



# Forecasting: principles and practice

Rob J Hyndman

3.1 Dynamic regression

# Outline

- 1 Regression with ARIMA errors
- 2 Lab session 19
- 3 Some useful predictors for linear models
- 4 Dynamic harmonic regression
- 5 Lab session 20
- 6 Lagged predictors

# Regression with ARIMA errors

## Regression models

$$y_t = \beta_0 + \beta_1 x_{1,t} + \cdots + \beta_k x_{k,t} + \varepsilon_t,$$

- $y_t$  modeled as function of  $k$  explanatory variables  $x_{1,t}, \dots, x_{k,t}$ .
- In regression, we assume that  $\varepsilon_t$  was WN.
- Now we want to allow  $\varepsilon_t$  to be autocorrelated.

# Regression with ARIMA errors

## Regression models

$$y_t = \beta_0 + \beta_1 x_{1,t} + \cdots + \beta_k x_{k,t} + \varepsilon_t,$$

- $y_t$  modeled as function of  $k$  explanatory variables  $x_{1,t}, \dots, x_{k,t}$ .
- In regression, we assume that  $\varepsilon_t$  was WN.
- Now we want to allow  $\varepsilon_t$  to be autocorrelated.

## Example: ARIMA(1,1,1) errors

$$y_t = \beta_0 + \beta_1 x_{1,t} + \cdots + \beta_k x_{k,t} + \eta_t,$$
$$(1 - \phi_1 B)(1 - B)\eta_t = (1 + \theta_1 B)\varepsilon_t,$$

where  $\varepsilon_t$  is white noise.

# Residuals and errors

**Example:  $\eta_t = \text{ARIMA}(1,1,1)$**

$$y_t = \beta_0 + \beta_1 x_{1,t} + \cdots + \beta_k x_{k,t} + \eta_t,$$

$$(1 - \phi_1 B)(1 - B)\eta_t = (1 + \theta_1 B)\varepsilon_t,$$

# Residuals and errors

**Example:  $\eta_t = \text{ARIMA}(1,1,1)$**

$$y_t = \beta_0 + \beta_1 x_{1,t} + \cdots + \beta_k x_{k,t} + \eta_t,$$
$$(1 - \phi_1 B)(1 - B)\eta_t = (1 + \theta_1 B)\varepsilon_t,$$

- Be careful in distinguishing  $\eta_t$  from  $\varepsilon_t$ .
- Only the errors  $\eta_t$  are assumed to be white noise.
- In ordinary regression,  $\eta_t$  is assumed to be white noise and so  $\eta_t = \varepsilon_t$ .

# Estimation

If we minimize  $\sum \eta_t^2$  (by using ordinary regression):

- 1 Estimated coefficients  $\hat{\beta}_0, \dots, \hat{\beta}_k$  are no longer optimal as some information ignored;
- 2 Statistical tests associated with the model (e.g., t-tests on the coefficients) are incorrect.
- 3  $p$ -values for coefficients usually too small (“spurious regression”).
- 4 AIC of fitted models misleading.

# Estimation

If we minimize  $\sum \eta_t^2$  (by using ordinary regression):

- 1 Estimated coefficients  $\hat{\beta}_0, \dots, \hat{\beta}_k$  are no longer optimal as some information ignored;
  - 2 Statistical tests associated with the model (e.g., t-tests on the coefficients) are incorrect.
  - 3  $p$ -values for coefficients usually too small (“spurious regression”).
  - 4 AIC of fitted models misleading.
- Minimizing  $\sum \varepsilon_t^2$  avoids these problems.
  - Maximizing likelihood is similar to minimizing  $\sum \varepsilon_t^2$ .



# Stationarity

## Regression with ARMA errors

$$y_t = \beta_0 + \beta_1 x_{1,t} + \cdots + \beta_k x_{k,t} + \eta_t,$$

where  $\eta_t$  is an ARMA process.

- If we estimate the model while any variable is non-stationary, the estimated coefficients can be incorrect.
- Difference variables until all stationary.
- If necessary, apply same differencing to all variables to preserve interpretability.

# Regression with ARIMA errors

Any regression with an ARIMA error can be rewritten as a regression with an ARMA error by differencing all variables with the same differencing operator as in the ARIMA model.

# Regression with ARIMA errors

Any regression with an ARIMA error can be rewritten as a regression with an ARMA error by differencing all variables with the same differencing operator as in the ARIMA model.

## Original data

$$y_t = \beta_0 + \beta_1 x_{1,t} + \cdots + \beta_k x_{k,t} + \eta_t$$

$$\text{where } \phi(B)(1-B)^d \eta_t = \theta(B)\varepsilon_t$$

# Regression with ARIMA errors

Any regression with an ARIMA error can be rewritten as a regression with an ARMA error by differencing all variables with the same differencing operator as in the ARIMA model.

## Original data

$$y_t = \beta_0 + \beta_1 x_{1,t} + \cdots + \beta_k x_{k,t} + \eta_t$$

$$\text{where } \phi(B)(1-B)^d \eta_t = \theta(B)\varepsilon_t$$

## After differencing all variables

$$y'_t = \beta_1 x'_{1,t} + \cdots + \beta_k x'_{k,t} + \eta'_t.$$

$$\text{where } \phi(B)\eta'_t = \theta(B)\varepsilon_t$$

$$\text{and } y'_t = (1-B)^d y_t$$

# Model selection

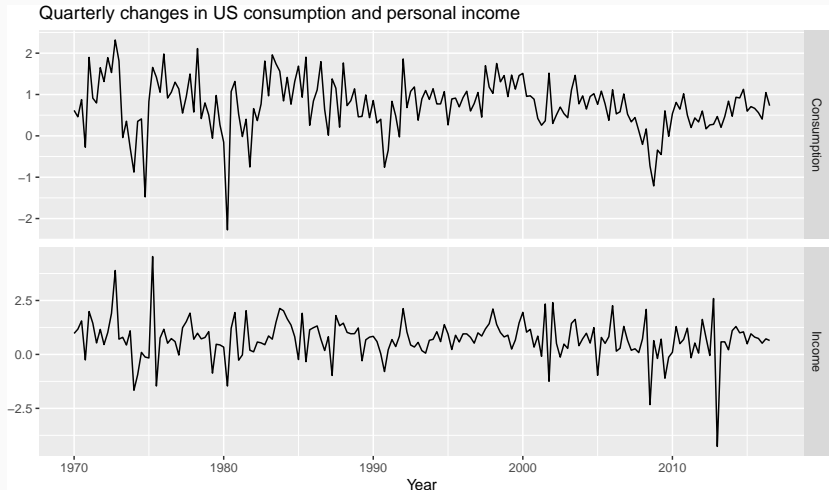
- Fit regression model with automatically selected ARIMA errors.
- Check that  $\varepsilon_t$  series looks like white noise.

## Selecting predictors

- AICc can be calculated for final model.
- Repeat procedure for all subsets of predictors to be considered, and select model with lowest AICc value.

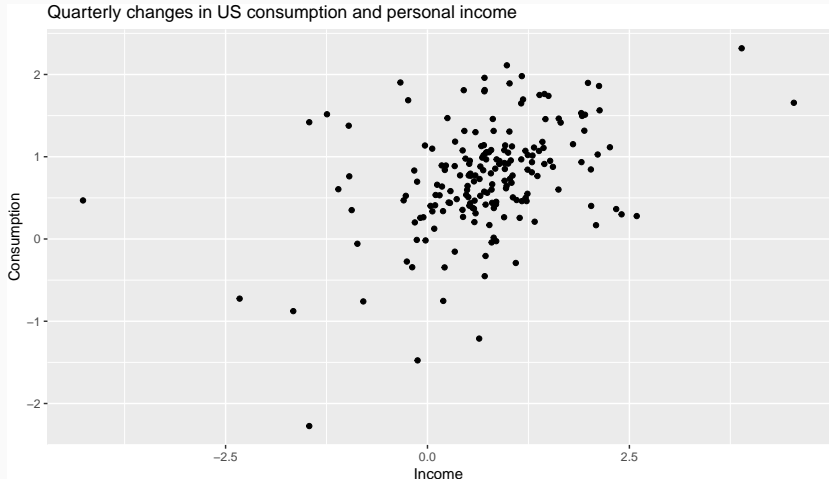
# US personal consumption and income

```
autoplot(uschange[,1:2], facets=TRUE) +  
  xlab("Year") + ylab("") +  
  ggtitle("Quarterly changes in US consumption and personal income")
```



# US personal consumption and income

```
qplot(Income, Consumption, data=as.data.frame(uschange)) +  
  ggtitle("Quarterly changes in US consumption and personal income")
```



# US personal consumption and income

- No need for transformations or further differencing.
- Increase in income does not necessarily translate into instant increase in consumption (e.g., after the loss of a job, it may take a few months for expenses to be reduced to allow for the new circumstances). We will ignore this for now.



# US personal consumption and income

```
(fit <- auto.arima(uschange[,1], xreg=uschange[,2]))
```

```
## Series: uschange[, 1]
## Regression with ARIMA(1,0,2) errors
##
## Coefficients:
##          ar1      ma1      ma2  intercept      xreg
##      0.692  -0.576  0.198      0.599  0.203
## s.e.  0.116   0.130  0.076      0.088  0.046
##
## sigma^2 estimated as 0.322:  log likelihood=-156.9
## AIC=325.9   AICc=326.4   BIC=345.3
```

# US personal consumption and income

```
(fit <- auto.arima(uschange[,1], xreg=uschange[,2]))
```

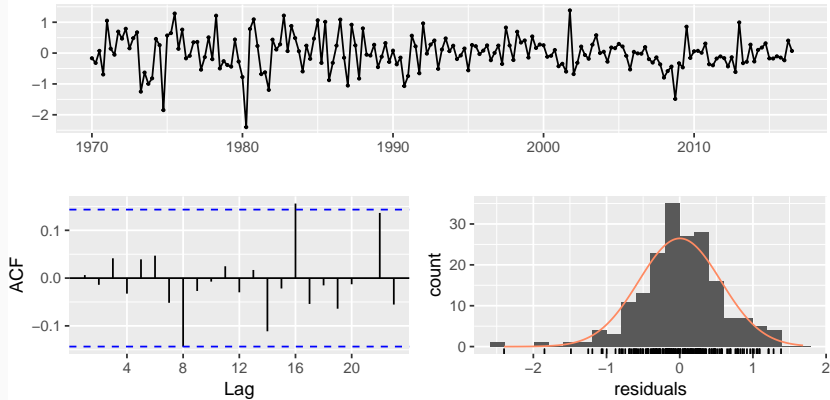
```
## Series: uschange[, 1]
## Regression with ARIMA(1,0,2) errors
##
## Coefficients:
##          ar1      ma1      ma2  intercept      xreg
##          0.692  -0.576   0.198         0.599   0.203
## s.e.    0.116    0.130   0.076         0.088   0.046
##
## sigma^2 estimated as 0.322:  log likelihood=-156.9
## AIC=325.9   AICc=326.4   BIC=345.3
```

Write down the equations for the fitted model.

# US personal consumption and income

```
checkresiduals(fit, test=FALSE)
```

Residuals from Regression with ARIMA(1,0,2) errors



# US personal consumption and income

```
checkresiduals(fit, plot=FALSE)
```

```
##
```

```
## Ljung-Box test
```

```
##
```

```
## data: Residuals from Regression with ARIMA(1,0,2) errors
```

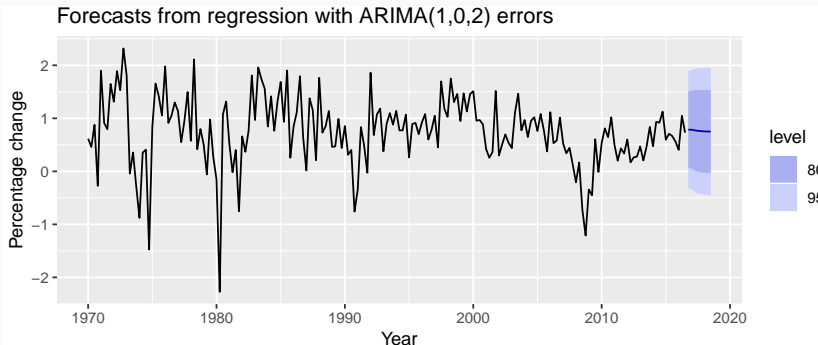
```
## Q* = 5.9, df = 3, p-value = 0.1
```

```
##
```

```
## Model df: 5. Total lags used: 8
```

# US personal consumption and income

```
fcast <- forecast(fit,  
  xreg=rep(mean(uschange[,2]),8), h=8)  
autoplot(fcast) + xlab("Year") +  
  ylab("Percentage change") +  
  ggtitle("Forecasts from regression with ARIMA(1,0,2) errors")
```



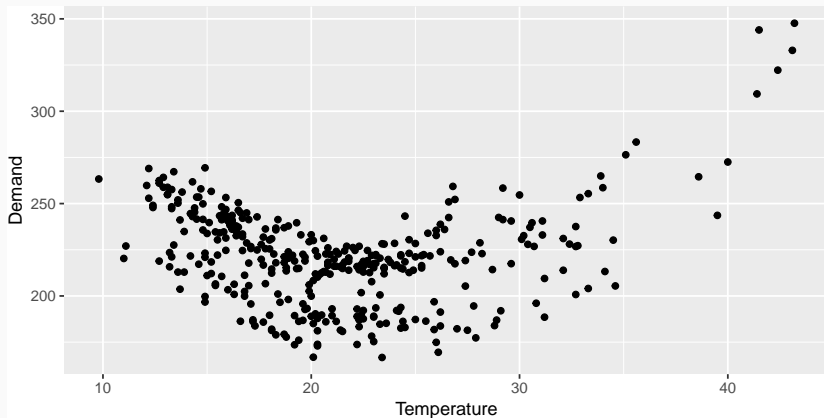
# Forecasting

- To forecast a regression model with ARIMA errors, we need to forecast the regression part of the model and the ARIMA part of the model and combine the results.
- Some predictors are known into the future (e.g., time, dummies).
- Separate forecasting models may be needed for other predictors.
- Forecast intervals ignore the uncertainty in forecasting the predictors.

# Daily electricity demand

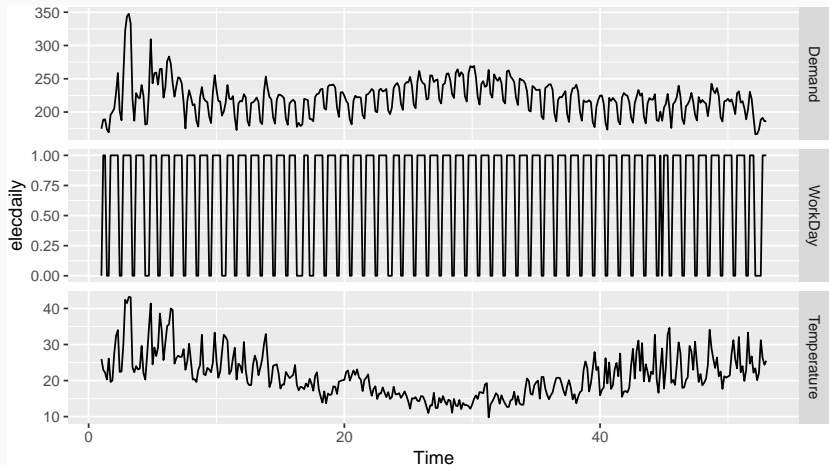
Model daily electricity demand as a function of temperature using quadratic regression with ARMA errors.

```
qplot(elecdaily[, "Temperature"], elecdaily[, "Demand"]) +  
  xlab("Temperature") + ylab("Demand")
```



# Daily electricity demand

```
autoplot(elecdaily, facets = TRUE)
```

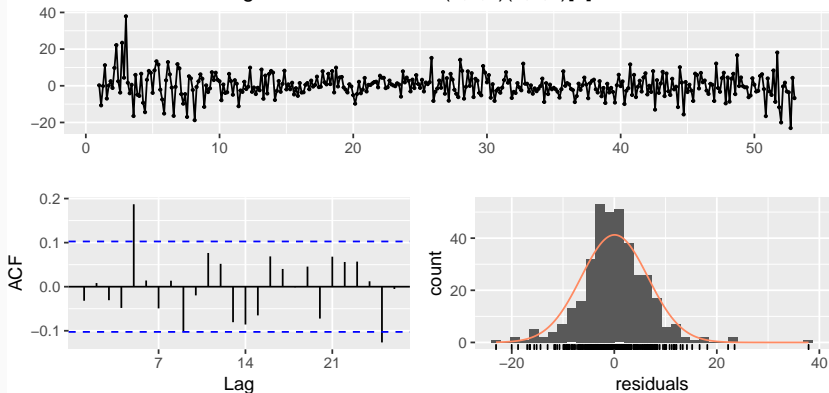




# Daily electricity demand

```
xreg <- cbind(MaxTemp = elecdaily[, "Temperature"],  
              MaxTempSq = elecdaily[, "Temperature"]^2,  
              Workday = elecdaily[, "WorkDay"])  
fit <- auto.arima(elecdaily[, "Demand"], xreg = xreg)  
checkresiduals(fit)
```

Residuals from Regression with ARIMA(2,1,2)(2,0,0)[7] errors



# Daily electricity demand

```
##  
##  Ljung-Box test  
##  
## data:  Residuals from Regression with ARIMA(2,1,2)(2,0,0)[7] errors  
## Q* = 28, df = 4, p-value = 1e-05  
##  
## Model df: 10.    Total lags used: 14
```

# Daily electricity demand

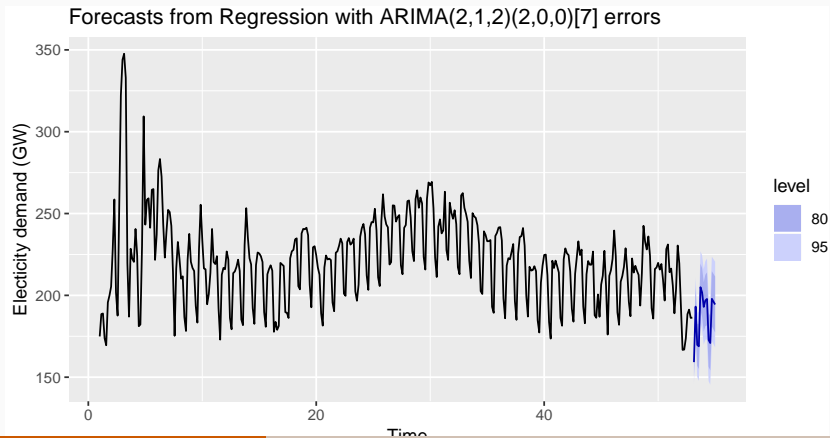
```
# Forecast one day ahead
```

```
forecast(fit, xreg = cbind(26, 26^2, 1))
```

```
##          Point Forecast Lo 80 Hi 80 Lo 95 Hi 95  
## 53.14          189.8 181.3 198.2 176.8 202.7
```

# Daily electricity demand

```
fcast <- forecast(fit,  
  xreg = cbind(rep(26,14), rep(26^2,14),  
    c(0,1,0,0,1,1,1,1,1,0,0,1,1,1)))  
autoplot(fcast) + ylab("Electricity demand (GW)")
```



# Outline

- 1 Regression with ARIMA errors
- 2 Lab session 19
- 3 Some useful predictors for linear models
- 4 Dynamic harmonic regression
- 5 Lab session 20
- 6 Lagged predictors

# Lab Session 19

# Outline

- 1 Regression with ARIMA errors
- 2 Lab session 19
- 3 Some useful predictors for linear models
- 4 Dynamic harmonic regression
- 5 Lab session 20
- 6 Lagged predictors

## Linear trend

$$x_t = t$$

- $t = 1, 2, \dots, T$
- Strong assumption that trend will continue.



# Dummy variables

If a categorical variable takes only two values (e.g., 'Yes' or 'No'), then an equivalent numerical variable can be constructed taking value 1 if yes and 0 if no. This is called a **dummy variable**.

	A	B
1	Yes	1
2	Yes	1
3	No	0
4	Yes	1
5	No	0
6	No	0
7	Yes	1
8	Yes	1
9	No	0
10	No	0
11	No	0
12	No	0
13	Yes	1
14	No	0

# Dummy variables

If there are more than two categories, then the variable can be coded using several dummy variables (one fewer than the total number of categories).

	A	B	C	D	E
1	Monday	1	0	0	0
2	Tuesday	0	1	0	0
3	Wednesday	0	0	1	0
4	Thursday	0	0	0	1
5	Friday	0	0	0	0
6	Monday	1	0	0	0
7	Tuesday	0	1	0	0
8	Wednesday	0	0	1	0
9	Thursday	0	0	0	1
10	Friday	0	0	0	0
11	Monday	1	0	0	0
12	Tuesday	0	1	0	0
13	Wednesday	0	0	1	0
14	Thursday	0	0	0	1
15	Friday	0	0	0	0

# Beware of the dummy variable trap!

- Using one dummy for each category gives too many dummy variables!
- The regression will then be singular and inestimable.
- Either omit the constant, or omit the dummy for one category.
- The coefficients of the dummies are relative to the omitted category.

# Uses of dummy variables

## Seasonal dummies

- For quarterly data: use 3 dummies
- For monthly data: use 11 dummies
- For daily data: use 6 dummies
- What to do with weekly data?

# Uses of dummy variables

## Seasonal dummies

- For quarterly data: use 3 dummies
- For monthly data: use 11 dummies
- For daily data: use 6 dummies
- What to do with weekly data?

## Outliers

- If there is an outlier, you can use a dummy variable (taking value 1 for that observation and 0 elsewhere) to remove its effect.

# Uses of dummy variables

## Seasonal dummies

- For quarterly data: use 3 dummies
- For monthly data: use 11 dummies
- For daily data: use 6 dummies
- What to do with weekly data?

## Outliers

- If there is an outlier, you can use a dummy variable (taking value 1 for that observation and 0 elsewhere) to remove its effect.

## Public holidays

- For daily data: if it is a public holiday, dummy=1, otherwise dummy=0.

# Fourier series

Periodic seasonality can be handled using pairs of Fourier terms:

$$s_k(t) = \sin\left(\frac{2\pi kt}{m}\right) \quad c_k(t) = \cos\left(\frac{2\pi kt}{m}\right)$$

$$y_t = a + bt + \sum_{k=1}^K [\alpha_k s_k(t) + \beta_k c_k(t)] + \varepsilon_t$$

- Every periodic function can be approximated by sums of sin and cos terms for large enough  $K$ .
- Choose  $K$  by minimizing AICc.
- Called “harmonic regression”
- `fourier()` function generates these.

# Intervention variables

## Spikes

- Equivalent to a dummy variable for handling an outlier.



# Intervention variables

## Spikes

- Equivalent to a dummy variable for handling an outlier.

## Steps

- Variable takes value 0 before the intervention and 1 afterwards.

# Intervention variables

## Spikes

- Equivalent to a dummy variable for handling an outlier.

## Steps

- Variable takes value 0 before the intervention and 1 afterwards.

## Change of slope

- Variables take values 0 before the intervention and values  $\{1, 2, 3, \dots\}$  afterwards.

## For monthly data

- Christmas: always in December so part of monthly seasonal effect
- Easter: use a dummy variable  $v_t = 1$  if any part of Easter is in that month,  $v_t = 0$  otherwise.
- Ramadan and Chinese new year similar.

## Trading days

With monthly data, if the observations vary depending on how many different types of days in the month, then trading day predictors can be useful.

$z_1 = \# \text{ Mondays in month;}$

$z_2 = \# \text{ Tuesdays in month;}$

$\vdots$

$z_7 = \# \text{ Sundays in month.}$

# Distributed lags

Lagged values of a predictor.

Example:  $x$  is advertising which has a delayed effect

$x_1$  = advertising for previous month;

$x_2$  = advertising for two months previously;

$\vdots$

$x_m$  = advertising for  $m$  months previously.

# Outline

- 1 Regression with ARIMA errors
- 2 Lab session 19
- 3 Some useful predictors for linear models
- 4 Dynamic harmonic regression
- 5 Lab session 20
- 6 Lagged predictors

# Dynamic harmonic regression

## Combine Fourier terms with ARIMA errors

### Advantages

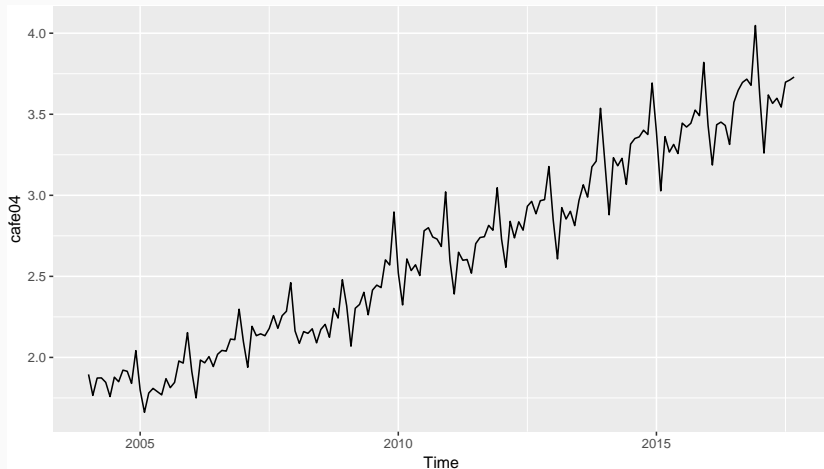
- it allows any length seasonality;
- for data with more than one seasonal period, you can include Fourier terms of different frequencies;
- the seasonal pattern is smooth for small values of  $K$  (but more wiggly seasonality can be handled by increasing  $K$ );
- the short-term dynamics are easily handled with a simple ARMA error.

### Disadvantages

- seasonality is assumed to be fixed

# Eating-out expenditure

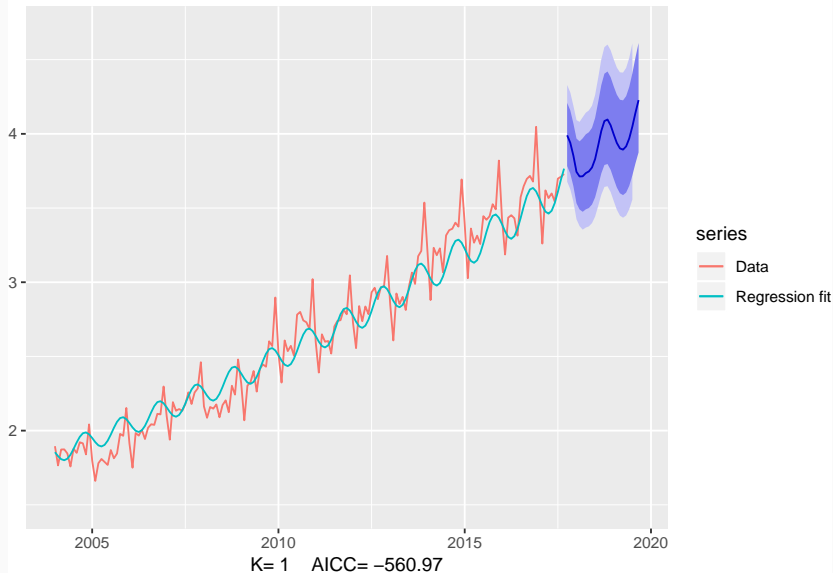
```
cafe04 <- window(auscafe, start=2004)  
autoplot(cafe04)
```





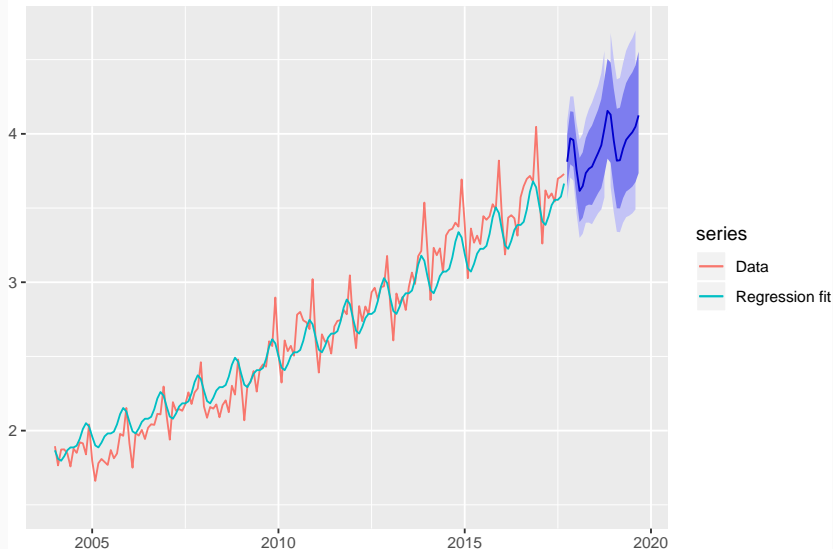
# Eating-out expenditure

Regression with ARIMA(3, 1, 4) errors and  $\lambda = 0$



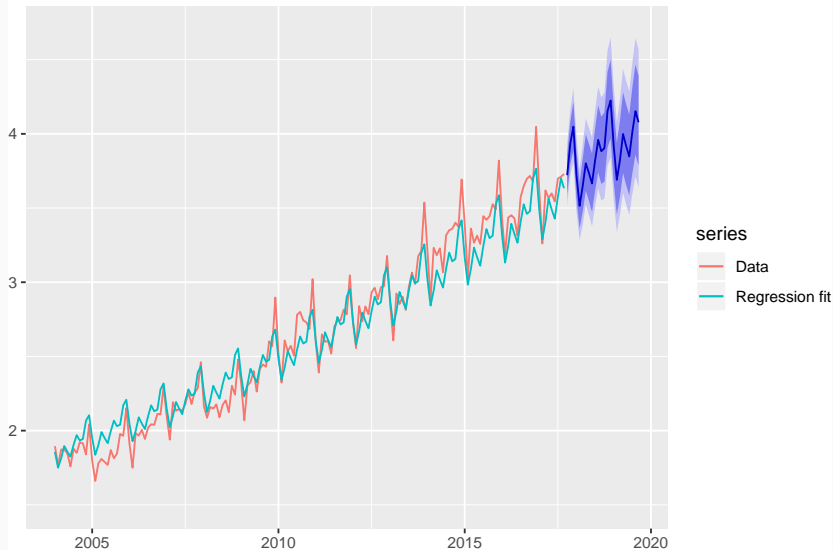
# Eating-out expenditure

Regression with ARIMA(3, 1, 2) errors and  $\lambda = 0$



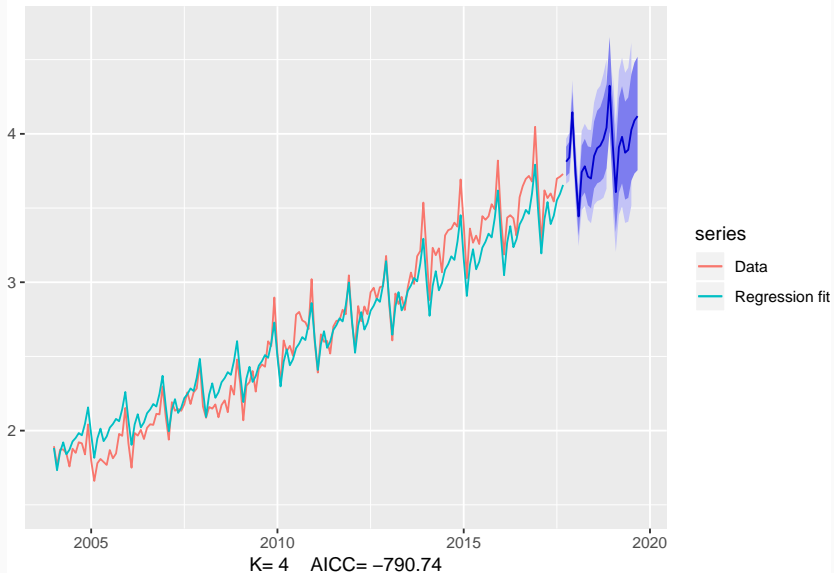
# Eating-out expenditure

Regression with ARIMA(2, 1, 0) errors and  $\lambda = 0$



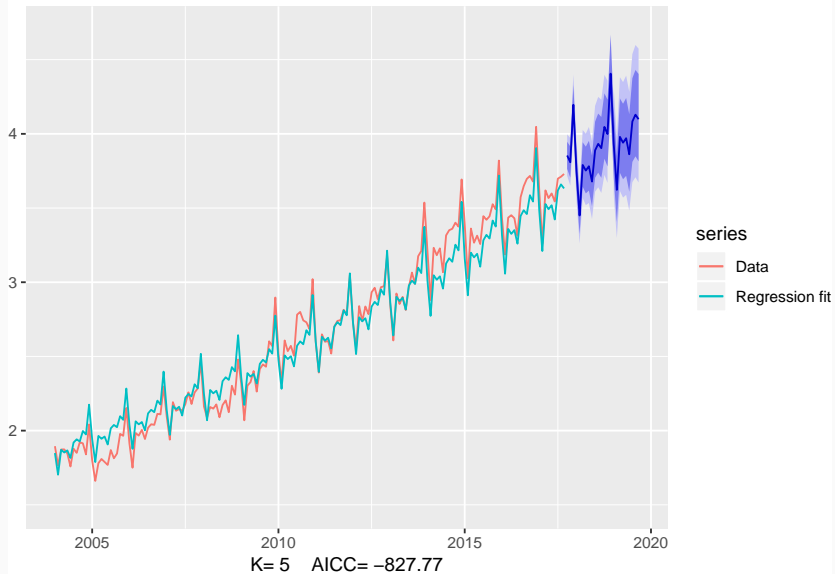
# Eating-out expenditure

Regression with ARIMA(5, 1, 0) errors and  $\lambda = 0$



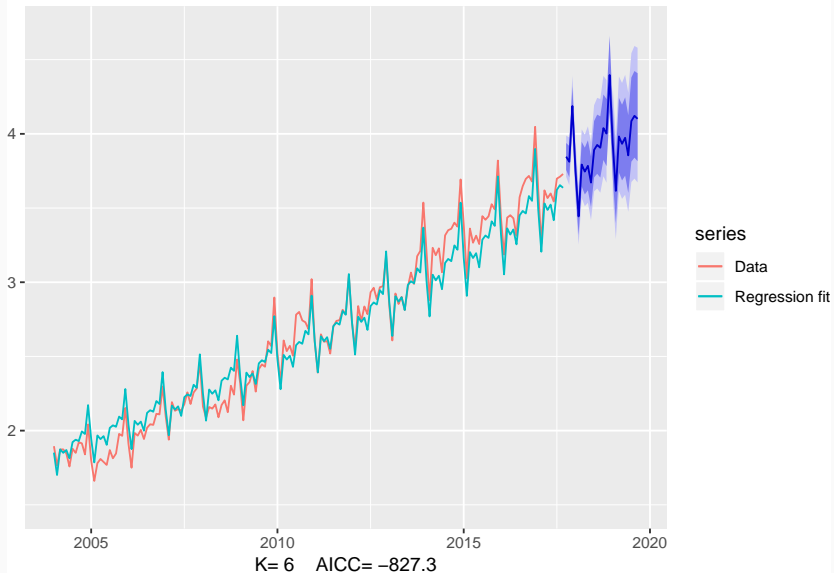
# Eating-out expenditure

Regression with ARIMA(0, 1, 1) errors and  $\lambda = 0$



# Eating-out expenditure

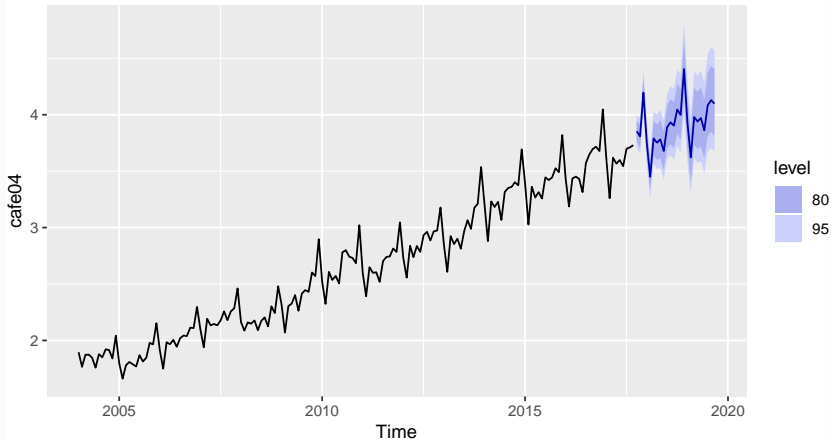
Regression with ARIMA(0, 1, 1) errors and  $\lambda = 0$



# Eating-out expenditure

```
fit <- auto.arima(cafe04, xreg=fourier(cafe04, K=5),  
                  seasonal = FALSE, lambda = 0)  
fc <- forecast(fit, xreg=fourier(cafe04, K=5, h=24))  
autoplot(fc)
```

Forecasts from Regression with ARIMA(0,1,1) errors



# Example: weekly gasoline products

```
harmonics <- fourier(gasoline, K = 13)
(fit <- auto.arima(gasoline, xreg = harmonics, seasonal = FALSE))
```

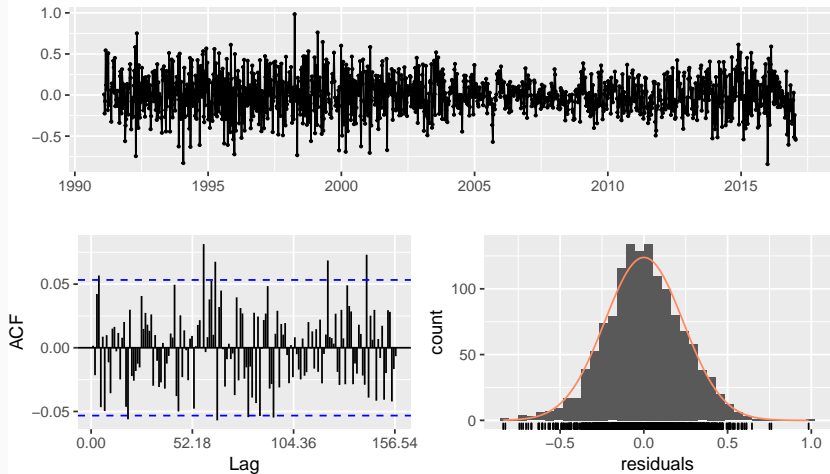
```
## Series: gasoline
## Regression with ARIMA(0,1,2) errors
##
## Coefficients:
##          ma1      ma2  drift  S1-52   C1-52   S2-52
##        -0.961  0.094  0.001  0.031 -0.255 -0.052
## s.e.    0.027  0.029  0.001  0.012  0.012  0.009
##          C2-52  S3-52   C3-52  S4-52   C4-52   S5-52
##        -0.017  0.024 -0.099  0.032 -0.026 -0.001
## s.e.    0.009  0.008  0.008  0.008  0.008  0.008
##          C5-52  S6-52   C6-52  S7-52   C7-52   S8-52
##        -0.047  0.058 -0.032  0.028  0.037  0.024
## s.e.    0.008  0.008  0.008  0.008  0.008  0.008
##          C8-52  S9-52  C9-52  S10-52  C10-52  S11-52
##         0.014 -0.017  0.012 -0.024  0.023  0.000
## s.e.    0.008  0.008  0.008  0.008  0.008  0.008
##          C11-52 S12-52  C12-52  S13-52  C13-52
##        -0.019 -0.029 -0.018  0.001 -0.018
## s.e.    0.008  0.008  0.008  0.008  0.008
##
## sigma^2 estimated as 0.056:  log likelihood=43.66
## AIC=-27.33   AICc=-25.92   BIC=129
```



# Example: weekly gasoline products

```
checkresiduals(fit, test=FALSE)
```

Residuals from Regression with ARIMA(0,1,2) errors



# Example: weekly gasoline products

```
checkresiduals(fit, plot=FALSE)
```

```
##
```

```
##  Ljung-Box test
```

```
##
```

```
## data:  Residuals from Regression with ARIMA(0,1,2) errors
```

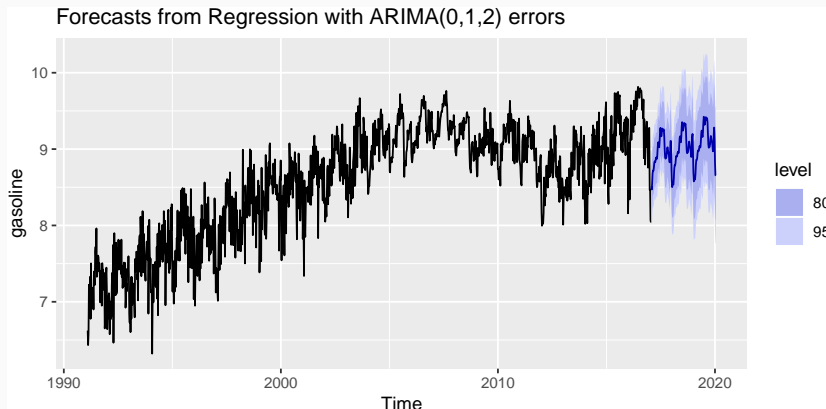
```
## Q* = 130, df = 75, p-value = 6e-05
```

```
##
```

```
## Model df: 29.    Total lags used: 104.357142857143
```

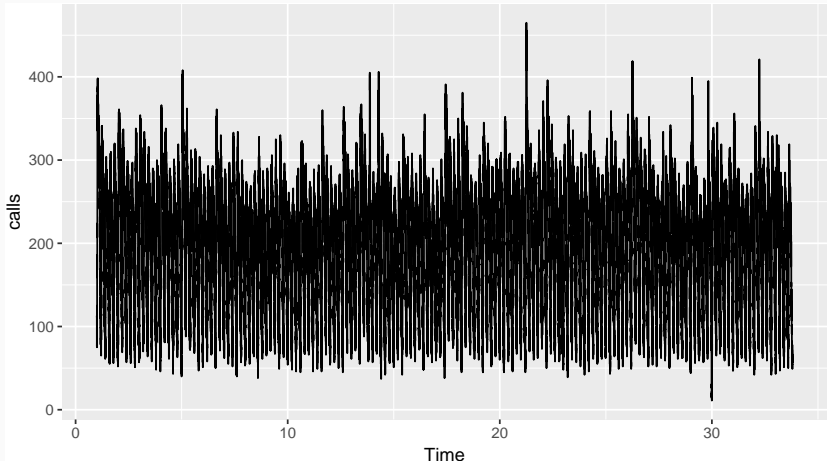
# Example: weekly gasoline products

```
newharmonics <- fourier(gasoline, K = 13, h = 156)  
fc <- forecast(fit, xreg = newharmonics)  
autoplot(fc)
```



# 5-minute call centre volume

```
autoplot(calls)
```



# 5-minute call centre volume

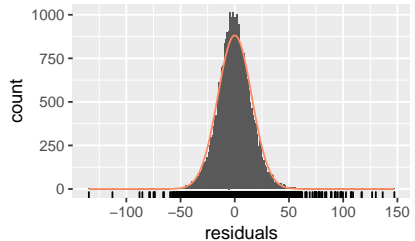
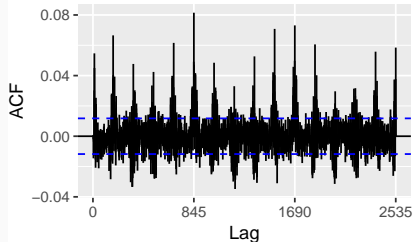
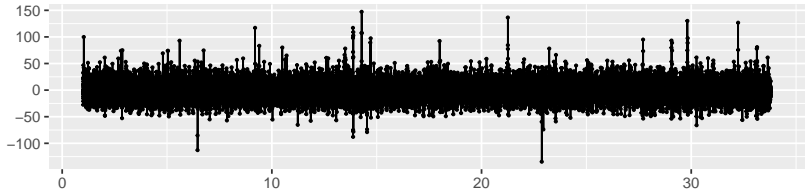
```
xreg <- fourier(calls, K = c(10,0))  
(fit <- auto.arima(calls, xreg=xreg, seasonal=FALSE, stationary=TRUE))
```

```
## Series: calls  
## Regression with ARIMA(3,0,2) errors  
##  
## Coefficients:  
##          ar1      ar2      ar3      ma1      ma2  intercept  
##          0.841  0.192 -0.044 -0.590 -0.189    192.070  
## s.e.      0.169  0.178  0.013  0.169  0.137     1.764  
##          S1-169  C1-169  S2-169  C2-169  S3-169  
##          55.245 -79.087  13.674 -32.375 -13.693  
## s.e.      0.701   0.701   0.379   0.379   0.273  
##          C3-169  S4-169  C4-169  S5-169  C5-169  S6-169  
##          -9.327 -9.532 -2.797 -2.239  2.893   0.173  
## s.e.      0.273   0.223   0.223   0.196   0.196   0.179  
##          C6-169  S7-169  C7-169  S8-169  C8-169  S9-169  
##          3.305   0.855   0.294   0.857 -1.391 -0.986  
## s.e.      0.179   0.168   0.168   0.160   0.160   0.155  
##          C9-169  S10-169 C10-169  
##          -0.345 -1.196   0.801  
## s.e.      0.155   0.150   0.150  
##  
## sigma^2 estimated as 243:  log likelihood=-115412  
## AIC=230877  AICc=230877  BIC=231099
```

# 5-minute call centre volume

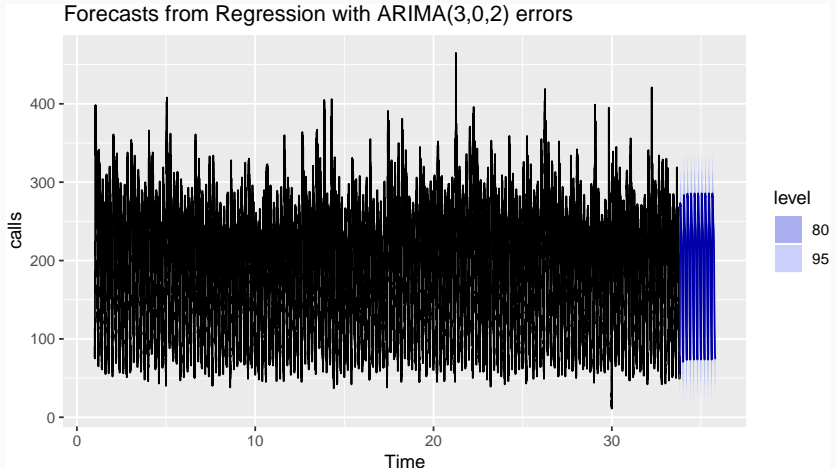
```
checkresiduals(fit, test=FALSE)
```

Residuals from Regression with ARIMA(3,0,2) errors



# 5-minute call centre volume

```
fc <- forecast(fit, xreg = fourier(calls, c(10,0), 1690))  
autoplot(fc)
```



# Outline

- 1 Regression with ARIMA errors
- 2 Lab session 19
- 3 Some useful predictors for linear models
- 4 Dynamic harmonic regression
- 5 Lab session 20
- 6 Lagged predictors



# Lab Session 20

# Outline

- 1 Regression with ARIMA errors
- 2 Lab session 19
- 3 Some useful predictors for linear models
- 4 Dynamic harmonic regression
- 5 Lab session 20
- 6 Lagged predictors

# Lagged predictors

Sometimes a change in  $x_t$  does not affect  $y_t$  instantaneously

# Lagged predictors

Sometimes a change in  $x_t$  does not affect  $y_t$  instantaneously

- $y_t$  = sales,  $x_t$  = advertising.
- $y_t$  = stream flow,  $x_t$  = rainfall.
- $y_t$  = size of herd,  $x_t$  = breeding stock.

# Lagged predictors

Sometimes a change in  $x_t$  does not affect  $y_t$  instantaneously

- $y_t$  = sales,  $x_t$  = advertising.
  - $y_t$  = stream flow,  $x_t$  = rainfall.
  - $y_t$  = size of herd,  $x_t$  = breeding stock.
- 
- These are dynamic systems with input ( $x_t$ ) and output ( $y_t$ ).
  - $x_t$  is often a leading indicator.
  - There can be multiple predictors.

# Lagged predictors

The model include present and past values of predictor:  $x_t, x_{t-1}, x_{t-2}, \dots$

$$y_t = a + \nu_0 x_t + \nu_1 x_{t-1} + \dots + \nu_k x_{t-k} + \eta_t$$

where  $\eta_t$  is an ARIMA process.

# Lagged predictors

The model include present and past values of predictor:  $x_t, x_{t-1}, x_{t-2}, \dots$

$$y_t = a + \nu_0 x_t + \nu_1 x_{t-1} + \dots + \nu_k x_{t-k} + \eta_t$$

where  $\eta_t$  is an ARIMA process.

**Rewrite model as**

$$\begin{aligned} y_t &= a + (\nu_0 + \nu_1 B + \nu_2 B^2 + \dots + \nu_k B^k) x_t + \eta_t \\ &= a + \nu(B) x_t + \eta_t. \end{aligned}$$

# Lagged predictors

The model include present and past values of predictor:  $x_t, x_{t-1}, x_{t-2}, \dots$

$$y_t = a + \nu_0 x_t + \nu_1 x_{t-1} + \dots + \nu_k x_{t-k} + \eta_t$$

where  $\eta_t$  is an ARIMA process.

**Rewrite model as**

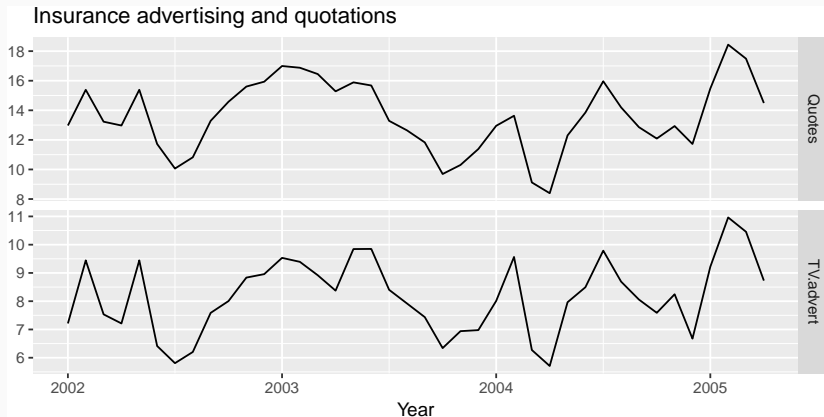
$$\begin{aligned} y_t &= a + (\nu_0 + \nu_1 B + \nu_2 B^2 + \dots + \nu_k B^k) x_t + \eta_t \\ &= a + \nu(B) x_t + \eta_t. \end{aligned}$$

- $\nu(B)$  is called a *transfer function* since it describes how change in  $x_t$  is transferred to  $y_t$ .
- $x$  can influence  $y$ , but  $y$  is not allowed to influence  $x$ .



# Example: Insurance quotes and TV adverts

```
autoplot(insurance, facets=TRUE) +  
  xlab("Year") + ylab("") +  
  ggtitle("Insurance advertising and quotations")
```



# Example: Insurance quotes and TV adverts

```
Advert <- cbind(  
  AdLag0 = insurance[, "TV.advert"],  
  AdLag1 = lag(insurance[, "TV.advert"], -1),  
  AdLag2 = lag(insurance[, "TV.advert"], -2),  
  AdLag3 = lag(insurance[, "TV.advert"], -3)) %>%  
  head(NROW(insurance))  
  
# Restrict data so models use same fitting period  
fit1 <- auto.arima(insurance[4:40,1], xreg=Advert[4:40,1],  
  stationary=TRUE)  
fit2 <- auto.arima(insurance[4:40,1], xreg=Advert[4:40,1:2],  
  stationary=TRUE)  
fit3 <- auto.arima(insurance[4:40,1], xreg=Advert[4:40,1:3],  
  stationary=TRUE)  
fit4 <- auto.arima(insurance[4:40,1], xreg=Advert[4:40,1:4],  
  stationary=TRUE)  
c(fit1$aicc, fit2$aicc, fit3$aicc, fit4$aicc)
```

```
## [1] 68.50 60.02 62.83 68.02
```

# Example: Insurance quotes and TV adverts

```
(fit <- auto.arima(insurance[,1], xreg=Advert[,1:2],  
  stationary=TRUE))
```

```
## Series: insurance[, 1]  
## Regression with ARIMA(3,0,0) errors  
##  
## Coefficients:  
##          ar1      ar2      ar3  intercept  AdLag0  AdLag1  
##          1.412   -0.932   0.359         2.039    1.256    0.162  
## s.e.    0.170     0.255   0.159         0.993    0.067    0.059  
##  
## sigma^2 estimated as 0.217:  log likelihood=-23.89  
## AIC=61.78   AICc=65.28   BIC=73.6
```

# Example: Insurance quotes and TV adverts

```
(fit <- auto.arima(insurance[,1], xreg=Advert[,1:2],  
stationary=TRUE))
```

```
## Series: insurance[, 1]  
## Regression with ARIMA(3,0,0) errors  
##  
## Coefficients:  
##          ar1      ar2      ar3  intercept  AdLag0  AdLag1  
##          1.412  -0.932  0.359         2.039   1.256   0.162  
## s.e.    0.170    0.255  0.159         0.993   0.067   0.059  
##  
## sigma^2 estimated as 0.217:  log likelihood=-23.89  
## AIC=61.78   AICc=65.28   BIC=73.6
```

$$y_t = 2.04 + 1.26x_t + 0.16x_{t-1} + \eta_t,$$
$$\eta_t = 1.41\eta_{t-1} - 0.93\eta_{t-2} + 0.36\eta_{t-3} + \varepsilon_t,$$

# Example: Insurance quotes and TV adverts

```
fc <- forecast(fit, h=20,  
  xreg=cbind(c(Advert[40,1],rep(10,19)), rep(10,20)))  
autoplot(fc)
```



# Example: Insurance quotes and TV adverts

```
fc <- forecast(fit, h=20,  
  xreg=cbind(c(Advert[40,1],rep(8,19)), rep(8,20)))  
autoplot(fc)
```



# Example: Insurance quotes and TV adverts

```
fc <- forecast(fit, h=20,  
  xreg=cbind(c(Advert[40,1],rep(6,19)), rep(6,20)))  
autoplot(fc)
```

