# Forecast reconciliation

## 2. Perspectives on forecast reconciliation

Rob J Hyndman

MONASH University

robjhyndman.com/fr2023

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# Outline

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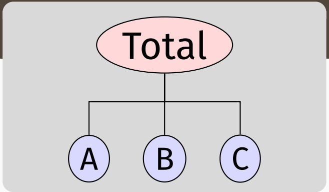
# Time series reconciliation

- Stone, Champernowne, and Meade (1942): reconciling national economic accounts (disaggregated into production, income, outlay, capital transactions, etc.)
- Byron (1978): extended Stone's work using more computationally efficient methods.
- 1984: Stone wins Nobel Prize in Economics.
- Same approach used for reconciling seasonally adjusted data.
- Chow and Lin (1971): Temporal reconciliation of monthly or quarterly estimates to sum to annual estimates.
- Di Fonzo (1990): Cross-temporal reconciliation of time series data.

# Outline

# Notation reminder




Every collection of time series with linear constraints can be written as

$$\boldsymbol{y}_t = \boldsymbol{S}\boldsymbol{b}_t$$

- $\boldsymbol{y}_t$ = vector of all series at time $t$
- $y_{\text{Total},t}$ = aggregate of all series at time $t$.
- $y_{X,t}$ = value of series $X$ at time $t$.
- $\boldsymbol{b}_t$ = vector of most disaggregated series at time $t$
- $\boldsymbol{S}$ = "summing matrix" containing the linear constraints.

$$\boldsymbol{y}_t = \begin{pmatrix} y_{\text{Total},t} \\ y_{A,t} \\ y_{B,t} \\ y_{C,t} \end{pmatrix} = \underbrace{\begin{pmatrix} 1 & 1 & 1 \\ 1 & 0 & 0 \\ 0 & 1 & 0 \\ 0 & 0 & 1 \end{pmatrix}}_{\boldsymbol{S}} \underbrace{\begin{pmatrix} y_{A,t} \\ y_{B,t} \\ y_{C,t} \end{pmatrix}}_{\boldsymbol{b}_t}$$

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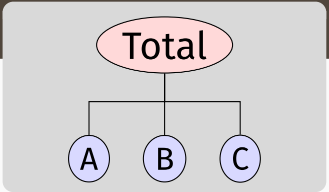


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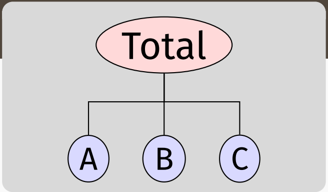
- $\boldsymbol{S}$ = "summing matrix" containing the linear constraints.

- Base forecasts: $\hat{\boldsymbol{y}}_{T+h|T}$
- Reconciled forecasts: $\tilde{\boldsymbol{y}}_{T+h|T} = \boldsymbol{S}\boldsymbol{G}\hat{\boldsymbol{y}}_{T+h|T}$
- MinT: $\boldsymbol{G} = (\boldsymbol{S}'\boldsymbol{W}_h^{-1}\boldsymbol{S})^{-1}\boldsymbol{S}'\boldsymbol{W}_h^{-1}$ where $\boldsymbol{W}_h$ is covariance matrix of base forecast errors.

# Notation




## Aggregation matrix

$$\boldsymbol{y}_t = \boldsymbol{S}\boldsymbol{b}_t$$

$$\begin{pmatrix} y_{\text{Total},t} \\ y_{A,t} \\ y_{B,t} \\ y_{C,t} \end{pmatrix} = \begin{pmatrix} 1 & 1 & 1 \\ 1 & 0 & 0 \\ 0 & 1 & 0 \\ 0 & 0 & 1 \end{pmatrix} \begin{pmatrix} y_{A,t} \\ y_{B,t} \\ y_{C,t} \end{pmatrix}$$

$$\begin{pmatrix} \boldsymbol{a}_t \\ \boldsymbol{b}_t \end{pmatrix} = \begin{pmatrix} \boldsymbol{A} \\ \boldsymbol{I}_{n_b} \end{pmatrix} \boldsymbol{b}_t$$

## Constraint matrix

$$\boldsymbol{C}\boldsymbol{y}_t = \boldsymbol{0}$$

where

$$\boldsymbol{C} = \begin{bmatrix} 1 & -1 & -1 & -1 \end{bmatrix} = \begin{bmatrix} \boldsymbol{I}_{n_a} & -\boldsymbol{A} \end{bmatrix}$$

# Zero-constraint representation

## Aggregation matrix $A$

$$\boldsymbol{y}_t = \begin{bmatrix} \boldsymbol{a}_t \\ \boldsymbol{b}_t \end{bmatrix} = \begin{bmatrix} \boldsymbol{A} \\ \boldsymbol{I}_{n_b} \end{bmatrix} \boldsymbol{b}_t = \boldsymbol{S}\boldsymbol{b}_t$$

# Zero-constraint representation

## Aggregation matrix $\boldsymbol{A}$

$$\boldsymbol{y}_t = \begin{bmatrix} \boldsymbol{a}_t \\ \boldsymbol{b}_t \end{bmatrix} = \begin{bmatrix} \boldsymbol{A} \\ \boldsymbol{I}_{n_b} \end{bmatrix} \boldsymbol{b}_t = \boldsymbol{S}\boldsymbol{b}_t$$

## Constraint matrix $\boldsymbol{C}$

$$\boldsymbol{C}\boldsymbol{y}_t = \boldsymbol{0}$$

- Constraint matrix approach more general & more parsimonious.
- $\boldsymbol{C} = [\boldsymbol{I}_{n_a} \quad -\boldsymbol{A}]$.
- $\boldsymbol{S}$, $\boldsymbol{A}$ and $\boldsymbol{C}$ may contain any real values (not just 0s and 1s).

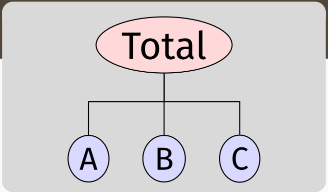
# Zero-constraint representation

Assuming $\boldsymbol{C}$ is full rank

$$\tilde{\boldsymbol{y}}_{T+h|T} = \boldsymbol{M}\hat{\boldsymbol{y}}_{T+h|T}$$
$$\text{where} \qquad \boldsymbol{M} = \boldsymbol{I} - \boldsymbol{W}_h\boldsymbol{C}'(\boldsymbol{C}\boldsymbol{W}_h\boldsymbol{C}')^{-1}\boldsymbol{C}$$

- Originally proved by Byron (1978) for reconciling data.
- Re-discovered by Wickramasuriya, Athanasopoulos, and Hyndman (2019) for reconciling forecasts.
- $\boldsymbol{M} = \boldsymbol{S}\boldsymbol{G}$ (the MinT solution)
- Leads to more efficient reconciliation than using $\boldsymbol{G}$.

# Zero-constraint representation




Suppose $\boldsymbol{W}_h = \boldsymbol{I}$. Then

$$\boldsymbol{M} = \boldsymbol{I} - \boldsymbol{W}_h\boldsymbol{C}'(\boldsymbol{C}\boldsymbol{W}_h\boldsymbol{C}')^{-1}\boldsymbol{C}$$

$$= \begin{pmatrix} 1 & 0 & 0 & 0 \\ 0 & 1 & 0 & 0 \\ 0 & 0 & 1 & 0 \\ 0 & 0 & 0 & 1 \end{pmatrix} - \begin{pmatrix} 1 \\ -1 \\ -1 \\ -1 \end{pmatrix} \frac{1}{4} \begin{pmatrix} 1 & -1 & -1 & -1 \end{pmatrix}$$

$$= \begin{pmatrix} 1 & 0 & 0 & 0 \\ 0 & 1 & 0 & 0 \\ 0 & 0 & 1 & 0 \\ 0 & 0 & 0 & 1 \end{pmatrix} - \begin{pmatrix} 1 & -1 & -1 & -1 \\ -1 & 1 & 1 & 1 \\ -1 & 1 & 1 & 1 \\ -1 & 1 & 1 & 1 \end{pmatrix}$$

$$= \begin{pmatrix} \frac{3}{4} & \frac{1}{4} & \frac{1}{4} & \frac{1}{4} \\ \frac{1}{4} & \frac{3}{4} & -\frac{1}{4} & -\frac{1}{4} \\ \frac{1}{4} & -\frac{1}{4} & \frac{3}{4} & -\frac{1}{4} \\ \frac{1}{4} & -\frac{1}{4} & -\frac{1}{4} & \frac{3}{4} \end{pmatrix}$$

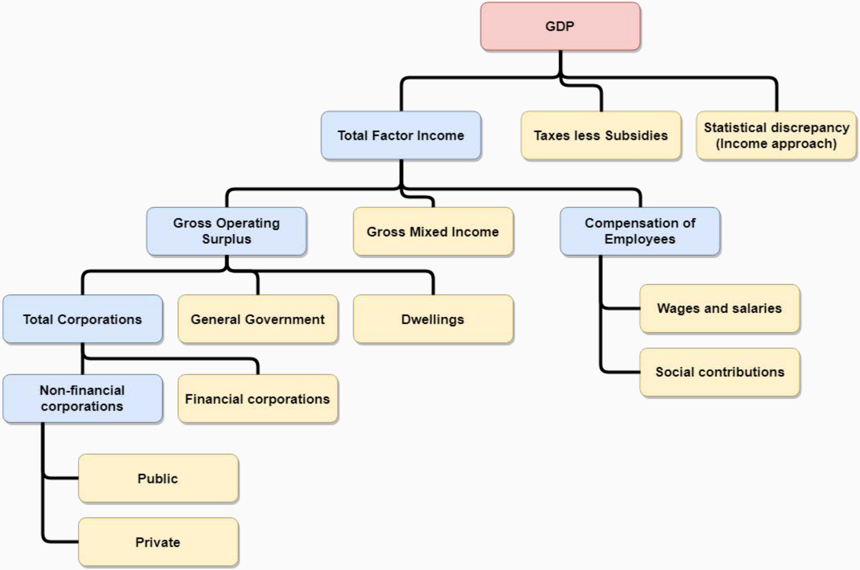
$$\boldsymbol{A} = \begin{pmatrix} 1 & 1 & 1 \end{pmatrix}$$

$$\boldsymbol{S} = \begin{pmatrix} \boldsymbol{A} \\ \boldsymbol{I}_{n_b} \end{pmatrix} = \begin{pmatrix} 1 & 1 & 1 \\ 1 & 0 & 0 \\ 0 & 1 & 0 \\ 0 & 0 & 1 \end{pmatrix}$$

$$\boldsymbol{C} = \begin{pmatrix} \boldsymbol{I}_{n_a} & -\boldsymbol{A} \end{pmatrix} = \begin{pmatrix} 1 & -1 & -1 & -1 \end{pmatrix}$$

# Outline

# Example: reconciling GDP forecasts



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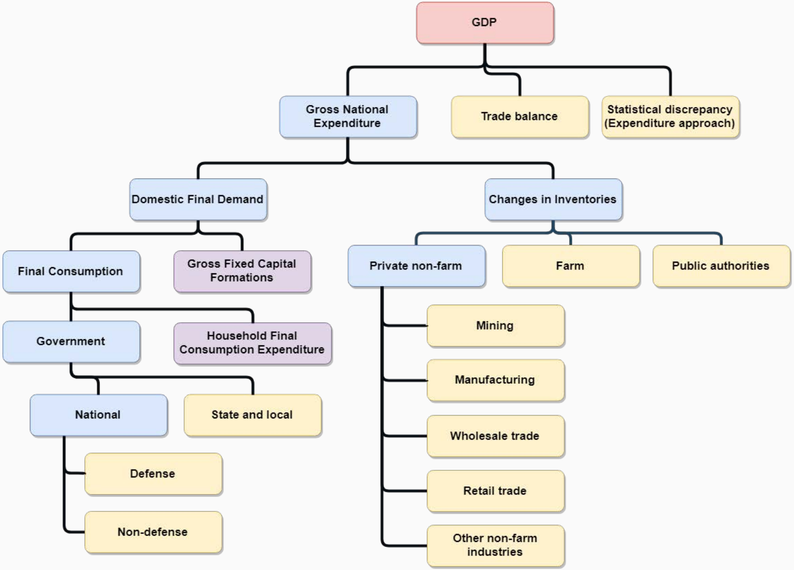

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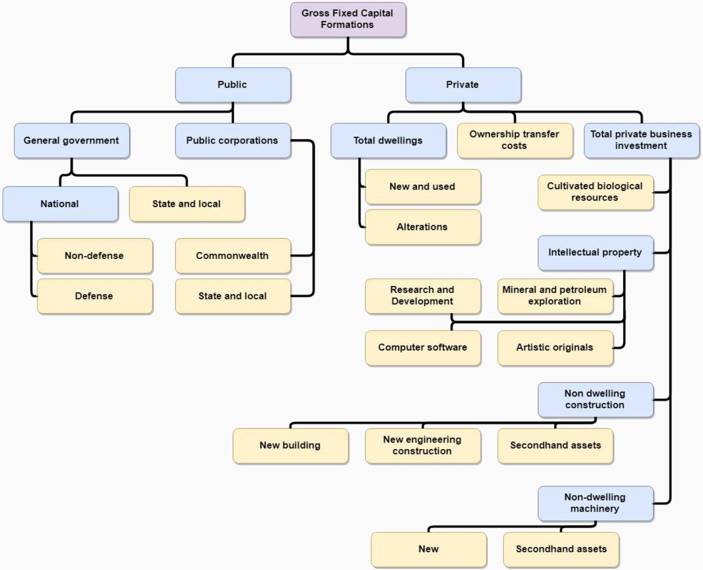

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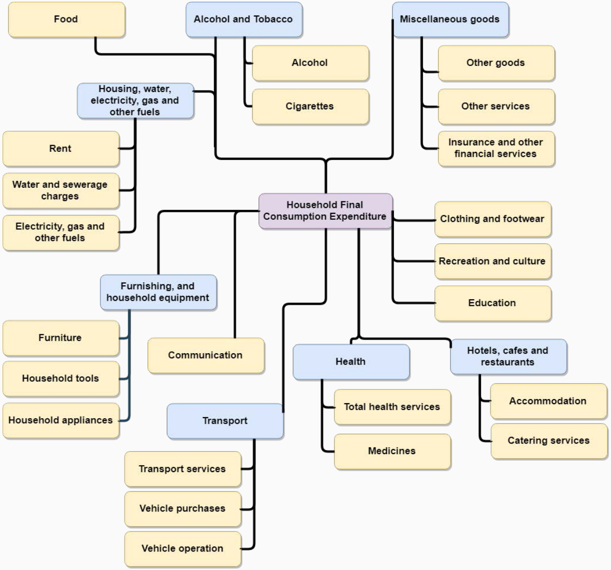


# Example: reconciling GDP forecasts

- No unique hierarchy.
- Several disaggregations with the same parent node
- Not possible to represent using structural $\boldsymbol{S}$ notation.
- Instead, we can use the constraint $\boldsymbol{C}$ notation.

# Example: reconciling GDP forecasts

## Using structural notation:

$$\boldsymbol{y}_t^I = \begin{bmatrix} x_t \\ \boldsymbol{a}_t^I \\ \boldsymbol{b}_t^I \end{bmatrix} = \boldsymbol{S}^I \boldsymbol{b}_t^I \qquad \boldsymbol{y}_t^E = \begin{bmatrix} x_t \\ \boldsymbol{a}_t^E \\ \boldsymbol{b}_t^E \end{bmatrix} = \boldsymbol{S}^E \boldsymbol{b}_t^E$$

where

$$\boldsymbol{S}^I = \begin{bmatrix} \boldsymbol{1}_{10}' \\ \boldsymbol{A}^I \\ \boldsymbol{I}_{10} \end{bmatrix} \qquad \boldsymbol{S}^E = \begin{bmatrix} \boldsymbol{1}_{53}' \\ \boldsymbol{A}^E \\ \boldsymbol{I}_{53} \end{bmatrix}$$

- Can reconcile both trees, but the totals won't be equal.

# Example: reconciling GDP forecasts

## Using constraint notation:

$$\boldsymbol{C}\boldsymbol{y}_t = \mathbf{0}$$

where

$$\boldsymbol{y}_t = \begin{bmatrix} x_t \\ \boldsymbol{a}_t^I \\ \boldsymbol{b}_t^I \\ \boldsymbol{a}_t^E \\ \boldsymbol{b}_t^E \end{bmatrix} \qquad \text{and} \qquad \boldsymbol{C} = \begin{bmatrix} 1 & \mathbf{0}_5' & -\mathbf{1}_{10}' & \mathbf{0}_{26}' & \mathbf{0}_{53}' \\ 1 & \mathbf{0}_5' & \mathbf{0}_{10}' & \mathbf{0}_{26}' & -\mathbf{1}_{53}' \\ \mathbf{0}_5 & \boldsymbol{I}_5 & -\boldsymbol{A}^I & \mathbf{0}_{5\times 26} & \mathbf{0}_{5\times 53} \\ \mathbf{0}_{26} & \mathbf{0}_{26\times 5} & \mathbf{0}_{26\times 10} & \boldsymbol{I}_{26} & -\boldsymbol{A}^E \end{bmatrix}$$

Ref: Bisaglia, Di Fonzo, and Girolimetto (2020)

# Outline

# The coherent subspace

## Coherent subspace

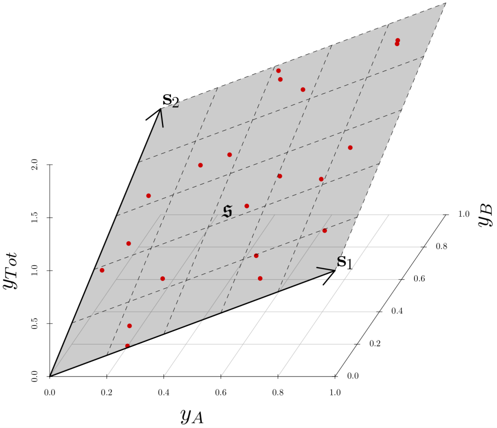
$n_b$-dimensional linear subspace $\mathfrak{s} \subset \chi^n$ for which linear constraints hold for all $\boldsymbol{y} \in \mathfrak{s}$.

## Hierarchical time series

An $n$-dimensional multivariate time series such that $\boldsymbol{y}_t \in \mathfrak{s} \quad \forall t$.

## Coherent point forecasts

$\tilde{\boldsymbol{y}}_{t+h|t}$ is *coherent* if $\tilde{\boldsymbol{y}}_{t+h|t} \in \mathfrak{s}$.




$y_{Tot} = y_A + y_B$

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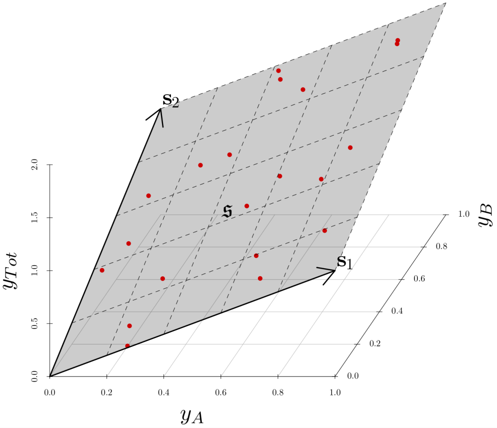
## Base forecasts

Let $\hat{\boldsymbol{y}}_{t+h|t}$ be vector of *incoherent* initial $h$-step forecasts.

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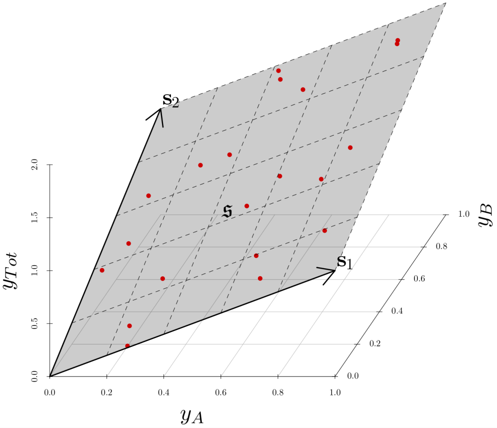



$y_{Tot} = y_A + y_B$

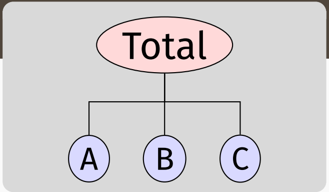
## Base forecasts

Let $\hat{\boldsymbol{y}}_{t+h|t}$ be vector of *incoherent* initial $h$-step forecasts.

## Reconciled forecasts

Let $\psi$ be a mapping, $\psi : \chi^n \rightarrow \mathfrak{s}$. $\tilde{\boldsymbol{y}}_{t+h|t} = \psi(\hat{\boldsymbol{y}}_{t+h|t})$ "reconciles" $\hat{\boldsymbol{y}}_{t+h|t}$.

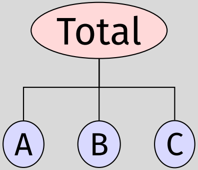
# The coherent subspace




The columns of $\boldsymbol{S}$ form a basis set for $\mathfrak{s}$.

They are not unique.
Each corresponds to different vector of “bottom-level” series.

# The coherent subspace

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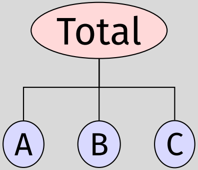


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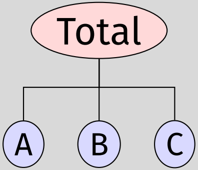


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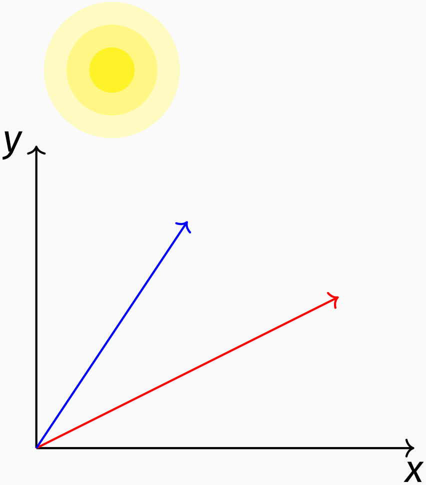
# Projections in linear algebra



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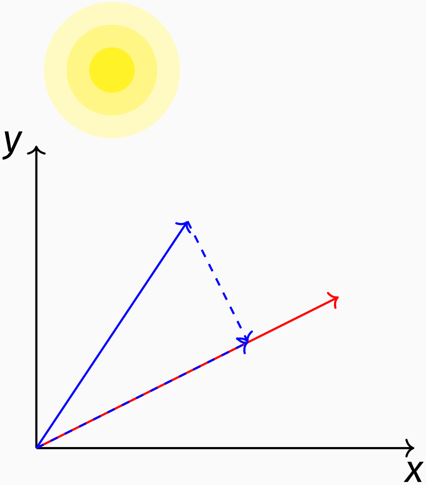

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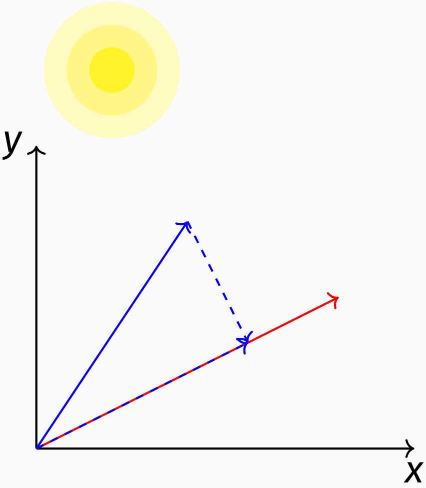


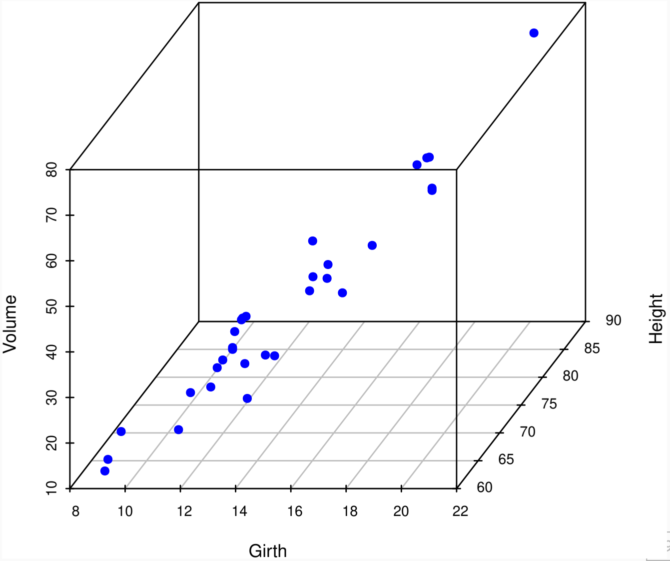

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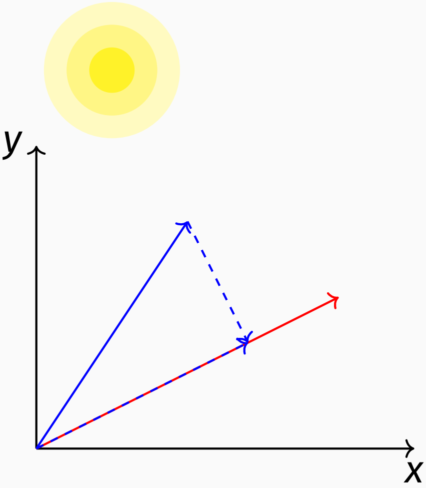


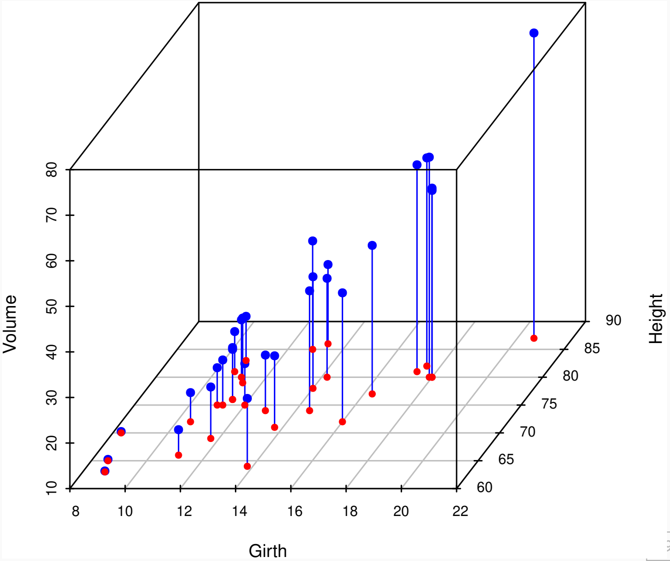

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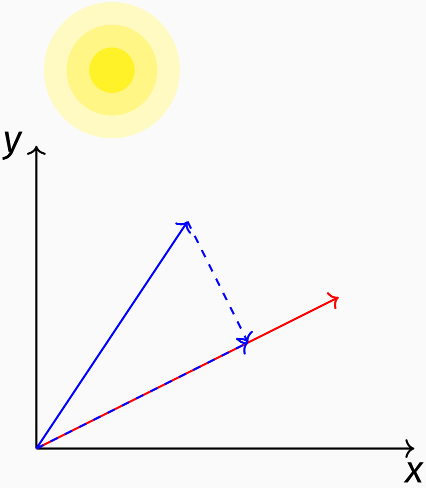


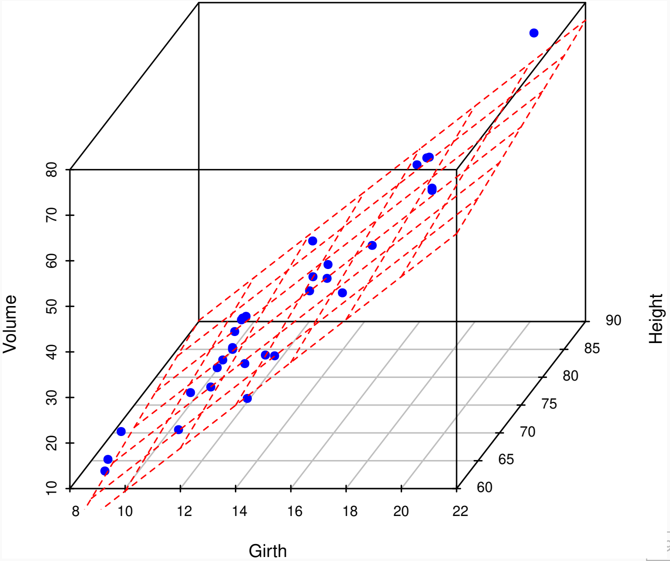

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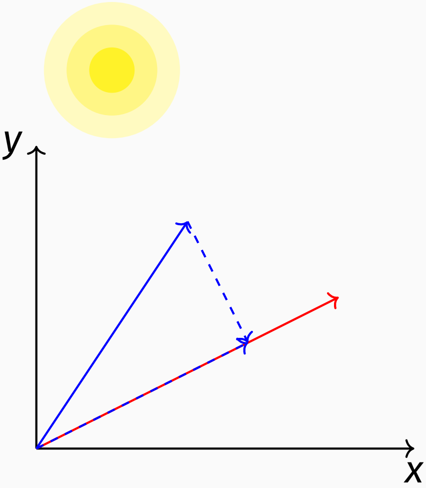
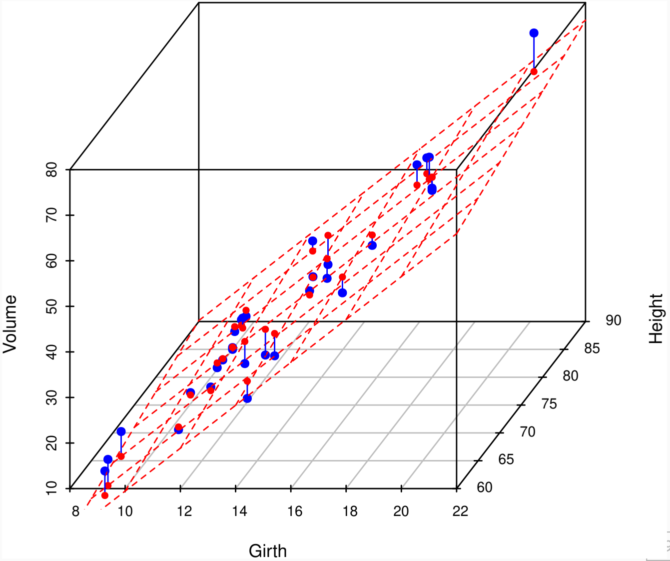


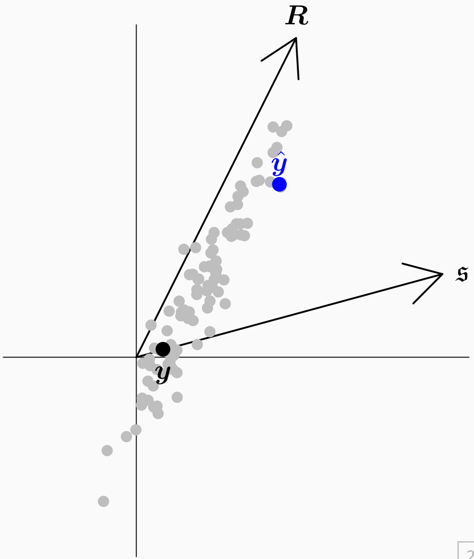



# Projections in linear algebra

- A projection is a linear transformation $\boldsymbol{M}$ such that $\boldsymbol{M}^2 = \boldsymbol{M}$.
- i.e., $M$ is idempotent: it leaves its image unchanged.
- $\boldsymbol{M}$ projects onto $\mathfrak{s}$ if $\boldsymbol{M}\boldsymbol{y} = \boldsymbol{y}$ for all $\boldsymbol{y} \in \mathfrak{s}$.
- All eigenvalues of $\boldsymbol{M}$ are either 0 or 1.
- All singular values of $\boldsymbol{M}$ are greater than or equal to 1 (with equality iff $\boldsymbol{M}$ is orthogonal).
- A projection is *orthogonal* if $\boldsymbol{M}' = \boldsymbol{M}$.
- If a projection is not orthogonal, it is called *oblique*.
- In regression, OLS is an orthogonal projection onto space spanned by predictors.

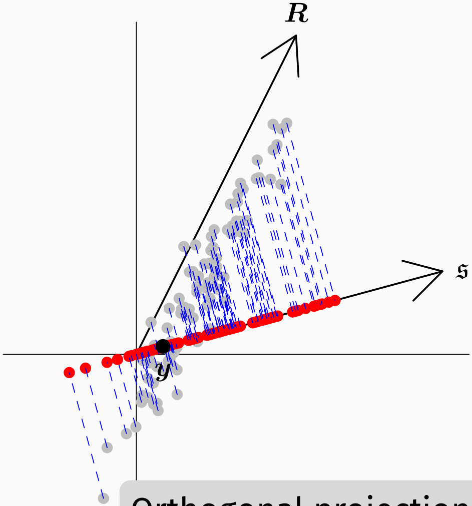
# Linear projection reconciliation

- $R$ is the most likely direction of deviations from $\mathfrak{s}$.
- Grey: potential base forecasts



# Linear projection reconciliation

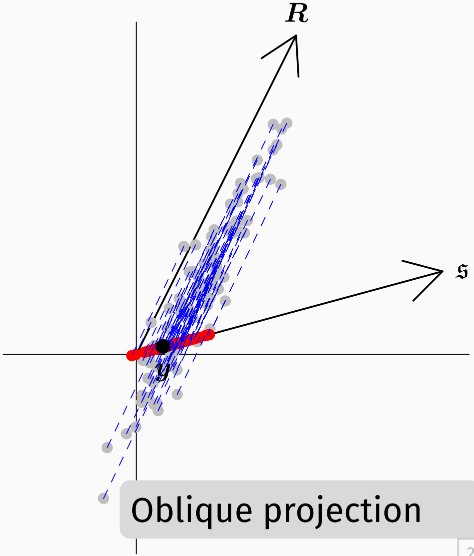
- $R$ is the most likely direction of deviations from $\mathfrak{s}$.
- Grey: potential base forecasts
- Red: reconciled forecasts
- Orthogonal projections (i.e., OLS) lead to smallest possible adjustments of base forecasts.




Orthogonal projection

# Linear projection reconciliation

- $R$ is the most likely direction of deviations from $\mathfrak{s}$.
- Grey: potential base forecasts
- Red: reconciled forecasts
- Orthogonal projections (i.e., OLS) lead to smallest possible adjustments of base forecasts.
- Oblique projections (i.e., MinT) give reconciled forecasts with smallest variance.




Oblique projection

# Linear projection reconciliation

$$\tilde{\boldsymbol{y}}_{t+h|t} = \psi(\hat{\boldsymbol{y}}_{t+h|t}) = \boldsymbol{M}\hat{\boldsymbol{y}}_{t+h|t}$$

- $\boldsymbol{M}$ is a projection onto $\mathfrak{s}$ if and only if $\boldsymbol{My} = \boldsymbol{y}$ for all $\boldsymbol{y} \in \mathfrak{s}$.
- Coherent base forecasts are unchanged since $\boldsymbol{M}\hat{\boldsymbol{y}} = \hat{\boldsymbol{y}}$
- If $\hat{\boldsymbol{y}}$ is unbiased, then $\tilde{\boldsymbol{y}}$ is also unbiased since

  $$\text{E}(\tilde{\boldsymbol{y}}_{t+h|t}) = \text{E}(\boldsymbol{M}\hat{\boldsymbol{y}}_{t+h|t}) = \boldsymbol{M}\text{E}(\hat{\boldsymbol{y}}_{t+h|t}) = \text{E}(\hat{\boldsymbol{y}}_{t+h|t}),$$

  and unbiased estimates must lie on $\mathfrak{s}$.
- The projection is orthogonal if and only if $\boldsymbol{M}' = \boldsymbol{M}$.
- If $\boldsymbol{S}$ forms a basis set for $\mathfrak{s}$, then projections are of the form $\boldsymbol{M} = \boldsymbol{S}(\boldsymbol{S}'\Psi\boldsymbol{S})^{-1}\boldsymbol{S}'\Psi$ where $\Psi$ is a positive definite matrix.

# Linear projection reconciliation

$$\tilde{\boldsymbol{y}}_{t+h|t} = \psi(\hat{\boldsymbol{y}}_{t+h|t}) = \boldsymbol{M}\hat{\boldsymbol{y}}_{t+h|t}, \qquad \text{where} \quad \boldsymbol{M} = \boldsymbol{S}(\boldsymbol{S}'\Psi\boldsymbol{S})^{-1}\boldsymbol{S}'\Psi$$

| | | | |
|---|---|---|---|
| OLS: | $\Psi = \boldsymbol{I}$ | $\boldsymbol{M} = \boldsymbol{S}(\boldsymbol{S}'\boldsymbol{S})^{-1}\boldsymbol{S}'$ | $= \boldsymbol{I} - \boldsymbol{C}'(\boldsymbol{C}\boldsymbol{C}')^{-1}\boldsymbol{C}$ |
| MinT: | $\Psi = \boldsymbol{W}_h$ | $\boldsymbol{M} = \boldsymbol{S}(\boldsymbol{S}'\boldsymbol{W}_h^{-1}\boldsymbol{S})^{-1}\boldsymbol{S}'\boldsymbol{W}_h^{-1}$ | $= \boldsymbol{I} - \boldsymbol{W}_h\boldsymbol{C}'(\boldsymbol{C}\boldsymbol{W}_h\boldsymbol{C}')^{-1}\boldsymbol{C}$ |

- $\boldsymbol{M}$ is orthogonal iff $\Psi = \boldsymbol{I}$.
- $\boldsymbol{W}_h = \text{Var}[\boldsymbol{y}_{T+h} - \hat{\boldsymbol{y}}_{T+h|T} \mid \boldsymbol{y}_1, \dots, \boldsymbol{y}_T]$ is the covariance matrix of the base forecast errors.
- $\boldsymbol{V}_h = \text{Var}[\boldsymbol{y}_{T+h} - \tilde{\boldsymbol{y}}_{T+h|T} \mid \boldsymbol{y}_1, \dots, \boldsymbol{y}_T] = \boldsymbol{M}\boldsymbol{W}_h\boldsymbol{M}'$ is minimized when $\Psi = \boldsymbol{W}_h$.

# Mean square error bounds

Panagiotelis et al. (2021)

## Distance reducing property

Let $\|\boldsymbol{u}\|_\Psi = \boldsymbol{u}'\Psi\boldsymbol{u}$. Then

$$\|\boldsymbol{y}_{t+h} - \tilde{\boldsymbol{y}}_{t+h|t}\|_\Psi \le \|\boldsymbol{y}_{t+h} - \hat{\boldsymbol{y}}_{t+h|t}\|_\Psi$$

- $\Psi$-projection is guaranteed to improve forecast accuracy over base forecasts *using this distance measure*.
- Distance reduction holds for any realisation and any forecast.
- OLS reconciliation minimizes Euclidean distance.
- Other measures of forecast accuracy may be worse.

# Mean square error bounds

Wickramasuriya (2021)

$$
\begin{aligned}
\|\boldsymbol{y}_{t+h} - \tilde{\boldsymbol{y}}_{t+h}\|_2^2 &= \|\boldsymbol{M}(\boldsymbol{y}_{t+h} - \hat{\boldsymbol{y}}_{t+h})\|_2^2 \\
&\leq \|\boldsymbol{M}\|_2^2 \|\boldsymbol{y}_{t+h} - \hat{\boldsymbol{y}}_{t+h}\|_2^2 \\
&= \sigma_{\text{max}}^2 \|\boldsymbol{y}_{t+h} - \hat{\boldsymbol{y}}_{t+h}\|_2^2
\end{aligned}
$$

- $\sigma_{\text{max}}$ is the largest eigenvalue of $\boldsymbol{M}$
- $\sigma_{\text{max}} \geq 1$ as $\boldsymbol{M}$ is a projection matrix.
- Every projection reconciliation is better than base forecasts using Euclidean distance.

# Mean square error bounds

Wickramasuriya (2021)

$$
\begin{aligned}
&\operatorname{tr}\Big(\mathrm{E}[\boldsymbol{y}_{t+h} - \tilde{\boldsymbol{y}}^{\text{MinT}}_{t+h|t}]'[\boldsymbol{y}_{t+h} - \tilde{\boldsymbol{y}}^{\text{MinT}}_{t+h|t}]\Big) \\
\leq\ &\operatorname{tr}\Big(\mathrm{E}[\boldsymbol{y}_{t+h} - \tilde{\boldsymbol{y}}^{\text{OLS}}_{t+h|t}]'[\boldsymbol{y}_{t+h} - \tilde{\boldsymbol{y}}^{\text{OLS}}_{t+h|t}]\Big) \\
\leq\ &\operatorname{tr}\Big(\mathrm{E}[\boldsymbol{y}_{t+h} - \hat{\boldsymbol{y}}_{t+h|t}]'[\boldsymbol{y}_{t+h} - \hat{\boldsymbol{y}}_{t+h|t}]\Big)
\end{aligned}
$$

Using sums of variances:

- MinT reconciliation is better than OLS reconciliation
- OLS reconciliation is better than base forecasts

# Outline

# Minimum trace reconciliation

## Minimum trace (MinT) reconciliation

If $\boldsymbol{SG}$ is a projection, then the trace of $\boldsymbol{V}_h = \text{Var}(\tilde{\boldsymbol{y}}_{t+h|t} - \boldsymbol{y}_{t+h})$ is **minimized** when

$$\boldsymbol{G} = (\boldsymbol{S}'\boldsymbol{W}_h^{-1}\boldsymbol{S})^{-1}\boldsymbol{S}'\boldsymbol{W}_h^{-1}$$

$$\tilde{\boldsymbol{y}}_{T+h|T} = \boldsymbol{S}(\boldsymbol{S}'\boldsymbol{W}_h^{-1}\boldsymbol{S})^{-1}\boldsymbol{S}'\boldsymbol{W}_h^{-1}\hat{\boldsymbol{y}}_{T+h|T}$$

Reconciled forecasts　　　　Base forecasts

- Trace of $\boldsymbol{V}_h$ is sum of forecast variances.
- MinT solution is $L_2$ **optimal** amongst linear unbiased forecasts.

# A game theoretic perspective

van Erven and Cugliari (2015)

Find the solution to the minimax problem

$$V = \min_{\tilde{\boldsymbol{y}} \in \mathfrak{s}} \max_{\boldsymbol{y} \in \mathfrak{s}} \left\{ \ell(\boldsymbol{y}, \tilde{\boldsymbol{y}}) - \ell(\boldsymbol{y}, \hat{\boldsymbol{y}}) \right\},$$

where $\ell$ is a loss function, and $\mathfrak{s}$ is the coherent subspace.

- $V \leq 0$: reconciliation guaranteed to reduce loss.
- If $\ell(\boldsymbol{y}, \tilde{\boldsymbol{y}}) = \|\boldsymbol{y} - \tilde{\boldsymbol{y}}\|_{\Psi} = (\boldsymbol{y} - \tilde{\boldsymbol{y}})'\Psi(\boldsymbol{y} - \tilde{\boldsymbol{y}})$, where $\Psi$ is any symmetric pd matrix, then:
  1. $\tilde{\boldsymbol{y}} = \boldsymbol{S}(\boldsymbol{S}'\Psi\boldsymbol{S})^{-1}\boldsymbol{S}'\Psi\hat{\boldsymbol{y}}$ will always improve upon the base forecasts;
  2. The MinT solution $\tilde{\boldsymbol{y}} = \boldsymbol{S}(\boldsymbol{S}'\boldsymbol{W}_h^{-1}\boldsymbol{S})^{-1}\boldsymbol{S}'\boldsymbol{W}_h^{-1}\hat{\boldsymbol{y}}$ will optimise loss in expectation over any choice of $\Psi$.

# Biased reconciliation

Ben Taieb and Koo (2019)

Regularized empirical risk minimization problem:

$$\min_{\boldsymbol{G}} \frac{1}{Nn} \|\boldsymbol{Y} - \hat{\boldsymbol{Y}}\boldsymbol{G}'\boldsymbol{S}'\|_F + \lambda\|\text{vec}\boldsymbol{G}\|_1,$$

- $N = T - T_1 - h + 1, \quad T_1$ is minimum training sample size
- $\|\cdot\|_F$ is the Frobenius norm
- $\boldsymbol{Y} = [\boldsymbol{y}_{T_1+h}, \dots, \boldsymbol{y}_T]'$
- $\hat{\boldsymbol{Y}} = [\hat{\boldsymbol{y}}_{T_1+h|T_1}, \dots, \hat{\boldsymbol{y}}_{T|T-h}]'$
- $\lambda$ is a regularization parameter

When $\lambda = 0$: $\quad \hat{\boldsymbol{G}} = \boldsymbol{B}'\hat{\boldsymbol{Y}}(\hat{\boldsymbol{Y}}'\hat{\boldsymbol{Y}})^{-1}$ where $\boldsymbol{B} = [\boldsymbol{b}_{T_1+h}, \dots, \boldsymbol{b}_T]'$.

Reference: Ben Taieb and Koo (2019)

# MinT expressed as a regression

Since $\tilde{\boldsymbol{b}}_{t+h|t} = (\boldsymbol{S}'\boldsymbol{W}_h^{-1}\boldsymbol{S})^{-1}\boldsymbol{S}'\boldsymbol{W}_h^{-1}\hat{\boldsymbol{y}}_{t+h|t}$, we can write the MinT solution as a regression problem:

$$\begin{aligned}
\tilde{\boldsymbol{b}}_{t+h|t} &= \arg\min_{\boldsymbol{b}} \left[\hat{\boldsymbol{y}}_{t+h|t} - \boldsymbol{S}\boldsymbol{b}\right]' \boldsymbol{W}_h^{-1} \left[\hat{\boldsymbol{y}}_{t+h|t} - \boldsymbol{S}\boldsymbol{b}\right] \\
&= \arg\min_{\boldsymbol{b}} \left[\boldsymbol{b}'\boldsymbol{S}'\boldsymbol{W}_h^{-1}\boldsymbol{S}\boldsymbol{b} - 2\boldsymbol{b}'\boldsymbol{S}'\boldsymbol{W}_h^{-1}\hat{\boldsymbol{y}}_{t+h|t} + \hat{\boldsymbol{y}}'_{t+h|t}\boldsymbol{W}_h^{-1}\hat{\boldsymbol{y}}_{t+h|t}\right] \\
&= \arg\min_{\boldsymbol{b}} \left[\boldsymbol{b}'\boldsymbol{S}'\boldsymbol{W}_h^{-1}\boldsymbol{S}\boldsymbol{b} - 2\boldsymbol{b}'\boldsymbol{S}'\boldsymbol{W}_h^{-1}\hat{\boldsymbol{y}}_{t+h|t}\right]
\end{aligned}$$

- MinT solution is equivalent to a GLS regression of $\hat{\boldsymbol{y}}_{t+h|t}$ on $\boldsymbol{S}$ with covariance weights $\boldsymbol{W}_h^{-1}$.
- The estimated coefficients are the forecasts of the bottom level series.

# Non-negative forecasts

$$\min_{\boldsymbol{G}_h} \text{tr}\Big(\text{E}[\boldsymbol{y}_{t+h} - \boldsymbol{S}\boldsymbol{G}_h\hat{\boldsymbol{y}}_{t+h|t}]'[\boldsymbol{y}_{t+h} - \boldsymbol{S}\boldsymbol{G}_h\hat{\boldsymbol{y}}_{t+h|t}]\Big)$$
$$\text{such that } \boldsymbol{b}_{t+h|t} = \boldsymbol{G}_h\hat{\boldsymbol{y}}_{t+h|t} \geq 0$$

# Non-negative forecasts

$$\min_{\boldsymbol{G}_h} \text{tr}\Big(\text{E}[\boldsymbol{y}_{t+h} - \boldsymbol{S}\boldsymbol{G}_h\hat{\boldsymbol{y}}_{t+h|t}]'[\boldsymbol{y}_{t+h} - \boldsymbol{S}\boldsymbol{G}_h\hat{\boldsymbol{y}}_{t+h|t}]\Big)$$
$$\text{such that } \boldsymbol{b}_{t+h|t} = \boldsymbol{G}_h\hat{\boldsymbol{y}}_{t+h|t} \geq 0$$

**Solve via quadratic programming:**

$$\min_{\boldsymbol{b}}\Big[\boldsymbol{b}'\boldsymbol{S}'\boldsymbol{W}_h^{-1}\boldsymbol{S}\boldsymbol{b} - 2\boldsymbol{b}'\boldsymbol{S}'\boldsymbol{W}_h^{-1}\hat{\boldsymbol{y}}_{T+h|T}\Big] \quad \text{s.t.} \;\; \boldsymbol{b} \geq 0$$

(Wickramasuriya, Turlach, and Hyndman, 2020)

# Non-negative forecasts

$$\min_{\boldsymbol{G}_h} \text{tr}\Big(\text{E}[\boldsymbol{y}_{t+h} - \boldsymbol{S}\boldsymbol{G}_h\hat{\boldsymbol{y}}_{t+h|t}]'[\boldsymbol{y}_{t+h} - \boldsymbol{S}\boldsymbol{G}_h\hat{\boldsymbol{y}}_{t+h|t}]\Big)$$
$$\text{such that } \boldsymbol{b}_{t+h|t} = \boldsymbol{G}_h\hat{\boldsymbol{y}}_{t+h|t} \geq 0$$

## Solve via quadratic programming:

$$\min_{\boldsymbol{b}}\left[\boldsymbol{b}'\boldsymbol{S}'\boldsymbol{W}_h^{-1}\boldsymbol{S}\boldsymbol{b} - 2\boldsymbol{b}'\boldsymbol{S}'\boldsymbol{W}_h^{-1}\hat{\boldsymbol{y}}_{T+h|T}\right] \quad \text{s.t. } \boldsymbol{b} \geq 0$$

(Wickramasuriya, Turlach, and Hyndman, 2020)

## Set-negative-to-zero heuristic solution

- Negative reconciled forecasts at bottom level set to zero
- Remaining forecasts computed via aggregation

(Di Fonzo and Girolimetto, 2023)

# Immutable forecasts

Zhang et al. (2022)

$$\hat{\boldsymbol{y}}_{t+h|t} = \begin{bmatrix}\hat{\boldsymbol{a}}_{t+h|t}\\ \hat{\boldsymbol{v}}_{t+h|t}\\ \hat{\boldsymbol{u}}_{t+h|t}\end{bmatrix} = \begin{bmatrix}\boldsymbol{A}_1 & \boldsymbol{A}_2\\ \boldsymbol{I}_{n_b-k} & \boldsymbol{O}\\ \boldsymbol{O} & \boldsymbol{I}_k\end{bmatrix}\begin{bmatrix}\hat{\boldsymbol{v}}_{t+h|t}\\ \hat{\boldsymbol{u}}_{t+h|t}\end{bmatrix}$$

Suppose $\hat{\boldsymbol{u}}_{t+h|t}$ are fixed and let $\hat{\boldsymbol{w}}_{t+h|t} = \begin{bmatrix}\hat{\boldsymbol{a}}_{t+h|t} - \boldsymbol{A}_2\hat{\boldsymbol{u}}_{t+h|t}\\ \hat{\boldsymbol{v}}_{t+h|t}\end{bmatrix}$.

## Optimization problem

$$\min_{\boldsymbol{v}}\left[\hat{\boldsymbol{w}}_{t+h|t} - \boldsymbol{A}_3\boldsymbol{v}\right]'\boldsymbol{W}_{\boldsymbol{v}}^{-1}\left[\hat{\boldsymbol{w}}_{t+h|t} - \boldsymbol{A}_3\boldsymbol{v}\right] \qquad \text{where} \qquad \boldsymbol{A}_3 = \begin{bmatrix}\boldsymbol{A}_1\\ \boldsymbol{I}_{n_b-k}\end{bmatrix}$$

and $\boldsymbol{W}_{\boldsymbol{v}}$ contains elements of $\boldsymbol{W}_h$ corresponding to $\hat{\boldsymbol{v}}_{t+h|t}$.

# Immutable forecasts

Zhang et al. (2022)

$$\hat{\boldsymbol{y}}_{t+h|t} = \begin{bmatrix}\hat{\boldsymbol{a}}_{t+h|t}\\ \hat{\boldsymbol{v}}_{t+h|t}\\ \hat{\boldsymbol{u}}_{t+h|t}\end{bmatrix} = \begin{bmatrix}\boldsymbol{A}_1 & \boldsymbol{A}_2\\ \boldsymbol{I}_{n_b-k} & \boldsymbol{O}\\ \boldsymbol{O} & \boldsymbol{I}_k\end{bmatrix}\begin{bmatrix}\hat{\boldsymbol{v}}_{t+h|t}\\ \hat{\boldsymbol{u}}_{t+h|t}\end{bmatrix}$$

Suppose $\hat{\boldsymbol{u}}_{t+h|t}$ are fixed and let $\hat{\boldsymbol{w}}_{t+h|t} = \begin{bmatrix}\hat{\boldsymbol{a}}_{t+h|t} - \boldsymbol{A}_2\hat{\boldsymbol{u}}_{t+h|t}\\ \hat{\boldsymbol{v}}_{t+h|t}\end{bmatrix}$.

## Solve with non-negativity constraint

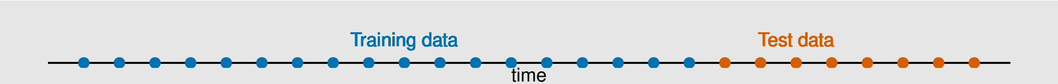
$$\min_{\boldsymbol{v}}\left[\hat{\boldsymbol{w}}_{t+h|t} - \boldsymbol{A}_3\boldsymbol{v}\right]'\boldsymbol{W}_{\boldsymbol{v}}^{-1}\left[\hat{\boldsymbol{w}}_{t+h|t} - \boldsymbol{A}_3\boldsymbol{v}\right] \qquad \text{where} \qquad \boldsymbol{A}_3 = \begin{bmatrix}\boldsymbol{A}_1\\ \boldsymbol{I}_{n_b-k}\end{bmatrix}$$

$$\text{such that} \qquad \boldsymbol{A}_3\boldsymbol{v} \geq \begin{bmatrix}-\boldsymbol{A}_2\hat{\boldsymbol{u}}_{t+h|t}\\ \boldsymbol{0}\end{bmatrix}$$

# Outline

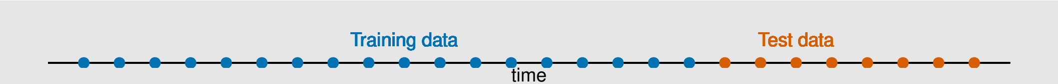
# Time series cross-validation

## Traditional evaluation

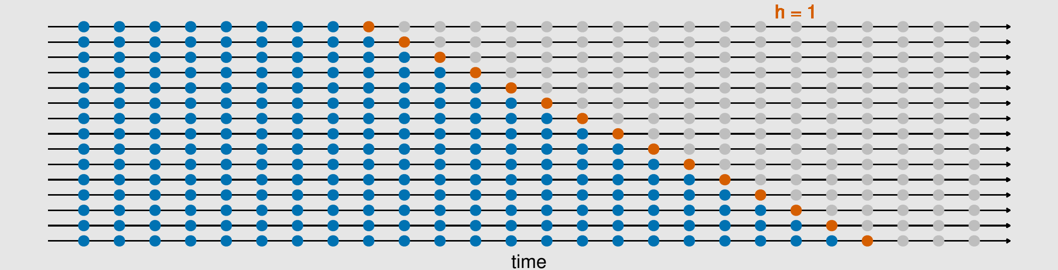


# Time series cross-validation

## Traditional evaluation

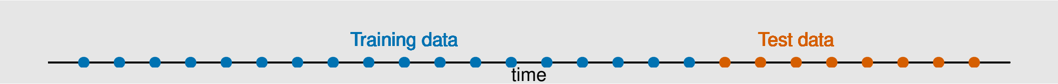



## Time series cross-validation

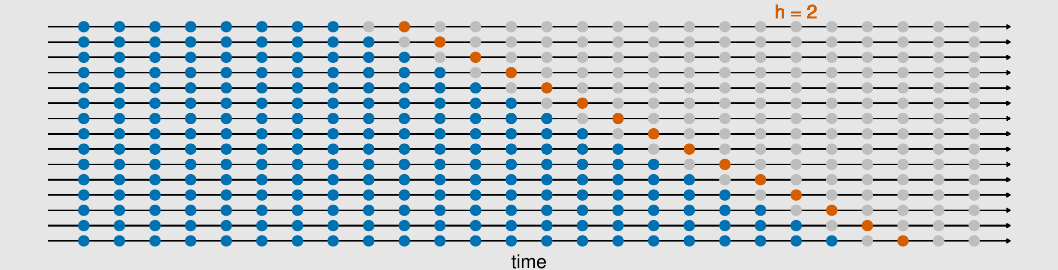


# Time series cross-validation

## Traditional evaluation

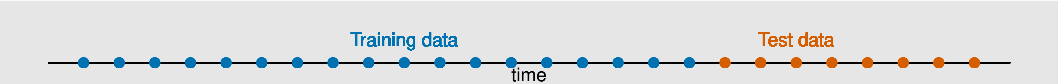



## Time series cross-validation

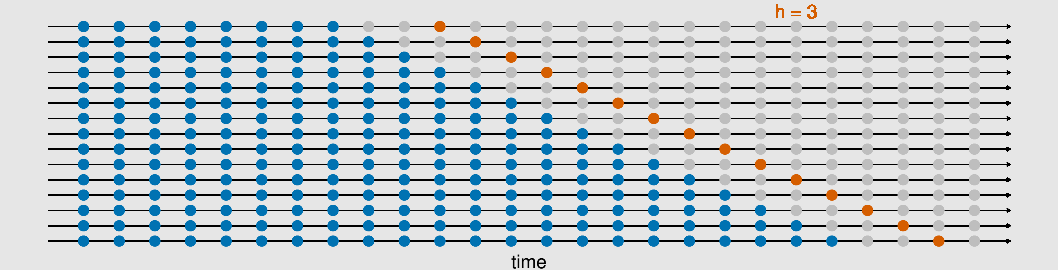


# Time series cross-validation

## Traditional evaluation

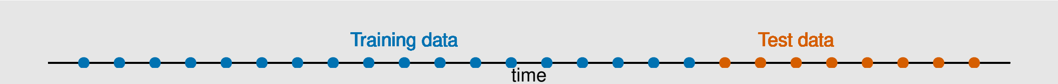



## Time series cross-validation

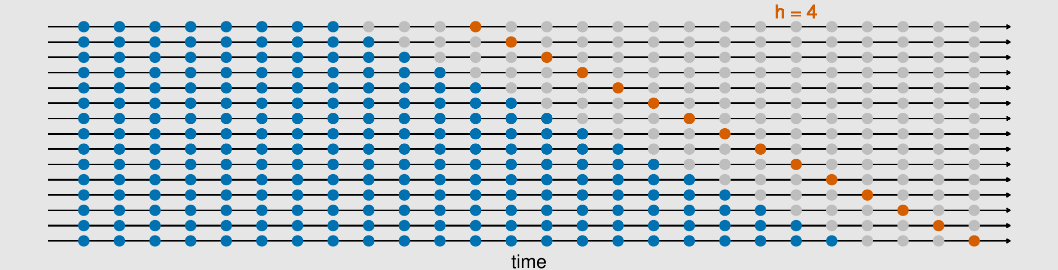


# Time series cross-validation

## Traditional evaluation

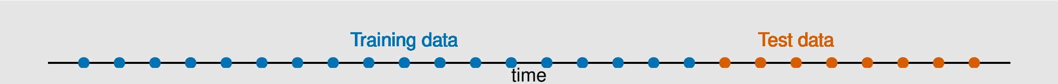



## Time series cross-validation

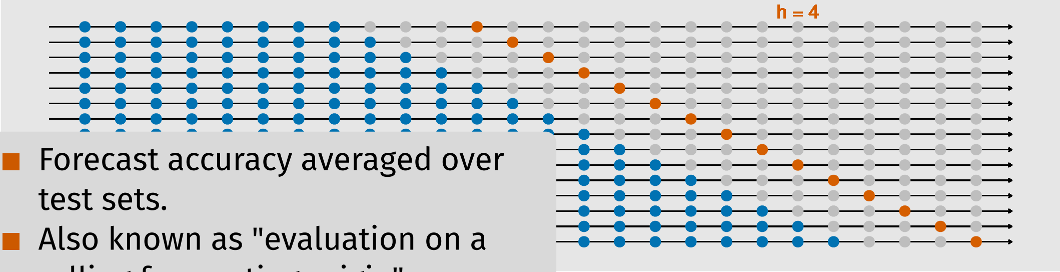


# Time series cross-validation

## Traditional evaluation




## Time series cross-validation



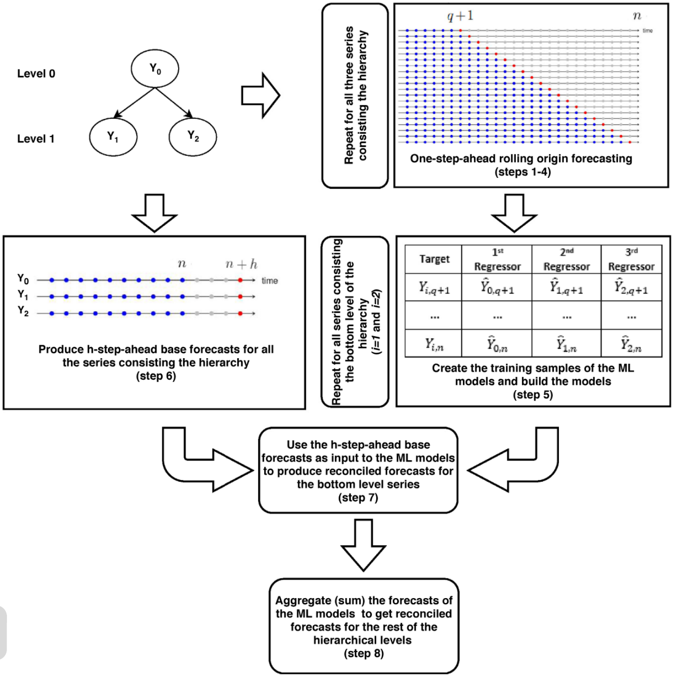

- Forecast accuracy averaged over test sets.
- Also known as "evaluation on a rolling forecasting origin"

# Outline

# ML reconciliation

1. Split all series using time series cross-validation
2. For each training set, compute one-step-ahead forecasts for all series
3. For each bottom-level series, use RF or XGB to predict values using forecasts of all series as inputs
4. Forecast all series
5. For each bottom-level series, apply ML model to improve forecasts
6. Aggregate bottom-level forecasts to obtain forecasts for other series.

Spiliotis et al. (ASC, 2021)



# ML reconciliation: tourism data

| Method | Total | States | Zones | Regions | Average |
|---|---|---|---|---|---|
| | | | MASE | | |
| MinT-Struct | 1.094 | 0.968 | 0.887 | 0.843 | 0.948 |
| MinT-Shrink | 1.047 | **0.956** | 0.872 | 0.824 | 0.925 |
| ML-RF | 1.045 | 0.964 | 0.859 | 0.812 | 0.920 |
| ML-XGB | **1.043** | 0.965 | **0.859** | **0.812** | **0.920** |
| | | | RMSSE | | |
| MinT-Struct | 1.308 | 1.225 | 1.137 | 1.109 | 1.195 |
| MinT-Shrink | 1.265 | 1.214 | 1.120 | 1.086 | 1.171 |
| ML-RF | 1.261 | **1.208** | 1.104 | 1.066 | 1.159 |
| ML-XGB | 1.255 | 1.208 | **1.101** | **1.064** | **1.157** |
| | | | AMSE | | |
| MinT-Struct | 0.988 | 0.611 | 0.426 | 0.349 | 0.593 |
| MinT-Shrink | 0.935 | 0.599 | 0.417 | 0.337 | 0.572 |
| ML-RF | 0.780 | **0.526** | 0.366 | 0.319 | 0.498 |
| ML-XGB | **0.779** | 0.526 | **0.365** | **0.317** | **0.497** |

- ML methods not significantly different.
- MinT methods significantly different from each other and from ML methods.

# ML and regularization

Mishchenko, Montgomery, and Vaggi (2019):
Optimize all forecasts with an incoherence penalty

$$\min_{\hat{\boldsymbol{y}}_t} \sum_{t=1}^{T} \|\boldsymbol{y}_t - \hat{\boldsymbol{y}}_t\|_2 + \lambda \sum_{t=1}^{T} \|\hat{\boldsymbol{y}}_t - \boldsymbol{S}_t \hat{\boldsymbol{b}}_t\|_2$$

# ML and regularization

Mishchenko, Montgomery, and Vaggi (2019):
Optimize all forecasts with an incoherence penalty

$$\min_{\hat{\boldsymbol{y}}_t} \sum_{t=1}^{T} \|\boldsymbol{y}_t - \hat{\boldsymbol{y}}_t\|_2 + \lambda \sum_{t=1}^{T} \|\hat{\boldsymbol{y}}_t - \boldsymbol{S}_t\hat{\boldsymbol{b}}_t\|_2$$

Shiratori, Kobayashi, and Takano (2020):
Optimize bottom level forecasts with an incoherence penalty

$$\min_{\hat{\boldsymbol{b}}_t} \sum_{t=1}^{T} \|\hat{\boldsymbol{b}}_t - \boldsymbol{b}_t\|_2 + \sum_{t=1}^{T} \Lambda\|\boldsymbol{a}_t - \boldsymbol{A}_t\hat{\boldsymbol{b}}_t\|_2$$

# Outline

# In-built coherence

**Two-step approach**: compute base forecasts $\hat{\boldsymbol{y}}_h$, and then reconcile them to produce $\tilde{\boldsymbol{y}}_h$.

**One-step approaches:** compute coherent $\tilde{\boldsymbol{y}}_h$ directly.

- Ashouri, Hyndman, and Shmueli (2022): linear regression models
- Pennings and Dalen (2017): state space models
- Villegas and Pedregal (2018): state space models

# In-built coherence using linear models

Suppose $\hat{y}_{t,i} = \hat{\beta}_i' \boldsymbol{x}_{t,i}$ with $\boldsymbol{x}_{t,i} = (1, x_{t,1,i}, \dots, x_{t,p,i})$ & $\hat{\boldsymbol{y}}_i = (\hat{y}_{1,i}, \dots, \hat{y}_{T,i})$.

# In-built coherence using linear models

Suppose $\hat{y}_{t,i} = \hat{\beta}_i' \boldsymbol{x}_{t,i}$ with $\boldsymbol{x}_{t,i} = (1, x_{t,1,i}, \dots, x_{t,p,i})$ & $\hat{\boldsymbol{y}}_i = (\hat{y}_{1,i}, \dots, \hat{y}_{T,i})$.

$$\begin{pmatrix} \hat{\boldsymbol{y}}_1 \\ \hat{\boldsymbol{y}}_2 \\ \vdots \\ \hat{\boldsymbol{y}}_n \end{pmatrix} = \begin{pmatrix} \boldsymbol{X}_1 & 0 & \dots & 0 \\ 0 & \boldsymbol{X}_2 & \ddots & \vdots \\ \vdots & \ddots & \ddots & 0 \\ 0 & \dots & 0 & \boldsymbol{X}_n \end{pmatrix} \begin{pmatrix} \hat{\beta}_1 \\ \hat{\beta}_2 \\ \vdots \\ \hat{\beta}_n \end{pmatrix}, \qquad \boldsymbol{X}_i = \begin{pmatrix} 1 & x_{1,i,1} & x_{1,i,2} & \dots & x_{1,i,p} \\ 1 & x_{2,i,1} & x_{2,i,2} & \dots & x_{2,i,p} \\ \vdots & \vdots & \vdots & & \vdots \\ 1 & x_{T,i,1} & x_{T,i,2} & \dots & x_{T,i,p} \end{pmatrix}$$

# In-built coherence using linear models

Suppose $\hat{y}_{t,i} = \hat{\beta}_i' \boldsymbol{x}_{t,i}$ with $\boldsymbol{x}_{t,i} = (1, x_{t,1,i}, \dots, x_{t,p,i})$ & $\hat{\boldsymbol{y}}_i = (\hat{y}_{1,i}, \dots, \hat{y}_{T,i})$.

$$\begin{pmatrix} \hat{\boldsymbol{y}}_1 \\ \hat{\boldsymbol{y}}_2 \\ \vdots \\ \hat{\boldsymbol{y}}_n \end{pmatrix} = \begin{pmatrix} \boldsymbol{X}_1 & 0 & \dots & 0 \\ 0 & \boldsymbol{X}_2 & \ddots & \vdots \\ \vdots & \ddots & \ddots & 0 \\ 0 & \dots & 0 & \boldsymbol{X}_n \end{pmatrix} \begin{pmatrix} \hat{\beta}_1 \\ \hat{\beta}_2 \\ \vdots \\ \hat{\beta}_n \end{pmatrix}, \qquad \boldsymbol{X}_i = \begin{pmatrix} 1 & x_{1,i,1} & x_{1,i,2} & \dots & x_{1,i,p} \\ 1 & x_{2,i,1} & x_{2,i,2} & \dots & x_{2,i,p} \\ \vdots & \vdots & \vdots & & \vdots \\ 1 & x_{T,i,1} & x_{T,i,2} & \dots & x_{T,i,p} \end{pmatrix}$$

$$\hat{\boldsymbol{B}} = (\boldsymbol{X}'\boldsymbol{X})^{-1}\boldsymbol{X}'\boldsymbol{Y}$$

# In-built coherence using linear models

Suppose $\hat{y}_{t,i} = \hat{\beta}_i' \boldsymbol{x}_{t,i}$ with $\boldsymbol{x}_{t,i} = (1, x_{t,1,i}, \dots, x_{t,p,i})$ & $\hat{\boldsymbol{y}}_i = (\hat{y}_{1,i}, \dots, \hat{y}_{T,i})$.

$$\begin{pmatrix} \hat{\boldsymbol{y}}_1 \\ \hat{\boldsymbol{y}}_2 \\ \vdots \\ \hat{\boldsymbol{y}}_n \end{pmatrix} = \begin{pmatrix} \boldsymbol{X}_1 & 0 & \dots & 0 \\ 0 & \boldsymbol{X}_2 & \ddots & \vdots \\ \vdots & \ddots & \ddots & 0 \\ 0 & \dots & 0 & \boldsymbol{X}_n \end{pmatrix} \begin{pmatrix} \hat{\beta}_1 \\ \hat{\beta}_2 \\ \vdots \\ \hat{\beta}_n \end{pmatrix}, \qquad \boldsymbol{X}_i = \begin{pmatrix} 1 & x_{1,i,1} & x_{1,i,2} & \dots & x_{1,i,p} \\ 1 & x_{2,i,1} & x_{2,i,2} & \dots & x_{2,i,p} \\ \vdots & \vdots & \vdots & & \vdots \\ 1 & x_{T,i,1} & x_{T,i,2} & \dots & x_{T,i,p} \end{pmatrix}$$

$$\hat{\boldsymbol{B}} = (\boldsymbol{X}'\boldsymbol{X})^{-1}\boldsymbol{X}'\boldsymbol{Y} \qquad \hat{\boldsymbol{y}}_{t+h} = \boldsymbol{X}^*_{t+h}\hat{\boldsymbol{B}}$$

# In-built coherence using linear models

Suppose $\hat{y}_{t,i} = \hat{\beta}_i' \boldsymbol{x}_{t,i}$ with $\boldsymbol{x}_{t,i} = (1, x_{t,1,i}, \dots, x_{t,p,i})$ & $\hat{\boldsymbol{y}}_i = (\hat{y}_{1,i}, \dots, \hat{y}_{T,i})$.

$$\begin{pmatrix} \hat{\boldsymbol{y}}_1 \\ \hat{\boldsymbol{y}}_2 \\ \vdots \\ \hat{\boldsymbol{y}}_n \end{pmatrix} = \begin{pmatrix} \boldsymbol{X}_1 & 0 & \dots & 0 \\ 0 & \boldsymbol{X}_2 & \ddots & \vdots \\ \vdots & \ddots & \ddots & 0 \\ 0 & \dots & 0 & \boldsymbol{X}_n \end{pmatrix} \begin{pmatrix} \hat{\beta}_1 \\ \hat{\beta}_2 \\ \vdots \\ \hat{\beta}_n \end{pmatrix}, \qquad \boldsymbol{X}_i = \begin{pmatrix} 1 & x_{1,i,1} & x_{1,i,2} & \dots & x_{1,i,p} \\ 1 & x_{2,i,1} & x_{2,i,2} & \dots & x_{2,i,p} \\ \vdots & \vdots & \vdots & & \vdots \\ 1 & x_{T,i,1} & x_{T,i,2} & \dots & x_{T,i,p} \end{pmatrix}$$

$$\hat{\boldsymbol{B}} = (\boldsymbol{X}'\boldsymbol{X})^{-1}\boldsymbol{X}'\boldsymbol{Y} \qquad \hat{\boldsymbol{y}}_{t+h} = \boldsymbol{X}^*_{t+h}\hat{\boldsymbol{B}} \qquad \boldsymbol{X}^*_{t+h} = \text{diag}(\boldsymbol{x}'_{t+h,i}, \dots, \boldsymbol{x}'_{t+h,n})$$

# In-built coherence using linear models

Suppose $\hat{y}_{t,i} = \hat{\beta}_i'\boldsymbol{x}_{t,i}$ with $\boldsymbol{x}_{t,i} = (1, x_{t,1,i}, \dots, x_{t,p,i})$ & $\hat{\boldsymbol{y}}_i = (\hat{y}_{1,i}, \dots, \hat{y}_{T,i})$.

$$\begin{pmatrix} \hat{\boldsymbol{y}}_1 \\ \hat{\boldsymbol{y}}_2 \\ \vdots \\ \hat{\boldsymbol{y}}_n \end{pmatrix} = \begin{pmatrix} \boldsymbol{X}_1 & 0 & \dots & 0 \\ 0 & \boldsymbol{X}_2 & \ddots & \vdots \\ \vdots & \ddots & \ddots & 0 \\ 0 & \dots & 0 & \boldsymbol{X}_n \end{pmatrix} \begin{pmatrix} \hat{\beta}_1 \\ \hat{\beta}_2 \\ \vdots \\ \hat{\beta}_n \end{pmatrix}, \qquad \boldsymbol{X}_i = \begin{pmatrix} 1 & x_{1,i,1} & x_{1,i,2} & \dots & x_{1,i,p} \\ 1 & x_{2,i,1} & x_{2,i,2} & \dots & x_{2,i,p} \\ \vdots & \vdots & \vdots & & \vdots \\ 1 & x_{T,i,1} & x_{T,i,2} & \dots & x_{T,i,p} \end{pmatrix}$$

$$\hat{\boldsymbol{B}} = (\boldsymbol{X}'\boldsymbol{X})^{-1}\boldsymbol{X}'\boldsymbol{Y} \qquad \hat{\boldsymbol{y}}_{t+h} = \boldsymbol{X}^*_{t+h}\hat{\boldsymbol{B}} \qquad \boldsymbol{X}^*_{t+h} = \text{diag}(\boldsymbol{x}'_{t+h,i}, \dots, \boldsymbol{x}'_{t+h,n})$$

$$\tilde{\boldsymbol{y}}_{t+h} = \boldsymbol{S}(\boldsymbol{S}'\boldsymbol{W}_h\boldsymbol{S})^{-1}\boldsymbol{S}'\boldsymbol{W}_h\hat{\boldsymbol{y}}_{t+h} = \boldsymbol{S}(\boldsymbol{S}'\boldsymbol{W}_h\boldsymbol{S})^{-1}\boldsymbol{S}'\boldsymbol{W}_h\boldsymbol{X}^*_{t+h}(\boldsymbol{X}'\boldsymbol{X})^{-1}\boldsymbol{X}'\boldsymbol{Y}$$

$$\boldsymbol{V}_h = \sigma^2\boldsymbol{S}(\boldsymbol{S}'\boldsymbol{W}_h\boldsymbol{S})^{-1}\boldsymbol{S}'\boldsymbol{W}_h\left[1 + \boldsymbol{X}^*_{T+h}(\boldsymbol{X}'\boldsymbol{X})^{-1}(\boldsymbol{X}^*_{T+h})'\right]\boldsymbol{W}_h\boldsymbol{S}'(\boldsymbol{S}'\boldsymbol{W}_h\boldsymbol{S})^{-1}\boldsymbol{S}'$$

Reference: Ashouri, Hyndman, and Shmueli (2022)

# In-built coherence using state space models

Pennings and Dalen (2017) propose the state space model

$$\begin{aligned} \boldsymbol{y}_t &= \boldsymbol{S}\boldsymbol{\mu}_t + \boldsymbol{Z}_t\beta + \varepsilon_t, & \varepsilon_t &\sim N(\mathbf{0}, \Sigma_\varepsilon), \\ \boldsymbol{\mu}_t &= \boldsymbol{\mu}_{t-1} + \boldsymbol{\eta}_t, & \eta_t &\sim N(\mathbf{0}, \Sigma_\eta). \end{aligned}$$

- Coherent forecasts arise naturally using the Kalman filter
- Covariance matrices difficult to estimate except for small hierarchies.
- Requires the same model for all series
- A related approach proposed by Villegas and Pedregal (2018)

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