \varepsilon_{t-1} + \varepsilon_t$

R model

Intercept form

$$(1 - \phi_1 B - \dots - \phi_p B^p) y'_t = c + (1 + \theta_1 B + \dots + \theta_q B^q) \varepsilon_t$$

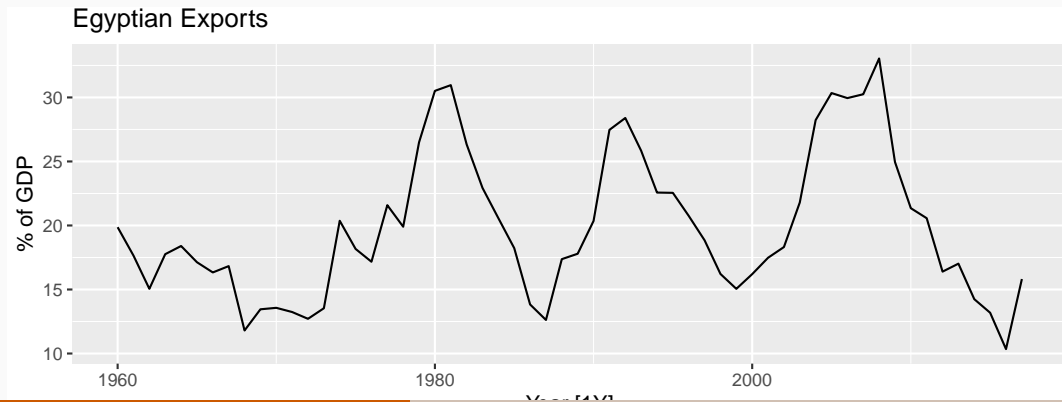
Mean form

$$(1 - \phi_1 B - \dots - \phi_p B^p)(y'_t - \mu) = (1 + \theta_1 B + \dots + \theta_q B^q) \varepsilon_t$$

- $y'_t = (1 - B)^d y_t$
- μ is the mean of y'_t .
- $c = \mu(1 - \phi_1 - \dots - \phi_p)$.
- fable uses intercept form

Egyptian exports

```
global_economy %>%  
  filter(Code == "EGY") %>%  
  autoplot(Exports) +  
  labs(y = "% of GDP", title = "Egyptian Exports")
```



Egyptian exports

```
fit <- global_economy %>% filter(Code == "EGY") %>%  
  model(ARIMA(Exports))  
report(fit)
```

```
## Series: Exports  
## Model: ARIMA(2,0,1) w/ mean  
##  
## Coefficients:  
##          ar1      ar2      ma1  constant  
##          1.676  -0.8034  -0.690      2.562  
## s.e.    0.111    0.0928    0.149      0.116  
##  
## sigma^2 estimated as 8.046:  log likelihood=-142  
## AIC=293    AICc=294    BIC=303
```

Egyptian exports

```
fit <- global_economy %>% filter(Code == "EGY") %>%  
  model(ARIMA(Exports))  
report(fit)
```

```
## Series: Exports  
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## sigma^2 estimated as 8.046:  log likelihood=-142
```

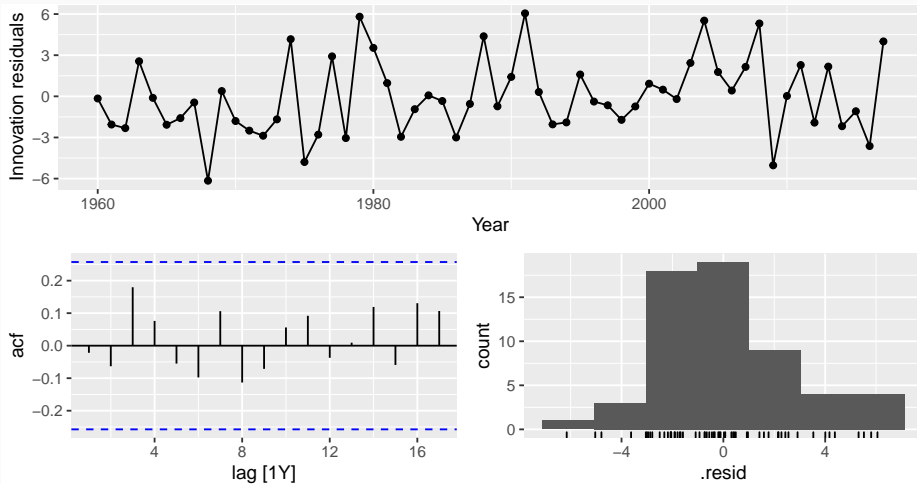
ARIMA(2,0,1) model:

$$y_t = 2.56 + 1.68y_{t-1} - 0.80y_{t-2} - 0.69\varepsilon_{t-1} + \varepsilon_t,$$

where ε_t is white noise with a standard deviation of $2.837 = \sqrt{8.046}$.

Egyptian exports

```
gg_tsresiduals(fit)
```



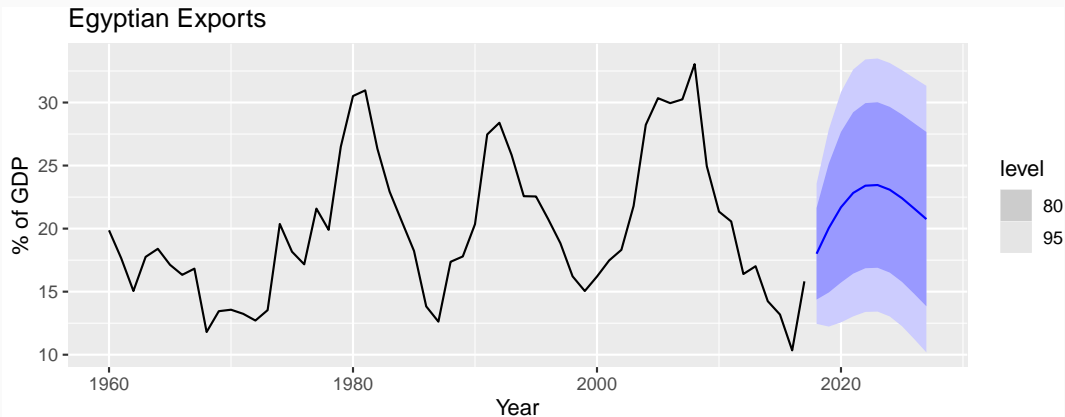
Egyptian exports

```
augment(fit) %>%  
  features(.innov, ljung_box, lag = 10, dof = 4)
```

```
## # A tibble: 1 x 4  
##   Country      .model      lb_stat lb_pvalue  
##   <fct>        <chr>        <dbl>    <dbl>  
## 1 Egypt, Arab Rep. ARIMA(Exports)    5.78    0.448
```

Egyptian exports

```
fit %>% forecast(h=10) %>%  
  autoplot(global_economy) +  
  labs(y = "% of GDP", title = "Egyptian Exports")
```



Understanding ARIMA models

- If $c = 0$ and $d = 0$, the long-term forecasts will go to zero.
- If $c = 0$ and $d = 1$, the long-term forecasts will go to a non-zero constant.
- If $c = 0$ and $d = 2$, the long-term forecasts will follow a straight line.
- If $c \neq 0$ and $d = 0$, the long-term forecasts will go to the mean of the data.
- If $c \neq 0$ and $d = 1$, the long-term forecasts will follow a straight line.
- If $c \neq 0$ and $d = 2$, the long-term forecasts will follow a quadratic trend.

Understanding ARIMA models

Forecast variance and d

- The higher the value of d , the more rapidly the prediction intervals increase in size.
- For $d = 0$, the long-term forecast standard deviation will go to the standard deviation of the historical data.

Cyclic behaviour

- For cyclic forecasts, $p \geq 2$ and some restrictions on coefficients are required.
- If $p = 2$, we need $\phi_1^2 + 4\phi_2 < 0$. Then average cycle of length
$$(2\pi) / \left[\arccos(-\phi_1(1 - \phi_2)/(4\phi_2)) \right] .$$

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Maximum likelihood estimation

Having identified the model order, we need to estimate the parameters $c, \phi_1, \dots, \phi_p, \theta_1, \dots, \theta_q$.

Maximum likelihood estimation

Having identified the model order, we need to estimate the parameters $c, \phi_1, \dots, \phi_p, \theta_1, \dots, \theta_q$.

- MLE is very similar to least squares estimation obtained by minimizing

$$\sum_{t=1}^T e_t^2$$

- The `ARIMA()` function allows CLS or MLE estimation.
- Non-linear optimization must be used in either case.
- Different software will give different estimates.

Partial autocorrelations

Partial autocorrelations measure relationship between y_t and y_{t-k} , when the effects of other time lags — $1, 2, 3, \dots, k-1$ — are removed.

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α_k = k th partial autocorrelation coefficient

= equal to the estimate of ϕ_k in regression:

$$y_t = c + \phi_1 y_{t-1} + \phi_2 y_{t-2} + \dots + \phi_k y_{t-k} + \varepsilon_t.$$

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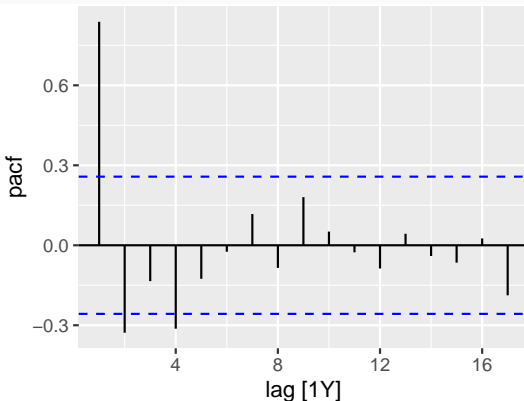
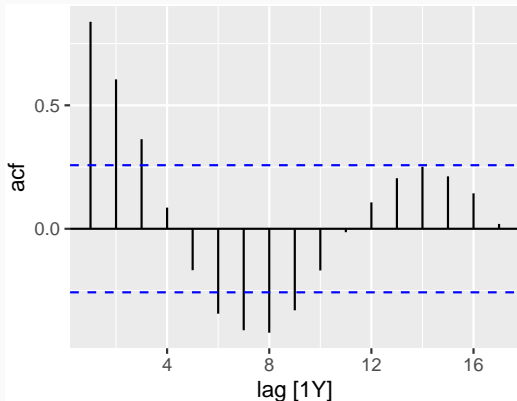
= equal to the estimate of ϕ_k in regression:

$$y_t = c + \phi_1 y_{t-1} + \phi_2 y_{t-2} + \dots + \phi_k y_{t-k} + \varepsilon_t.$$

- Varying number of terms on RHS gives α_k for different values of k .
- $\alpha_1 = \rho_1$
- same critical values of $\pm 1.96/\sqrt{T}$ as for ACF.
- Last significant α_k indicates the order of an AR model.

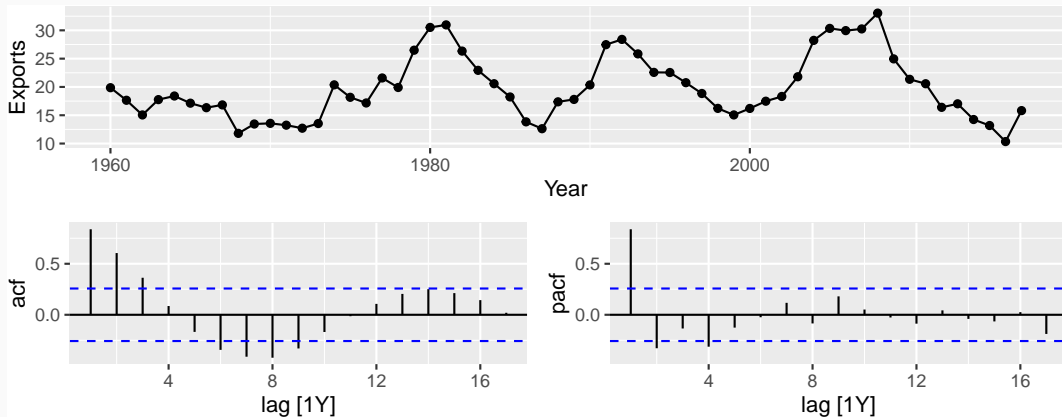
Egyptian exports

```
egypt <- global_economy %>% filter(Code == "EGY")  
egypt %>% ACF(Exports) %>% autoplot()  
egypt %>% PACF(Exports) %>% autoplot()
```



Egyptian exports

```
global_economy %>% filter(Code == "EGY") %>%  
  gg_tsdisplay(Exports, plot_type='partial')
```



ACF and PACF interpretation

AR(1)

$$\begin{aligned}\rho_k &= \phi_1^k && \text{for } k = 1, 2, \dots; \\ \alpha_1 &= \phi_1 && \alpha_k = 0 \quad \text{for } k = 2, 3, \dots\end{aligned}$$

So we have an AR(1) model when

- autocorrelations exponentially decay
- there is a single significant partial autocorrelation.

ACF and PACF interpretation

AR(p)

- ACF dies out in an exponential or damped sine-wave manner
- PACF has all zero spikes beyond the p th spike

So we have an AR(p) model when

- the ACF is exponentially decaying or sinusoidal
- there is a significant spike at lag p in PACF, but none beyond p

ACF and PACF interpretation

MA(1)

$$\begin{aligned}\rho_1 &= \theta_1 / (1 + \theta_1^2) & \rho_k &= 0 & \text{for } k = 2, 3, \dots; \\ \alpha_k &= -(-\theta_1)^k / (1 + \theta_1^2 + \dots + \theta_1^{2k})\end{aligned}$$

So we have an MA(1) model when

- the PACF is exponentially decaying and
- there is a single significant spike in ACF

ACF and PACF interpretation

MA(q)

- PACF dies out in an exponential or damped sine-wave manner
- ACF has all zero spikes beyond the q th spike

So we have an MA(q) model when

- the PACF is exponentially decaying or sinusoidal
- there is a significant spike at lag q in ACF, but none beyond q

Information criteria

Akaike's Information Criterion (AIC):

$$\text{AIC} = -2 \log(L) + 2(p + q + k + 1),$$

where L is the likelihood of the data, $k = 1$ if $c \neq 0$ and $k = 0$ if $c = 0$.

Information criteria

Akaike's Information Criterion (AIC):

$$\text{AIC} = -2 \log(L) + 2(p + q + k + 1),$$

where L is the likelihood of the data, $k = 1$ if $c \neq 0$ and $k = 0$ if $c = 0$.

Corrected AIC:

$$\text{AICc} = \text{AIC} + \frac{2(p + q + k + 1)(p + q + k + 2)}{T - p - q - k - 2}.$$

Information criteria

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$$\text{AICc} = \text{AIC} + \frac{2(p + q + k + 1)(p + q + k + 2)}{T - p - q - k - 2}.$$

Bayesian Information Criterion:

$$\text{BIC} = \text{AIC} + [\log(T) - 2](p + q + k + 1).$$

Information criteria

Akaike's Information Criterion (AIC):

$$\text{AIC} = -2 \log(L) + 2(p + q + k + 1),$$

where L is the likelihood of the data, $k = 1$ if $c \neq 0$ and $k = 0$ if $c = 0$.

Corrected AIC:

$$\text{AICc} = \text{AIC} + \frac{2(p + q + k + 1)(p + q + k + 2)}{T - p - q - k - 2}.$$

Bayesian Information Criterion:

$$\text{BIC} = \text{AIC} + [\log(T) - 2](p + q + k + 1).$$

Good models are obtained by minimizing either the AIC, AICc or BIC. Our preference is to use the AICc.

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How does ARIMA() work?

A non-seasonal ARIMA process

$$\phi(B)(1 - B)^d y_t = c + \theta(B)\varepsilon_t$$

Need to select appropriate orders: p, q, d

Hyndman and Khandakar (JSS, 2008) algorithm:

- Select no. differences d and D via KPSS test and seasonal strength measure.
- Select p, q by minimising AICc.
- Use stepwise search to traverse model space.

How does ARIMA() work?

$$\text{AICc} = -2 \log(L) + 2(p + q + k + 1) \left[1 + \frac{(p+q+k+2)}{T-p-q-k-2} \right].$$

where L is the maximised likelihood fitted to the *differenced* data, $k = 1$ if $c \neq 0$ and $k = 0$ otherwise.

How does ARIMA() work?

$$\text{AICc} = -2 \log(L) + 2(p + q + k + 1) \left[1 + \frac{(p+q+k+2)}{T-p-q-k-2} \right].$$

where L is the maximised likelihood fitted to the *differenced* data, $k = 1$ if $c \neq 0$ and $k = 0$ otherwise.

Step1: Select current model (with smallest AICc) from:

ARIMA(2, d , 2), ARIMA(0, d , 0), ARIMA(1, d , 0), ARIMA(0, d , 1)

How does ARIMA() work?

$$\text{AICc} = -2 \log(L) + 2(p + q + k + 1) \left[1 + \frac{(p+q+k+2)}{T-p-q-k-2} \right].$$

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Step1: Select current model (with smallest AICc) from:

ARIMA(2, d , 2), ARIMA(0, d , 0), ARIMA(1, d , 0), ARIMA(0, d , 1)

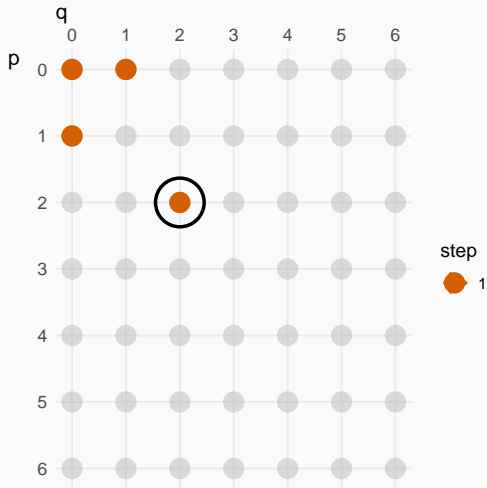
Step 2: Consider variations of current model:

- vary one of p, q , from current model by ± 1 ;
- p, q both vary from current model by ± 1 ;
- Include/exclude c from current model.

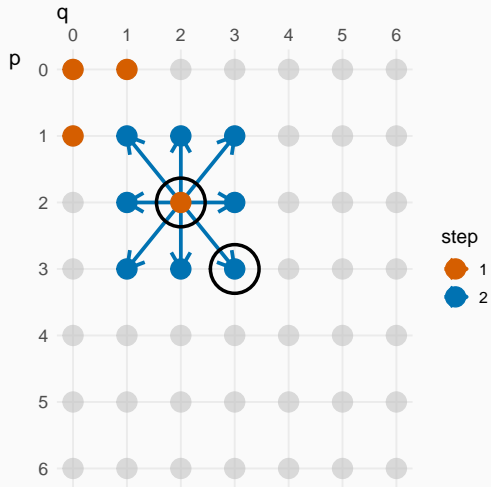
Model with lowest AICc becomes current model.

Repeat Step 2 until no lower AICc can be found.

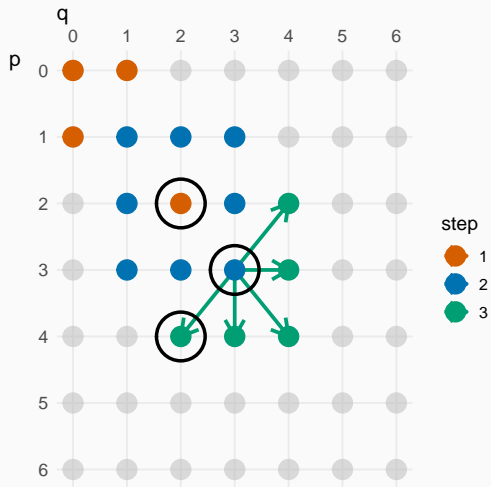
How does ARIMA() work?



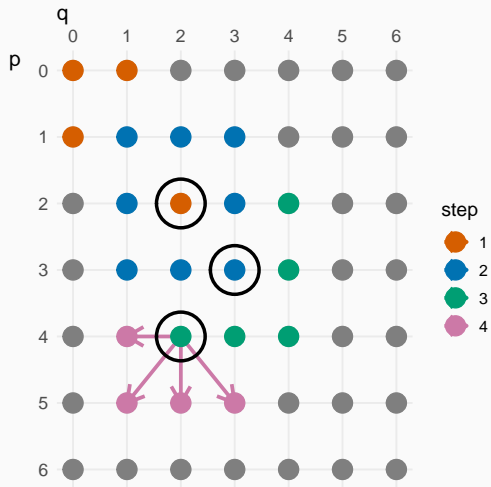
How does ARIMA() work?



How does ARIMA() work?

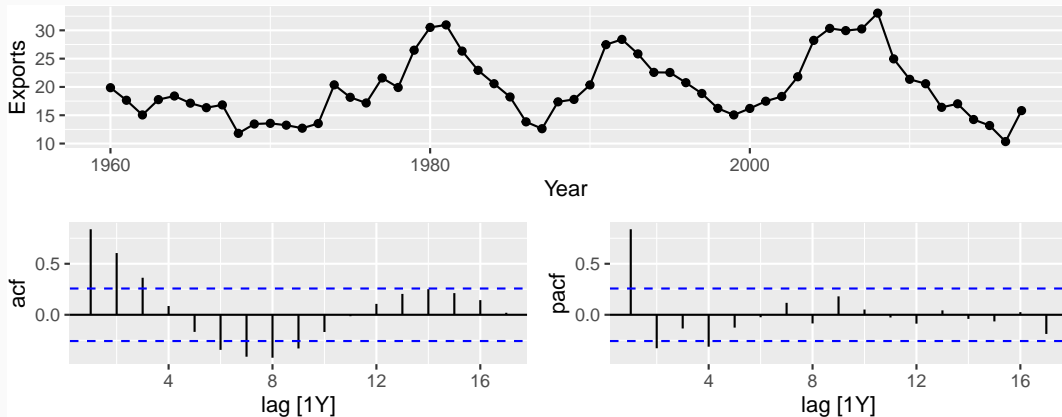


How does ARIMA() work?



Egyptian exports

```
global_economy %>% filter(Code == "EGY") %>%  
  gg_tsdisplay(Exports, plot_type='partial')
```



Egyptian exports

```
fit1 <- global_economy %>%  
  filter(Code == "EGY") %>%  
  model(ARIMA(Exports ~ pdq(4,0,0)))  
report(fit1)
```

```
## Series: Exports
```

```
## Model: ARIMA(4,0,0) w/ mean
```

```
##
```

```
## Coefficients:
```

```
##          ar1      ar2      ar3      ar4  constant
```

```
##          0.986  -0.172  0.181  -0.328      6.692
```

```
## s.e.    0.125    0.186  0.186    0.127      0.356
```

```
##
```

```
## sigma^2 estimated as 7.885:  log likelihood=-141
```

```
## AIC=293   AICc=295   BIC=305
```

Egyptian exports

```
fit2 <- global_economy %>%  
  filter(Code == "EGY") %>%  
  model(ARIMA(Exports))  
report(fit2)
```

```
## Series: Exports  
## Model: ARIMA(2,0,1) w/ mean  
##  
## Coefficients:  
##          ar1      ar2      ma1  constant  
##          1.676  -0.8034  -0.690      2.562  
## s.e.    0.111    0.0928    0.149      0.116  
##  
## sigma^2 estimated as 8.046:  log likelihood=-142  
## AIC=293   AICc=294   BIC=303
```

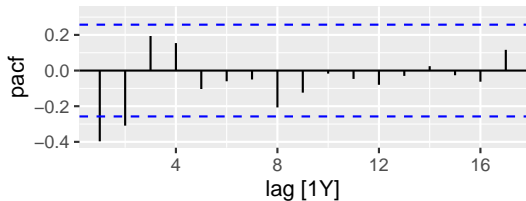
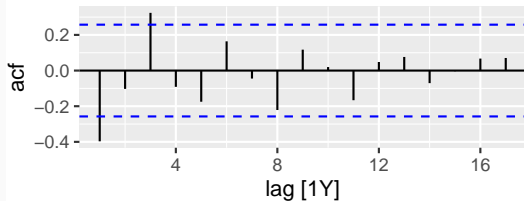
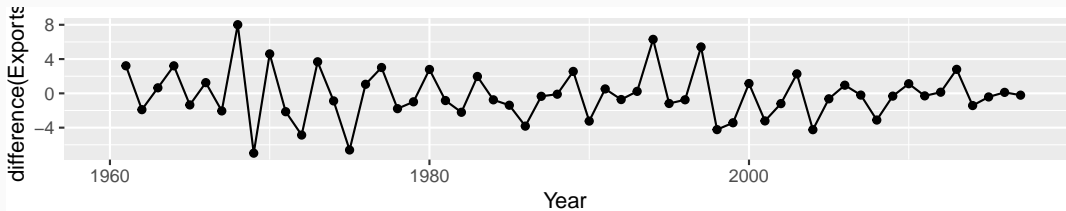

Central African Republic exports

```
global_economy %>%  
  filter(Code == "CAF") %>%  
  autoplot(Exports) +  
  labs(title="Central African Republic exports", y="% of GDP")
```



Central African Republic exports

```
global_economy %>%  
  filter(Code == "CAF") %>%  
  gg_tsdisplay(difference(Exports), plot_type='partial')
```



Central African Republic exports

```
caf_fit <- global_economy %>%  
  filter(Code == "CAF") %>%  
  model(arima210 = ARIMA(Exports ~ pdq(2,1,0)),  
        arima013 = ARIMA(Exports ~ pdq(0,1,3)),  
        stepwise = ARIMA(Exports),  
        search = ARIMA(Exports, stepwise=FALSE))
```

Central African Republic exports

```
caf_fit %>% pivot_longer(!Country, names_to = "Model name",  
                        values_to = "Orders")
```

```
## # A mable: 4 x 3
```

```
## # Key:      Country, Model name [4]
```

##	Country	`Model name`	Orders
##	<fct>	<chr>	<model>
## 1	Central African Republic	arima210	<ARIMA(2,1,0)>
## 2	Central African Republic	arima013	<ARIMA(0,1,3)>
## 3	Central African Republic	stepwise	<ARIMA(2,1,2)>
## 4	Central African Republic	search	<ARIMA(3,1,0)>

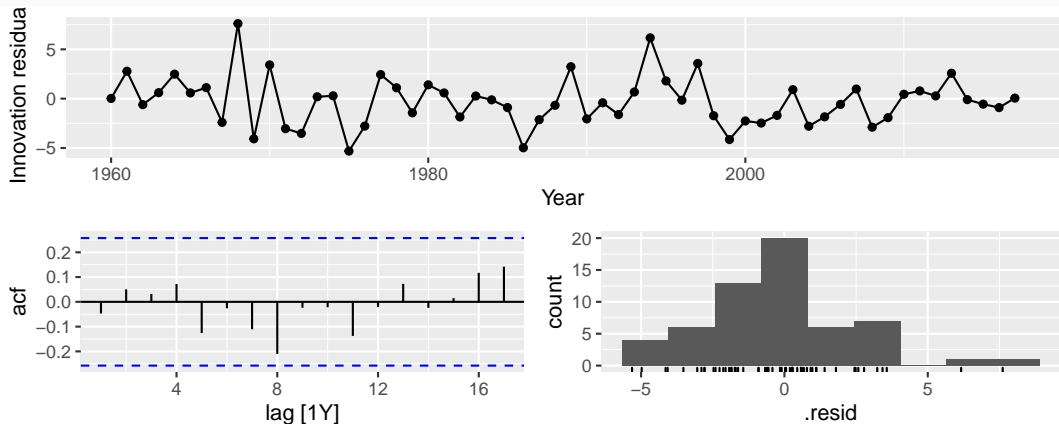
Central African Republic exports

```
glance(caf_fit) %>% arrange(AICc) %>% select(.model:BIC)
```

```
## # A tibble: 4 x 6
##   .model    sigma2 log_lik   AIC  AICc   BIC
##   <chr>      <dbl>   <dbl> <dbl> <dbl> <dbl>
## 1 search      6.52   -133.  274.  275.  282.
## 2 arima210    6.71   -134.  275.  275.  281.
## 3 arima013    6.54   -133.  274.  275.  282.
## 4 stepwise    6.42   -132.  274.  275.  284.
```

Central African Republic exports

```
caf_fit %>%  
  select(search) %>%  
  gg_tsresiduals()
```



Central African Republic exports

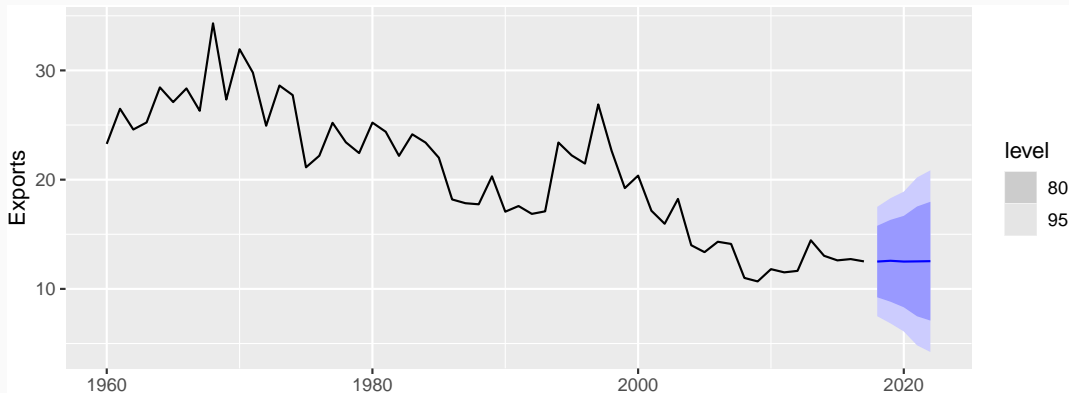
```
augment(caf_fit) %>%  
  filter(.model=='search') %>%  
  features(.innov, ljung_box, lag = 10, dof = 3)
```

```
## # A tibble: 1 x 4
```

##	Country	.model	lb_stat	lb_pvalue
##	<fct>	<chr>	<dbl>	<dbl>
## 1	Central African Republic	search	5.75	0.569

Central African Republic exports

```
caf_fit %>%  
  forecast(h=5) %>%  
  filter(.model=='search') %>%  
  autoplot(global_economy)
```



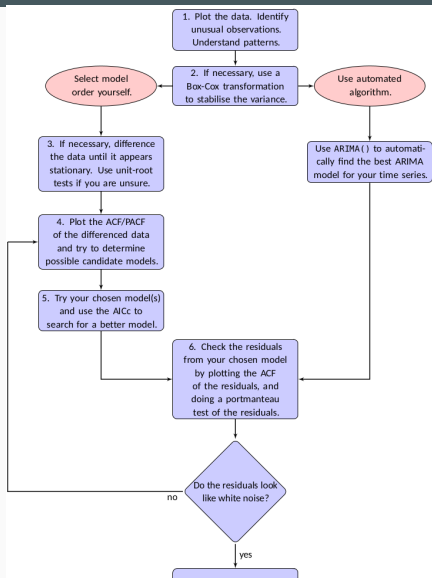
Modelling procedure with ARIMA ()

- 1 Plot the data. Identify any unusual observations.
- 2 If necessary, transform the data (using a Box-Cox transformation) to stabilize the variance.
- 3 If the data are non-stationary: take first differences of the data until the data are stationary.
- 4 Examine the ACF/PACF: Is an $AR(p)$ or $MA(q)$ model appropriate?
- 5 Try your chosen model(s), and use the AICc to search for a better model.
- 6 Check the residuals from your chosen model by plotting the ACF of the residuals, and doing a portmanteau test of the residuals. If they do not look like white noise, try a modified model.
- 7 Once the residuals look like white noise, calculate forecasts.

Automatic modelling procedure with ARIMA()

- 1 Plot the data. Identify any unusual observations.
- 2 If necessary, transform the data (using a Box-Cox transformation) to stabilize the variance.
- 3 Use ARIMA to automatically select a model.
- 4
- 5
- 6 Check the residuals from your chosen model by plotting the ACF of the residuals, and doing a portmanteau test of the residuals. If they do not look like white noise, try a modified model.
- 7 Once the residuals look like white noise, calculate forecasts.

Modelling procedure



Outline

- 1 Stationarity and differencing
- 2 Non-seasonal ARIMA models
- 3 Estimation and order selection
- 4 ARIMA modelling in R
- 5 Forecasting
- 6 Seasonal ARIMA models
- 7 ARIMA vs ETS

Point forecasts

- 1 Rearrange ARIMA equation so y_t is on LHS.
- 2 Rewrite equation by replacing t by $T + h$.
- 3 On RHS, replace future observations by their forecasts, future errors by zero, and past errors by corresponding residuals.

Start with $h = 1$. Repeat for $h = 2, 3, \dots$

Point forecasts

ARIMA(3,1,1) forecasts: Step 1

$$(1 - \phi_1 B - \phi_2 B^2 - \phi_3 B^3)(1 - B)y_t = (1 + \theta_1 B)\varepsilon_t,$$

Point forecasts

ARIMA(3,1,1) forecasts: Step 1

$$(1 - \phi_1 B - \phi_2 B^2 - \phi_3 B^3)(1 - B)y_t = (1 + \theta_1 B)\varepsilon_t,$$

$$\begin{aligned} \left[1 - (1 + \phi_1)B + (\phi_1 - \phi_2)B^2 + (\phi_2 - \phi_3)B^3 + \phi_3 B^4 \right] y_t \\ = (1 + \theta_1 B)\varepsilon_t, \end{aligned}$$

Point forecasts

ARIMA(3,1,1) forecasts: Step 1

$$(1 - \phi_1 B - \phi_2 B^2 - \phi_3 B^3)(1 - B)y_t = (1 + \theta_1 B)\varepsilon_t,$$

$$\begin{aligned} [1 - (1 + \phi_1)B + (\phi_1 - \phi_2)B^2 + (\phi_2 - \phi_3)B^3 + \phi_3 B^4] y_t \\ = (1 + \theta_1 B)\varepsilon_t, \end{aligned}$$

$$\begin{aligned} y_t - (1 + \phi_1)y_{t-1} + (\phi_1 - \phi_2)y_{t-2} + (\phi_2 - \phi_3)y_{t-3} \\ + \phi_3 y_{t-4} = \varepsilon_t + \theta_1 \varepsilon_{t-1}. \end{aligned}$$

Point forecasts

ARIMA(3,1,1) forecasts: Step 1

$$(1 - \phi_1 B - \phi_2 B^2 - \phi_3 B^3)(1 - B)y_t = (1 + \theta_1 B)\varepsilon_t,$$

$$\begin{aligned} [1 - (1 + \phi_1)B + (\phi_1 - \phi_2)B^2 + (\phi_2 - \phi_3)B^3 + \phi_3 B^4] y_t \\ = (1 + \theta_1 B)\varepsilon_t, \end{aligned}$$

$$\begin{aligned} y_t - (1 + \phi_1)y_{t-1} + (\phi_1 - \phi_2)y_{t-2} + (\phi_2 - \phi_3)y_{t-3} \\ + \phi_3 y_{t-4} = \varepsilon_t + \theta_1 \varepsilon_{t-1}. \end{aligned}$$

$$\begin{aligned} y_t = (1 + \phi_1)y_{t-1} - (\phi_1 - \phi_2)y_{t-2} - (\phi_2 - \phi_3)y_{t-3} \\ - \phi_3 y_{t-4} + \varepsilon_t + \theta_1 \varepsilon_{t-1}. \end{aligned}$$

Point forecasts (h=1)

$$y_t = (1 + \phi_1)y_{t-1} - (\phi_1 - \phi_2)y_{t-2} - (\phi_2 - \phi_3)y_{t-3} \\ - \phi_3y_{t-4} + \varepsilon_t + \theta_1\varepsilon_{t-1}.$$

Point forecasts (h=1)

$$y_t = (1 + \phi_1)y_{t-1} - (\phi_1 - \phi_2)y_{t-2} - (\phi_2 - \phi_3)y_{t-3} \\ - \phi_3y_{t-4} + \varepsilon_t + \theta_1\varepsilon_{t-1}.$$

ARIMA(3,1,1) forecasts: Step 2

$$y_{T+1} = (1 + \phi_1)y_T - (\phi_1 - \phi_2)y_{T-1} - (\phi_2 - \phi_3)y_{T-2} \\ - \phi_3y_{T-3} + \varepsilon_{T+1} + \theta_1\varepsilon_T.$$

Point forecasts (h=1)

$$y_t = (1 + \phi_1)y_{t-1} - (\phi_1 - \phi_2)y_{t-2} - (\phi_2 - \phi_3)y_{t-3} \\ - \phi_3y_{t-4} + \varepsilon_t + \theta_1\varepsilon_{t-1}.$$

ARIMA(3,1,1) forecasts: Step 2

$$y_{T+1} = (1 + \phi_1)y_T - (\phi_1 - \phi_2)y_{T-1} - (\phi_2 - \phi_3)y_{T-2} \\ - \phi_3y_{T-3} + \varepsilon_{T+1} + \theta_1\varepsilon_T.$$

ARIMA(3,1,1) forecasts: Step 3

$$\hat{y}_{T+1|T} = (1 + \phi_1)y_T - (\phi_1 - \phi_2)y_{T-1} - (\phi_2 - \phi_3)y_{T-2} \\ - \phi_3y_{T-3} + \theta_1e_T.$$

Point forecasts (h=2)

$$y_t = (1 + \phi_1)y_{t-1} - (\phi_1 - \phi_2)y_{t-2} - (\phi_2 - \phi_3)y_{t-3} \\ - \phi_3y_{t-4} + \varepsilon_t + \theta_1\varepsilon_{t-1}.$$

Point forecasts (h=2)

$$y_t = (1 + \phi_1)y_{t-1} - (\phi_1 - \phi_2)y_{t-2} - (\phi_2 - \phi_3)y_{t-3} \\ - \phi_3y_{t-4} + \varepsilon_t + \theta_1\varepsilon_{t-1}.$$

ARIMA(3,1,1) forecasts: Step 2

$$y_{T+2} = (1 + \phi_1)y_{T+1} - (\phi_1 - \phi_2)y_T - (\phi_2 - \phi_3)y_{T-1} \\ - \phi_3y_{T-2} + \varepsilon_{T+2} + \theta_1\varepsilon_{T+1}.$$

Point forecasts (h=2)

$$y_t = (1 + \phi_1)y_{t-1} - (\phi_1 - \phi_2)y_{t-2} - (\phi_2 - \phi_3)y_{t-3} \\ - \phi_3y_{t-4} + \varepsilon_t + \theta_1\varepsilon_{t-1}.$$

ARIMA(3,1,1) forecasts: Step 2

$$y_{T+2} = (1 + \phi_1)y_{T+1} - (\phi_1 - \phi_2)y_T - (\phi_2 - \phi_3)y_{T-1} \\ - \phi_3y_{T-2} + \varepsilon_{T+2} + \theta_1\varepsilon_{T+1}.$$

ARIMA(3,1,1) forecasts: Step 3

$$\hat{y}_{T+2|T} = (1 + \phi_1)\hat{y}_{T+1|T} - (\phi_1 - \phi_2)y_T - (\phi_2 - \phi_3)y_{T-1} \\ - \phi_3y_{T-2}.$$

Prediction intervals

95% prediction interval

$$\hat{y}_{T+h|T} \pm 1.96\sqrt{v_{T+h|T}}$$

where $v_{T+h|T}$ is estimated forecast variance.

Prediction intervals

95% prediction interval

$$\hat{y}_{T+h|T} \pm 1.96\sqrt{v_{T+h|T}}$$

where $v_{T+h|T}$ is estimated forecast variance.

- $v_{T+1|T} = \hat{\sigma}^2$ for all ARIMA models regardless of parameters and orders.
- Multi-step prediction intervals for ARIMA(0,0,q):

$$y_t = \varepsilon_t + \sum_{i=1}^q \theta_i \varepsilon_{t-i}.$$

$$v_{T|T+h} = \hat{\sigma}^2 \left[1 + \sum_{i=1}^{h-1} \theta_i^2 \right], \quad \text{for } h = 2, 3, \dots$$

Prediction intervals

95% prediction interval

$$\hat{y}_{T+h|T} \pm 1.96\sqrt{v_{T+h|T}}$$

where $v_{T+h|T}$ is estimated forecast variance.

- Multi-step prediction intervals for ARIMA(0,0,q):

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Prediction intervals

95% prediction interval

$$\hat{y}_{T+h|T} \pm 1.96\sqrt{v_{T+h|T}}$$

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- Multi-step prediction intervals for ARIMA(0,0,q):

$$y_t = \varepsilon_t + \sum_{i=1}^q \theta_i \varepsilon_{t-i}.$$

$$v_{T|T+h} = \hat{\sigma}^2 \left[1 + \sum_{i=1}^{h-1} \theta_i^2 \right], \quad \text{for } h = 2, 3, \dots$$

- AR(1): Rewrite as MA(∞) and use above result.
- Other models beyond scope of this subject.

Prediction intervals

- Prediction intervals **increase in size with forecast horizon.**
- Prediction intervals can be difficult to calculate by hand
- Calculations assume residuals are **uncorrelated** and **normally distributed.**
- Prediction intervals tend to be too narrow.
 - ▶ the uncertainty in the parameter estimates has not been accounted for.
 - ▶ the ARIMA model assumes historical patterns will not change during the forecast period.
 - ▶ the ARIMA model assumes uncorrelated future errors

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Seasonal ARIMA models

ARIMA	$\underbrace{(p, d, q)}$	$\underbrace{(P, D, Q)_m}$
	↑	↑
	Non-seasonal part of the model	Seasonal part of of the model

where m = number of observations per year.

Seasonal ARIMA models

E.g., $\text{ARIMA}(1, 1, 1)(1, 1, 1)_4$ model (without constant)

Seasonal ARIMA models

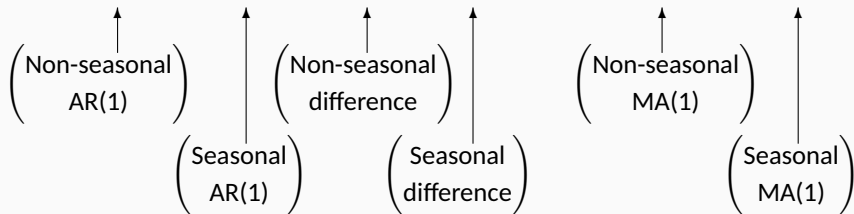
E.g., ARIMA(1, 1, 1)(1, 1, 1)₄ model (without constant)

$$(1 - \phi_1 B)(1 - \Phi_1 B^4)(1 - B)(1 - B^4)y_t = (1 + \theta_1 B)(1 + \Theta_1 B^4)\varepsilon_t.$$

Seasonal ARIMA models

E.g., ARIMA(1, 1, 1)(1, 1, 1)₄ model (without constant)

$$(1 - \phi_1 B)(1 - \Phi_1 B^4)(1 - B)(1 - B^4)y_t = (1 + \theta_1 B)(1 + \Theta_1 B^4)\varepsilon_t.$$



Seasonal ARIMA models

E.g., ARIMA(1, 1, 1)(1, 1, 1)₄ model (without constant)

$$(1 - \phi_1 B)(1 - \Phi_1 B^4)(1 - B)(1 - B^4)y_t = (1 + \theta_1 B)(1 + \Theta_1 B^4)\varepsilon_t.$$

All the factors can be multiplied out and the general model written as follows:

$$\begin{aligned} y_t = & (1 + \phi_1)y_{t-1} - \phi_1 y_{t-2} + (1 + \Phi_1)y_{t-4} \\ & - (1 + \phi_1 + \Phi_1 + \phi_1 \Phi_1)y_{t-5} + (\phi_1 + \phi_1 \Phi_1)y_{t-6} \\ & - \Phi_1 y_{t-8} + (\Phi_1 + \phi_1 \Phi_1)y_{t-9} - \phi_1 \Phi_1 y_{t-10} \\ & + \varepsilon_t + \theta_1 \varepsilon_{t-1} + \Theta_1 \varepsilon_{t-4} + \theta_1 \Theta_1 \varepsilon_{t-5}. \end{aligned}$$

Common ARIMA models

The US Census Bureau uses the following models most often:

ARIMA(0,1,1)(0,1,1)_m with log transformation

ARIMA(0,1,2)(0,1,1)_m with log transformation

ARIMA(2,1,0)(0,1,1)_m with log transformation

ARIMA(0,2,2)(0,1,1)_m with log transformation

ARIMA(2,1,2)(0,1,1)_m with no transformation

Seasonal ARIMA models

The seasonal part of an AR or MA model will be seen in the seasonal lags of the PACF and ACF.

ARIMA(0,0,0)(0,0,1)₁₂ will show:

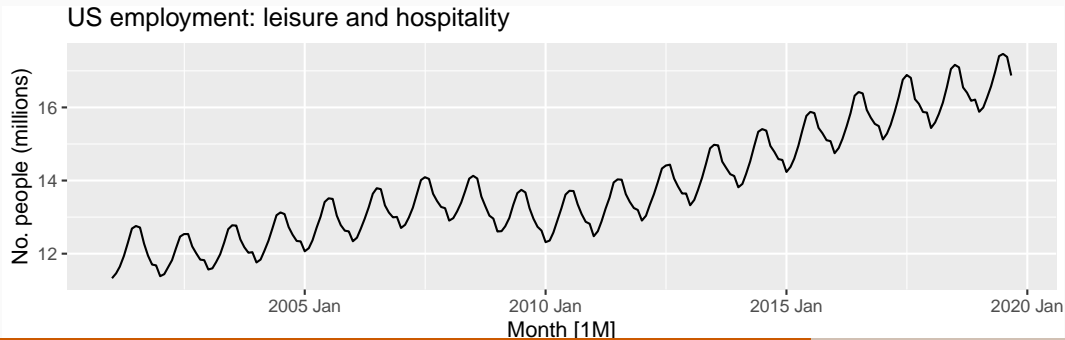
- a spike at lag 12 in the ACF but no other significant spikes.
- The PACF will show exponential decay in the seasonal lags; that is, at lags 12, 24, 36,

ARIMA(0,0,0)(1,0,0)₁₂ will show:

- exponential decay in the seasonal lags of the ACF
- a single significant spike at lag 12 in the PACF.

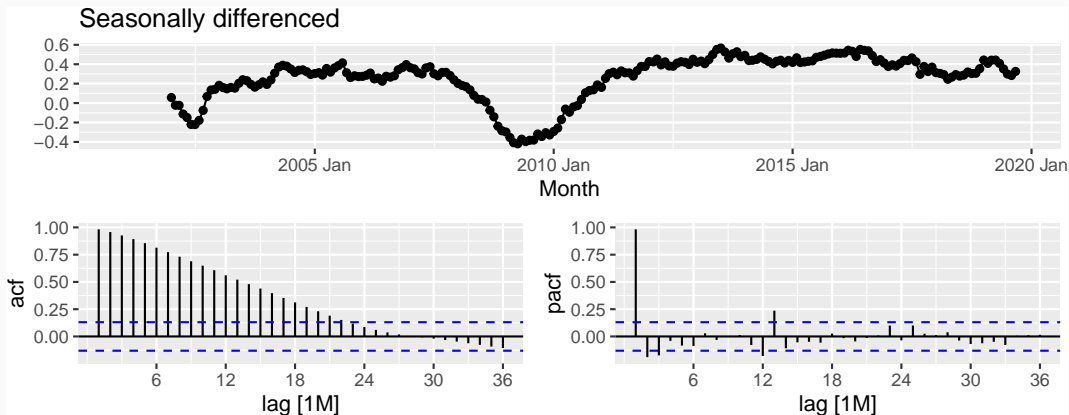
US leisure employment

```
leisure <- us_employment %>%  
  filter(Title == "Leisure and Hospitality", year(Month) > 2000) %>%  
  mutate(Employed = Employed/1000) %>%  
  select(Month, Employed)  
autoplot(leisure, Employed) +  
  labs(title = "US employment: leisure and hospitality", y="No. people (millions)")
```



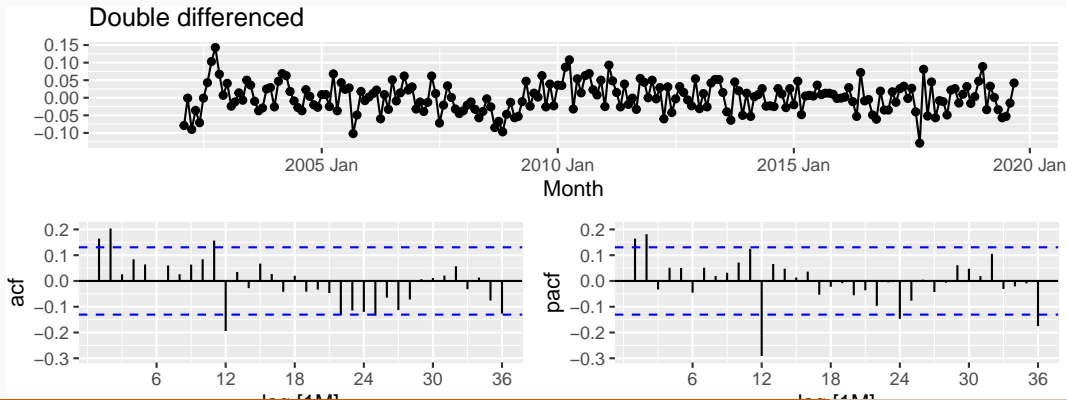
US leisure employment

```
leisure %>%  
  gg_tsddisplay(difference(Employed, 12), plot_type='partial', lag=36) +  
  labs(title="Seasonally differenced", y="")
```



US leisure employment

```
leisure %>%  
  gg_tsdisplay(difference(Employed, 12) %>% difference(),  
    plot_type='partial', lag=36) +  
  labs(title = "Double differenced", y="")
```



US leisure employment

```
fit <- leisure %>%  
  model(  
    arima012011 = ARIMA(Employed ~ pdq(0,1,2) + PDQ(0,1,1)),  
    arima210011 = ARIMA(Employed ~ pdq(2,1,0) + PDQ(0,1,1)),  
    auto = ARIMA(Employed, stepwise = FALSE, approx = FALSE)  
  )  
fit %>% pivot_longer(everything(), names_to = "Model name",  
                     values_to = "Orders")
```

```
## # A mable: 3 x 2  
## # Key:      Model name [3]  
##   `Model name`      Orders  
##   <chr>             <model>  
## 1 arima012011      <ARIMA(0,1,2)(0,1,1)[12]>  
## 2 arima210011      <ARIMA(2,1,0)(0,1,1)[12]>  
## 3 auto             <ARIMA(2,1,0)(1,1,1)[12]>
```

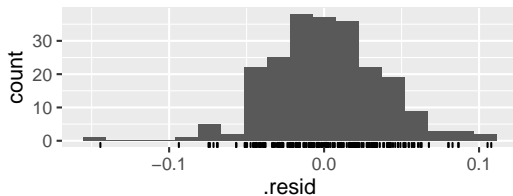
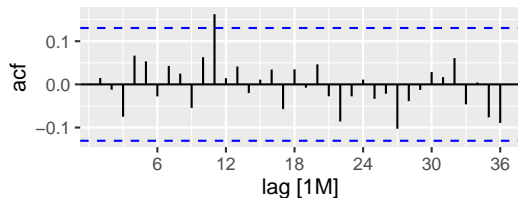
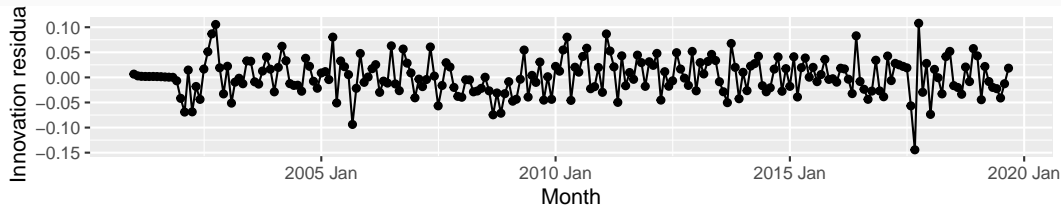

US leisure employment

```
glance(fit) %>% arrange(AICc) %>% select(.model:BIC)
```

```
## # A tibble: 3 x 6
##   .model      sigma2 log_lik   AIC  AICc   BIC
##   <chr>      <dbl>   <dbl> <dbl> <dbl> <dbl>
## 1 auto        0.00142    395. -780. -780. -763.
## 2 arima210011 0.00145    392. -776. -776. -763.
## 3 arima012011 0.00146    391. -775. -775. -761.
```

US leisure employment

```
fit %>% select(auto) %>% gg_tsresiduals(lag=36)
```



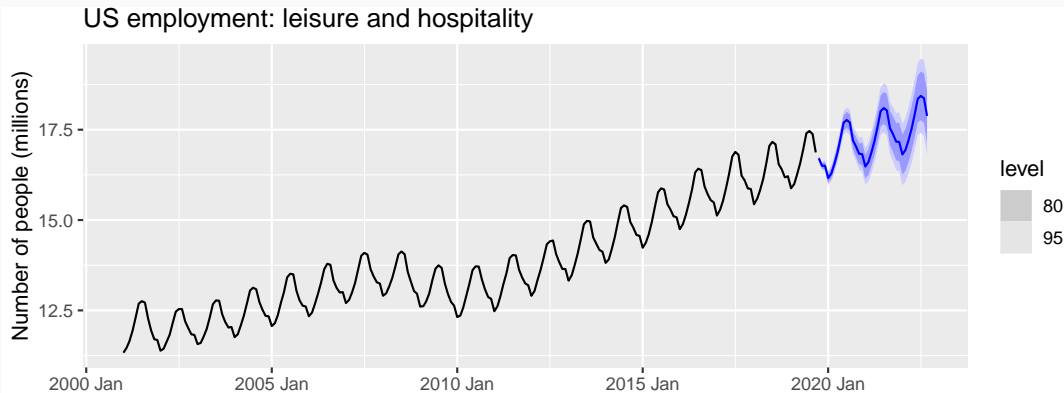
US leisure employment

```
augment(fit) %>% features(.innov, ljung_box, lag=24, dof=4)
```

```
## # A tibble: 3 x 3
##   .model      lb_stat lb_pvalue
##   <chr>      <dbl>    <dbl>
## 1 arima012011  22.4      0.320
## 2 arima210011  18.9      0.527
## 3 auto        16.6      0.680
```

US leisure employment

```
forecast(fit, h=36) %>%  
  filter(.model=='auto') %>%  
  autoplot(leisure) +  
  labs(title = "US employment: leisure and hospitality", y="Number of people (millions)")
```

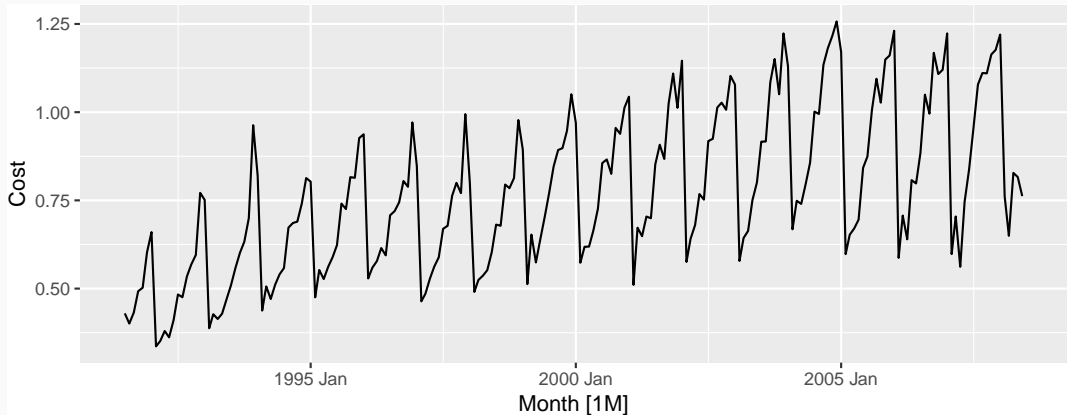


Corticosteroid drug sales

```
h02 <- PBS %>%  
  filter(ATC2 == "H02") %>%  
  summarise(Cost = sum(Cost)/1e6)
```

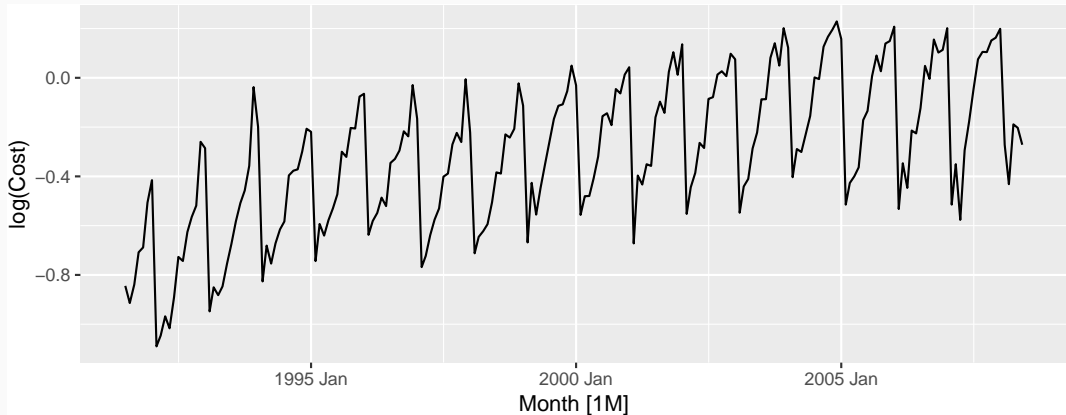
Corticosteroid drug sales

```
h02 %>% autoplot(  
  Cost  
)
```



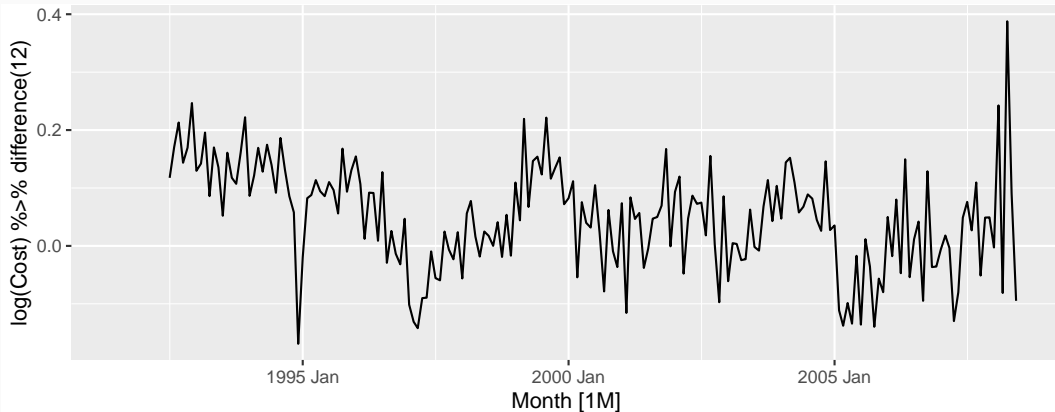
Corticosteroid drug sales

```
h02 %>% autoplot(  
  log(Cost)  
)
```



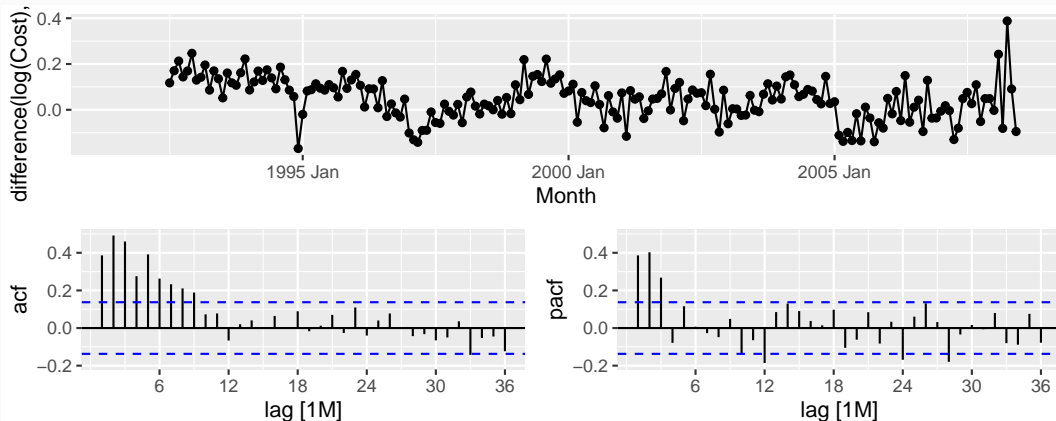
Corticosteroid drug sales

```
h02 %>% autoplot(  
  log(Cost) %>% difference(12)  
)
```



Corticosteroid drug sales

```
h02 %>% gg_tsdisplay(difference(log(Cost),12),  
  lag_max = 36, plot_type = 'partial')
```



Corticosteroid drug sales

- Choose $D = 1$ and $d = 0$.
- Spikes in PACF at lags 12 and 24 suggest seasonal AR(2) term.
- Spikes in PACF suggests possible non-seasonal AR(3) term.
- Initial candidate model: $\text{ARIMA}(3,0,0)(2,1,0)_{12}$.

Corticosteroid drug sales

.model	AICc
ARIMA(3,0,1)(0,1,2)[12]	-485
ARIMA(3,0,1)(1,1,1)[12]	-484
ARIMA(3,0,1)(0,1,1)[12]	-484
ARIMA(3,0,1)(2,1,0)[12]	-476
ARIMA(3,0,0)(2,1,0)[12]	-475
ARIMA(3,0,2)(2,1,0)[12]	-475
ARIMA(3,0,1)(1,1,0)[12]	-463

Corticosteroid drug sales

```
fit <- h02 %>%  
  model(best = ARIMA(log(Cost) ~ 0 + pdq(3,0,1) + PDQ(0,1,2)))  
report(fit)
```

```
## Series: Cost
```

```
## Model: ARIMA(3,0,1)(0,1,2)[12]
```

```
## Transformation: log(Cost)
```

```
##
```

```
## Coefficients:
```

	ar1	ar2	ar3	ma1	sma1	sma2
	-0.160	0.5481	0.5678	0.383	-0.5222	-0.1768
s.e.	0.164	0.0878	0.0942	0.190	0.0861	0.0872

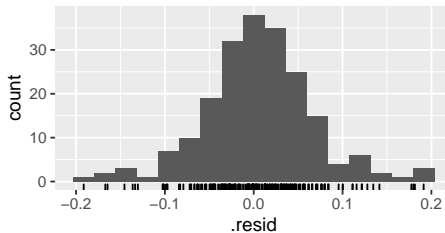
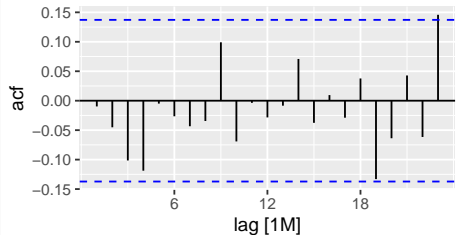
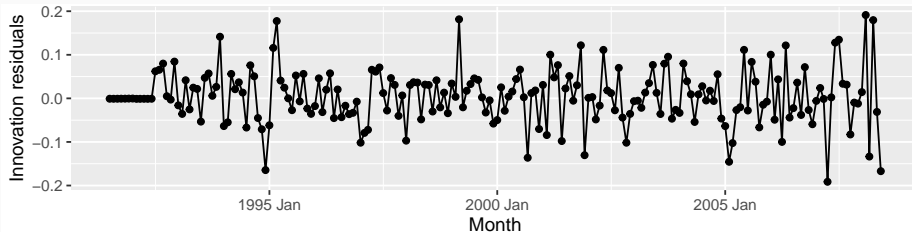
```
##
```

```
## sigma^2 estimated as 0.004278: log likelihood=250
```

```
## AIC=-486 AICc=-485 BIC=-463
```

Corticosteroid drug sales

```
gg_tsresiduals(fit)
```



Corticosteroid drug sales

```
augment(fit) %>%  
  features(.innov, ljung_box, lag = 36, dof = 6)
```

```
## # A tibble: 1 x 3  
##   .model lb_stat lb_pvalue  
##   <chr>    <dbl>    <dbl>  
## 1 best      50.7      0.0104
```

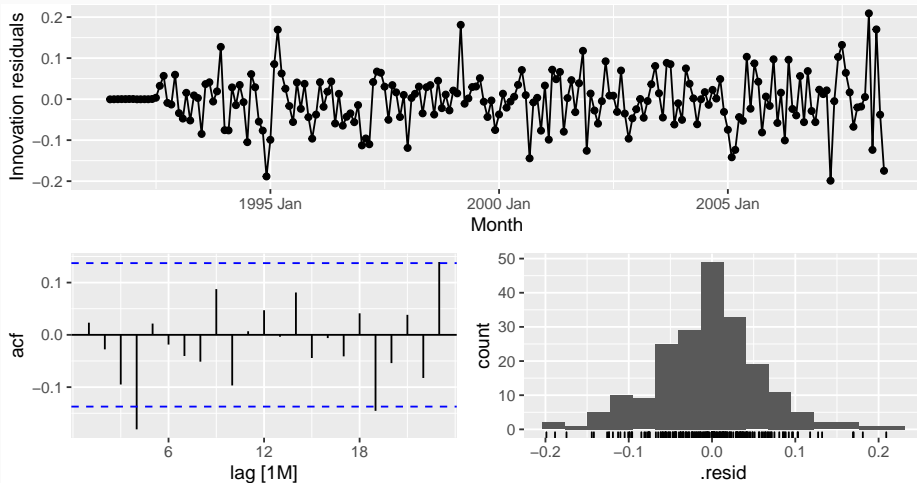
Corticosteroid drug sales

```
fit <- h02 %>% model(auto = ARIMA(log(Cost)))  
report(fit)
```

```
## Series: Cost  
## Model: ARIMA(2,1,0)(0,1,1)[12]  
## Transformation: log(Cost)  
##  
## Coefficients:  
##          ar1      ar2      sma1  
##      -0.8491  -0.4207  -0.6401  
## s.e.   0.0712   0.0714   0.0694  
##  
## sigma^2 estimated as 0.004387:  log likelihood=245  
## AIC=-483   AICc=-483   BIC=-470
```

Corticosteroid drug sales

```
gg_tsresiduals(fit)
```



Corticosteroid drug sales

```
augment(fit) %>%  
  features(.innov, ljung_box, lag = 36, dof = 3)
```

```
## # A tibble: 1 x 3  
##   .model lb_stat lb_pvalue  
##   <chr>    <dbl>    <dbl>  
## 1 auto      59.3    0.00332
```

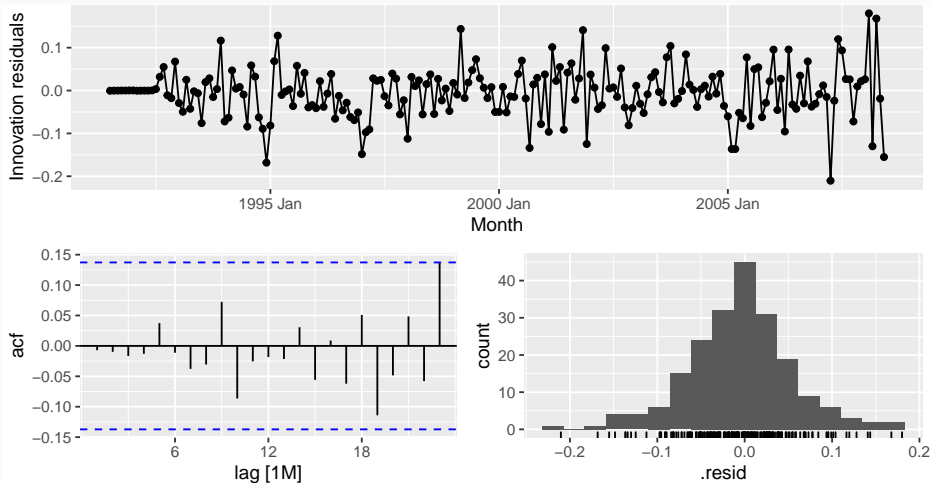
Corticosteroid drug sales

```
fit <- h02 %>%  
  model(best = ARIMA(log(Cost), stepwise = FALSE,  
    approximation = FALSE,  
    order_constraint = p + q + P + Q <= 9))  
report(fit)
```

```
## Series: Cost  
## Model: ARIMA(4,1,1)(2,1,2)[12]  
## Transformation: log(Cost)  
##  
## Coefficients:  
##          ar1      ar2      ar3      ar4      ma1      sar1      sar2      sma1      sma2  
##      -0.0425  0.210  0.202  -0.227  -0.742  0.621  -0.383  -1.202  0.496  
## s.e.   0.2167  0.181  0.114   0.081   0.207  0.242   0.118   0.249  0.213  
##  
## sigma^2 estimated as 0.004049:  log likelihood=254  
## AIC=-489    AICc=-487    BIC=-456
```

Corticosteroid drug sales

```
gg_tsresiduals(fit)
```



Corticosteroid drug sales

```
augment(fit) %>%  
  features(.innov, ljung_box, lag = 36, dof = 9)
```

```
## # A tibble: 1 x 3  
##   .model lb_stat lb_pvalue  
##   <chr>    <dbl>    <dbl>  
## 1 best      36.5      0.106
```

Corticosteroid drug sales

Training data: July 1991 to June 2006

Test data: July 2006–June 2008

```
fit <- h02 %>%  
  filter_index(~ "2006 Jun") %>%  
  model(  
    ARIMA(log(Cost) ~ 0 + pdq(3, 0, 0) + PDQ(2, 1, 0)),  
    ARIMA(log(Cost) ~ 0 + pdq(3, 0, 1) + PDQ(2, 1, 0)),  
    ARIMA(log(Cost) ~ 0 + pdq(3, 0, 2) + PDQ(2, 1, 0)),  
    ARIMA(log(Cost) ~ 0 + pdq(3, 0, 1) + PDQ(1, 1, 0))  
    # ... #  
  )  
  
fit %>%  
  forecast(h = "2 years") %>%  
  accuracy(h02)
```

Corticosteroid drug sales

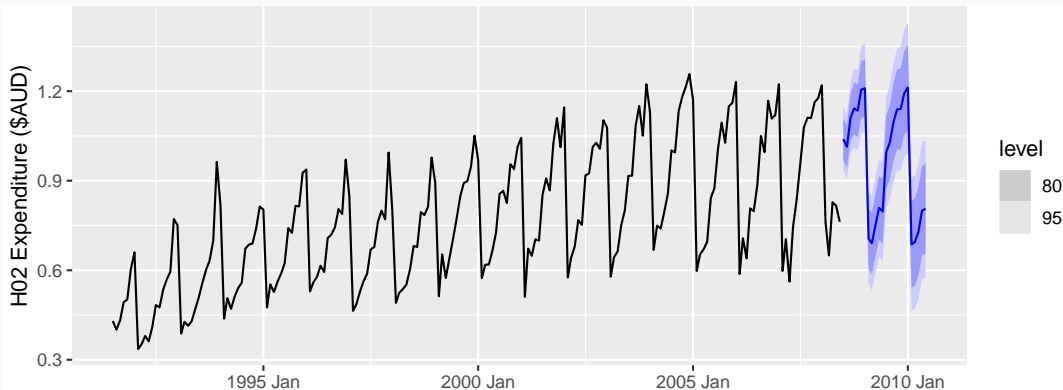
.model	RMSE
ARIMA(3,0,1)(1,1,1)[12]	0.0619
ARIMA(3,0,1)(0,1,2)[12]	0.0621
ARIMA(3,0,1)(0,1,1)[12]	0.0630
ARIMA(2,1,0)(0,1,1)[12]	0.0630
ARIMA(4,1,1)(2,1,2)[12]	0.0631
ARIMA(3,0,2)(2,1,0)[12]	0.0651
ARIMA(3,0,1)(2,1,0)[12]	0.0653
ARIMA(3,0,1)(1,1,0)[12]	0.0666
ARIMA(3,0,0)(2,1,0)[12]	0.0668

Corticosteroid drug sales

- Models with lowest AICc values tend to give slightly better results than the other models.
- AICc comparisons must have the same orders of differencing.
But RMSE test set comparisons can involve any models.
- Use the best model available, even if it does not pass all tests.

Corticosteroid drug sales

```
fit <- h02 %>%  
  model(ARIMA(Cost ~ 0 + pdq(3,0,1) + PDQ(0,1,2)))  
fit %>% forecast %>% autoplot(h02) +  
  labs(y = "H02 Expenditure ($AUD)")
```



Outline

- 1 Stationarity and differencing
- 2 Non-seasonal ARIMA models
- 3 Estimation and order selection
- 4 ARIMA modelling in R
- 5 Forecasting
- 6 Seasonal ARIMA models
- 7 ARIMA vs ETS

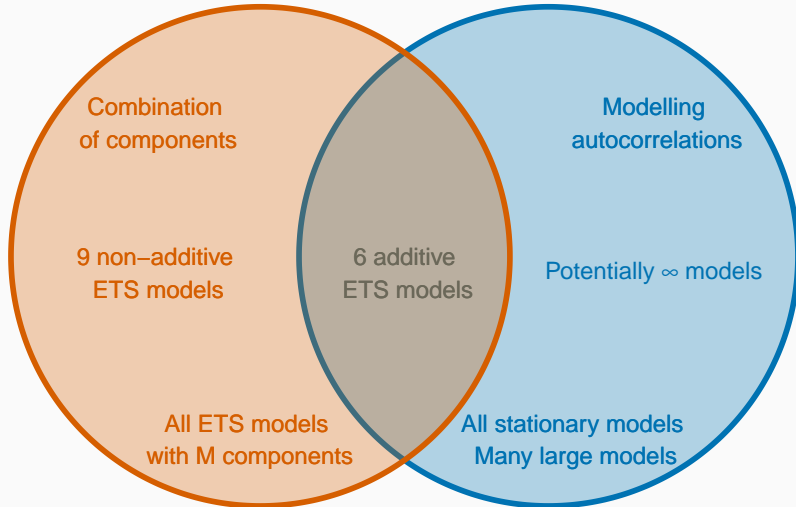
ARIMA vs ETS

- Myth that ARIMA models are more general than exponential smoothing.
- Linear exponential smoothing models all special cases of ARIMA models.
- Non-linear exponential smoothing models have no equivalent ARIMA counterparts.
- Many ARIMA models have no exponential smoothing counterparts.
- ETS models all non-stationary. Models with seasonality or non-damped trend (or both) have two unit roots; all other models have one unit root.

ARIMA vs ETS

ETS models

ARIMA models



Equivalences

ETS model	ARIMA model	Parameters
ETS(A,N,N)	ARIMA(0,1,1)	$\theta_1 = \alpha - 1$
ETS(A,A,N)	ARIMA(0,2,2)	$\theta_1 = \alpha + \beta - 2$ $\theta_2 = 1 - \alpha$
ETS(A,A _d ,N)	ARIMA(1,1,2)	$\phi_1 = \phi$ $\theta_1 = \alpha + \phi\beta - 1 - \phi$ $\theta_2 = (1 - \alpha)\phi$
ETS(A,N,A)	ARIMA(0,0,m)(0,1,0) _m	
ETS(A,A,A)	ARIMA(0,1,m+1)(0,1,0) _m	
ETS(A,A _d ,A)	ARIMA(1,0,m+1)(0,1,0) _m	

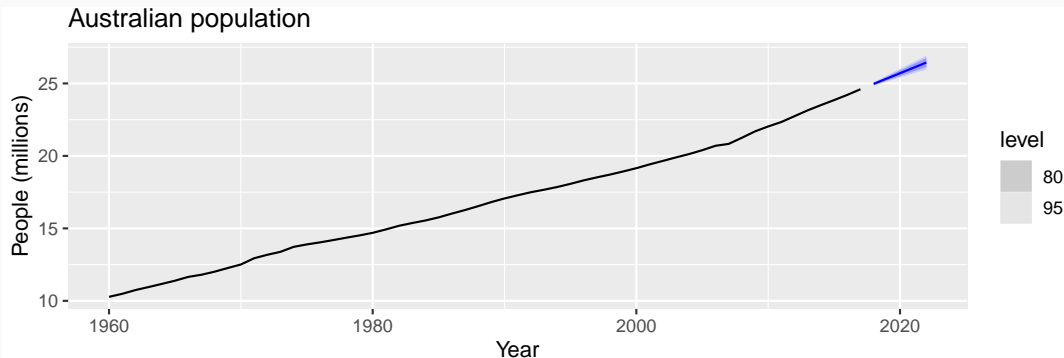
Example: Australian population

```
aus_economy <- global_economy %>% filter(Code == "AUS") %>%  
  mutate(Population = Population/1e6)  
aus_economy %>%  
  slice(-n()) %>%  
  stretch_tsibble(.init = 10) %>%  
  model(eta = ETS(Population),  
        arima = ARIMA(Population)  
  ) %>%  
  forecast(h = 1) %>%  
  accuracy(aus_economy) %>%  
  select(.model, ME:RMSSE)
```

```
## # A tibble: 2 x 8  
##   .model      ME    RMSE    MAE    MPE    MAPE    MASE  RMSSE  
##   <chr>    <dbl>  <dbl>  <dbl> <dbl>  <dbl>  <dbl>  <dbl>  
## 1 arima  0.0420  0.194  0.0789  0.277  0.509  0.317  0.746  
## 2 eta    0.0202  0.0774  0.0543  0.112  0.327  0.218  0.298
```

Example: Australian population

```
aus_economy %>%  
  model(ETS(Population)) %>%  
  forecast(h = "5 years") %>%  
  autoplot(aus_economy) +  
  labs(title = "Australian population", y = "People (millions)")
```



Example: Cement production

```
cement <- aus_production %>%  
  select(Cement) %>%  
  filter_index("1988 Q1" ~ .)  
train <- cement %>% filter_index(. ~ "2007 Q4")  
fit <- train %>%  
  model(  
    arima = ARIMA(Cement),  
    ets = ETS(Cement)  
  )
```

Example: Cement production

```
fit %>%  
  select(arima) %>%  
  report()
```

```
## Series: Cement  
## Model: ARIMA(1,0,1)(2,1,1)[4] w/ drift  
##  
## Coefficients:  
##          ar1      ma1      sar1      sar2      sma1      constant  
##      0.8886  -0.237   0.081   -0.234   -0.898         5.39  
## s.e.  0.0842   0.133   0.157    0.139    0.178         1.48  
##  
## sigma^2 estimated as 11456:  log likelihood=-464  
## AIC=941   AICc=943   BIC=957
```

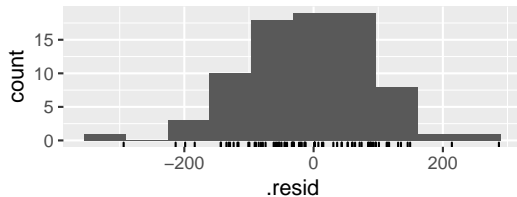
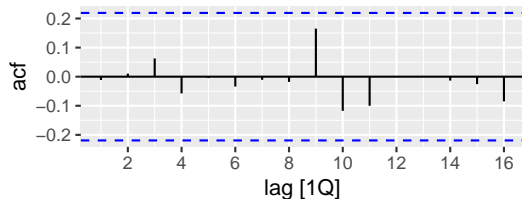
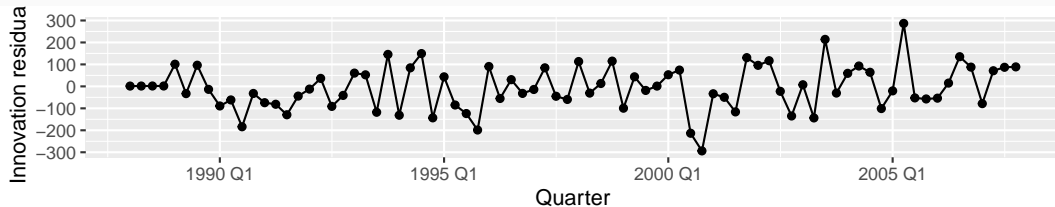

Example: Cement production

```
fit %>%  
  select(ets) %>%  
  report()
```

```
## Series: Cement  
## Model: ETS(M,N,M)  
## Smoothing parameters:  
##   alpha = 0.753  
##   gamma = 1e-04  
##  
## Initial states:  
## l[0] s[0] s[-1] s[-2] s[-3]  
## 1695 1.03  1.05  1.01 0.912  
##  
## sigma^2:  0.0034  
##  
## AIC AICc BIC  
## 1104 1106 1121
```

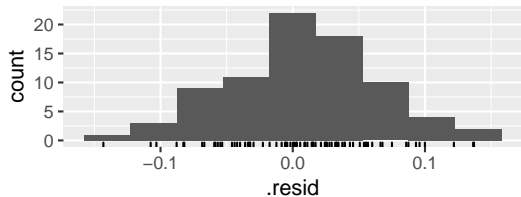
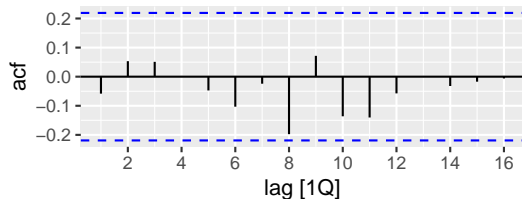
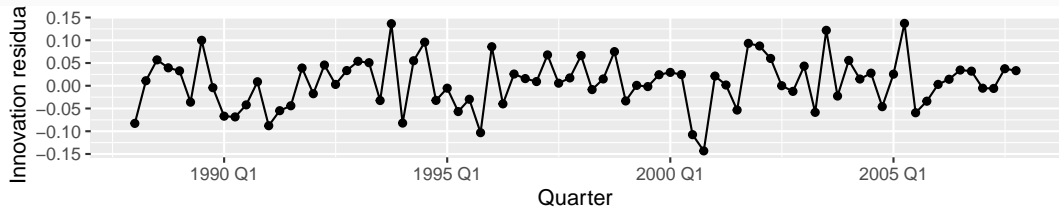
Example: Cement production

```
gg_tsresiduals(fit %>% select(arima), lag_max = 16)
```



Example: Cement production

```
gg_tsresiduals(fit %>% select(ets), lag_max = 16)
```



Example: Cement production

```
fit %>%  
  select(arima) %>%  
  augment() %>%  
  features(.innov, ljung_box, lag = 16, dof = 6)
```

```
## # A tibble: 1 x 3  
##   .model lb_stat lb_pvalue  
##   <chr>    <dbl>    <dbl>  
## 1 arima      6.37      0.783
```

Example: Cement production

```
fit %>%  
  select(ets) %>%  
  augment() %>%  
  features(.innov, ljung_box, lag = 16, dof = 6)
```

```
## # A tibble: 1 x 3  
##   .model lb_stat lb_pvalue  
##   <chr>    <dbl>    <dbl>  
## 1 ets      10.0      0.438
```

Example: Cement production

```
fit %>%  
  forecast(h = "2 years 6 months") %>%  
  accuracy(cement) %>%  
  select(-ME, -MPE, -ACF1)
```

```
## # A tibble: 2 x 7  
##   .model .type  RMSE    MAE  MAPE  MASE RMSSE  
##   <chr>  <chr> <dbl> <dbl> <dbl> <dbl> <dbl>  
## 1 arima  Test   216.  186.  8.68  1.27  1.26  
## 2 ets   Test   222.  191.  8.85  1.30  1.29
```

Example: Cement production

```
fit %>%  
  select(arima) %>%  
  forecast(h="3 years") %>%  
  autoplot(cement) +  
  labs(title = "Cement production in Australia", y="Tonnes ('000)")
```

