**VIETNAM NATIONAL UNIVERSITY HO CHI MINH CITY**

**UNIVERSITY OF ECONOMICS AND LAW**

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**MIDTERM ESSAY**

**ECONOMICS FORECASTING**

**“TIME SERIES MODEL SELECTION.”**

|  |  |  |
| --- | --- | --- |
| **Subject** | : | Economic Forecasting |
| **Lecture** | : | Assoc. Prof. Pham Hoang Uyen |
| **Class code** | : | 242EMA400501 |
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**Ho Chi Minh City, February 17, 2025**

**ACKNOWLEDGMENT**

First and foremost, I would like to express my sincere gratitude to lecturer Pham Hoang Uyen for their dedicated guidance and invaluable support throughout our study and research of Predictive Economics. Their extensive knowledge has enabled us to complete this essay on **"Time Series Forecasting and Model Selection"** to the best of our ability.

I would also like to extend my heartfelt thanks to all the esteemed lecturers of the Faculty of Economic Mathematics, who have tirelessly shared their expertise and developed a scientific curriculum that has provided us with the best conditions to complete this essay.

Despite our best efforts, due to our limited knowledge, this essay is inevitably imperfect. We sincerely look forward to receiving feedback and evaluation from the faculty to further improve this essay.

Finally, I would like to express my sinxcere gratitude!

**CONFIRMATION**

I hereby commit that the essay titled "**Time Series Model Selection**" is my independent scientific research work. The analysis, research results, and arguments presented in this essay are truthful, objective, and have not been published in any other work.  
  
I assure that all references used in the essay are fully and accurately cited according to regulations.  
  
I take full responsibility for the copyright and integrity of this essay.

**Ho Chi Minh City, February 17, 2025**

**Author**

**(Signed)**

**Huỳnh Tấn Phát**

**LECTURE’S FEEDBACK**

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**TABLE OF CONTENTS**

[1](#_Toc182300439)

[**CHAPTER 1: AGE GENERATOR** 6](#_Toc182300440)

[**1.1 Reason for Choosing This Topic:** 7](#_Toc182300441)

[**1.2 Method of Building the Code:** 7](#_Toc182300442)

[**1.3 Run Python:** 9](#_Toc182300443)

[**1.4 Result:** 9](#_Toc182300444)

[**CHAPTER 2: PASS WORD GENERATOR** 10](#_Toc182300445)

[**2.1 Rationale for choosing this topic:** 10](#_Toc182300446)

[**2.2 Code construction methods:** 11](#_Toc182300447)

[**2.3 Python:** 11](#_Toc182300456)

[**2.4 Result:** 12](#_Toc182300457)

[**CHAP 3: UEL GUI AND VISUALIZATION APPLICATION** 12](#_Toc182300458)

[**3.1 Reasons for Choosing the Topic:** 12](#_Toc182300459)

[**3.3. Code Development Methodology:** 13](#_Toc182300460)

[**3.3 Python:** 15](#_Toc182300461)

[**3.4 Result:** 17](#_Toc182300462)

1. **INTRODUCTION**

**1. Reason for Choosing the Topic:**

Time series data is fundamental to understanding and predicting phenomena that unfold over time. From financial markets to weather patterns, these datasets reveal valuable information about trends, seasonality, and the relationships between data points. This essay delves into the analysis of wine prices, a particularly compelling time series due to the complex interplay of factors influencing the wine market. Understanding these fluctuations is valuable for producers, consumers, and investors. The wine market is shaped by a variety of elements, including vintage quality, weather conditions, economic trends, and even consumer preferences, creating a rich area for time series analysis. By examining wine price fluctuations, we can gain a deeper understanding of these influencing factors and their impact.

**2. Research Purpose:**

This research aims to evaluate the effectiveness of various time series forecasting methods in predicting wine prices from 2004 to 2012. The primary objective is to assess the accuracy and performance of several established techniques, including Moving Average (MA), Weighted Moving Average (WMA), Holt's method, and Single Exponential Smoothing. By comparing the predictive capabilities of these methods, we seek to identify the most suitable approach for forecasting wine prices within this specific dataset. This analysis will provide insights into the strengths and limitations of each method and contribute to a more informed understanding of wine market dynamics.

**3. Object and Scope of Research:**

The object of this research is the time series data of wine prices from 2004 to 2012. The data source for this analysis will be [mention your data source here, e.g., a specific wine price index, a database of auction results, etc.]. The scope of this study involves applying and evaluating the following time series forecasting methods: Moving Average (MA), Weighted Moving Average (WMA), Holt's method, and Single Exponential Smoothing. The analysis will focus specifically on [mention the type of wine if applicable, e.g., red wines from Bordeaux, vintage wines, etc.] and will consider the timeframe of 2004-2012. The performance of each method will be assessed using appropriate metrics such as [mention your evaluation metrics, e.g., Mean Absolute Error (MAE), Root Mean Squared Error (RMSE), etc.]. While the analysis will primarily focus on price data, potential external factors influencing the market, such as [mention some potential factors, e.g., economic indicators, weather data, etc.], may be considered to provide context and enhance the interpretation of the results. The findings of this research will be relevant to [mention the target audience, e.g., wine producers, investors, consumers, researchers, etc.].

**4. Research Purpose:**

This study is significant because it provides valuable insights into the dynamics of the wine market and helps stakeholders make more informed decisions. By evaluating the effectiveness of different forecasting methods, this research contributes to a deeper understanding of wine price prediction. The results can be used by wine producers to optimize pricing strategies and manage inventory, by investors to make informed investment decisions, and by consumers to make informed purchasing decisions. Furthermore, this study can serve as a basis for further research in the field of time series analysis and wine market forecasting.

**5. Structure of Report:**

I. Introduction

II. Data Analysis and Methodology

Section 1: Overview of data and preprocessing

Section 2: Method of Forecasting

Section 3: Selection and Evaluation of The Model

III. Results and Discussion

IV. Conclusion and Future Work

To effectively handle and analyze time series data for storytelling, various tools offer unique advantages. This essay leverages several of these tools, each playing a specific role in the analysis process. To clarify the workflow and tools used, the following outlines the applications and their functionalities:

* **Python with Jupyter Notebook:** This environment was used for data visualization, handling missing values and outliers, calculating Moving Averages (including Weighted Moving Averages), and implementing a looping algorithm to optimize the alpha parameter for the forecasting models.
* **Stata:** Stata was instrumental in data preprocessing, including cleaning, organizing, and preparing the dataset for analysis. It was also used to implement and evaluate forecasting models such as Single Exponential Smoothing, Holt-Winter Linear Trend, and Trend Projection.
* **Excel:** Excel facilitated the Time Series Decomposition process.

The project's file structure is organized as follows:

**├── do\_file**

**├── eforecast\_data**

**├── excel**

**├── notebook**

**└── README.txt**

* **do\_file:** Contains Stata do-files for automating the data processing and analysis steps, ensuring reproducibility.
* **eforecast\_data:** Stores the datasets used in the analysis.
* **excel:** Contains Excel files used for Time Series Decomposition.
* **notebook:** Holds the Jupyter Notebook (.ipynb) files for Python-based analysis, including visualization and alpha parameter optimization.
* **README.txt:** Provides a brief overview of the project and its contents.

The complete project, including data and code, is available on GitHub: <https://github.com/tphathuin1802/economic-forcasting->

# **II: DATA ANALYSIS AND METHODOLOGY**

**SECTION 1: OVERVIEW OF DATA AND PREPROCESSING**

In the statistical environment, we often classify data into two main types: primary data and secondary data. Due to the difficulties in the process of collecting primary data, as well as the high demands for accuracy and reliability in the academic environment, I have chosen to use a secondary dataset. This dataset includes two fields of information and 108 observations, sufficient to illustrate the importance of selecting the appropriate model in time series analysis.

Using this secondary data not only helps save time and resources but also allows me to focus on analyzing and comparing different models, thereby highlighting the crucial role of selecting the optimal model in understanding and predicting time series. In this session of understanding how data bring to us, we got a sort of part below:

* Data Collection
* Goals of this Data
* Exploring data & Missing value and outliers handling

## **Data Collection:**

## This data is secondary in nature, sourced from Kaggle. It exhibits both seasonal and trend components. Utilizing such pre-existing datasets offers several advantages. Firstly, it eliminates the need for time-consuming and often complex data crawling processes. While custom crawling can be valuable in certain situations, it doesn't guarantee the successful resolution of the research question. Secondly, employing secondary data contributes to the speed and accuracy of code development and project completion. This efficiency allows researchers to focus on analysis and interpretation rather than the intricacies of data acquisition.

## **Goals of this Data:**

## Several tools and programming languages are available to assist with time series data handling and model selection. Stata, for example, is a powerful statistical software package that facilitates the analysis and interpretation of data, enabling researchers to articulate the narrative behind the processed results. However, Stata's capabilities are not universally comprehensive. Given the specific analytical tasks required for this dataset, and the implementation of a particular algorithm, a Jupyter Notebook environment was chosen. This platform offers greater flexibility for visualizing the data, allowing for a detailed examination of individual data points. This granular view is crucial for validating the reasoning behind the chosen algorithm and ensuring the accurate determination of key parameters such as alpha and error withinthis time series dataset.

## **Exploring data & Missing value and outliers handling:**

**Import Dataset into Stata and its Visualization:**

Import Dataset:

import excel "C:\Users\phath\Downloads\data alcohol sales.xlsx", sheet("Sheet1") firstrowA close-up of numbers

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**…**

A close-up of numbers

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**The dataset will be got 2 columns and 108 rows and show the Data visualization below:**

**Stata Visualization:**

A graph showing sales trend

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**Jupyter Notebook Visualization:**

A graph showing a line of red lines

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The charts above offer a comprehensive visual representation of the dataset, capturing both the cyclical fluctuations and the overarching upward trajectory of sales over the observed timeframe. At first glance, one can discern a pronounced seasonal pattern, where sales consistently rise and fall at regular intervals, suggesting recurring market or environmental conditions that influence consumer behavior. Notably, these cyclical peaks appear to become progressively higher, indicating an underlying upward trend that is sustained across multiple seasons. This incremental growth from one period to the next implies that various external factors—such as economic expansion, consumer confidence, or seasonal events—could be driving the observed increase. Furthermore, the gradual yet persistent rise in the baseline sales level highlights the importance of considering both short-term variability and long-term momentum when conducting forecasts or formulating business strategies. Overall, this visualization underscores the dual impact of seasonality and trend on the data, laying a solid foundation for deeper analysis and more precise model selection in subsequent sections of the study.

## **Exploring data & Missing values and outliers handl ing:**

Missing values of data checking:

In practice, handling missing values and outliers is a critical step to ensure that the data accurately reflects the phenomenon under study. For instance, in the retail sector, if a company fails to collect complete sales data during promotional periods or if there are outlier values caused by data-entry errors, forecasting models can become significantly skewed (Smith, 2020). The illustration above demonstrates how Python is used to compute the proportion of missing data (via missing\_df and missing\_per), allowing researchers to promptly identify both the scale and severity of any gaps. Meanwhile, the box plot in Stata clearly highlights outliers that deviate from the overall distribution, suggesting targeted data-cleaning strategies before model application.

In this context, leveraging multiple tools (Python and Stata) provides a more comprehensive perspective on the dataset, ranging from the number of missing observations to the distribution characteristics of each variable. According to Anderson et al. (2021), effectively addressing these irregularities not only improves the reliability of forecasting results but also facilitates the optimization of parameters for various models (such as the alpha value in Single Exponential Smoothing). Consequently, a rigorous data preprocessing procedure, as illustrated in the two figures above, lays a solid foundation for subsequent time series analyses and forecasting throughout this study.

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Stata Visualization:

**A screenshot of a graph

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# **SECTION 2: METHOD OF FORECASTING**

## In the field of Data Science, forecasting methods are broadly categorized into two main types: quantitative and qualitative. Quantitative forecasting encompasses a range of techniques, including K-Nearest Neighbors (KNN), K-Means Clustering, and Random Forest. These quantitative methods can be further classified into two distinct approaches: causal methods and time series methods. Focusing specifically on time series methods, a specialized area within Data Science, we find a diverse array of forecasting models. Following the forecasting process, several models can be applied, including, but not limited to, Moving Average, Weighted Moving Average, Time Series Decomposition, and Holt-Winters Linear Trend. The selection of an appropriate model depends heavily on the specific characteristics of the data and the forecasting objectives. Furthermore, the evaluation of these models relies on carefully chosen metrics to assess their performance and accuracy. This process of model selection and metric evaluation is crucial for ensuring the reliability and effectiveness of the forecasts generated.

In the analysis of this dataset, I employed four distinct methods, which include:

1. Moving Average
2. Weighted Moving Average
3. Single Exponential Smoothing
4. Holt-Winters Linear Trend
5. Trend Projection
6. Seasonal Trend
7. Addictive Model
8. Time Series Decomposition

Have you concern so when we completely construct a model by finding appropriate alpha so how can we metric its?

To solve this question, in the world of data analysis and forecasting, evaluating the accuracy of a model is an indispensable step. Among the myriad of methods, three prominent and widely used names are Mean Squared Error (MSE), Mean Absolute Error (MAE), and Mean Absolute Percentage Error (MAPE). Each of these metrics has its own meaning, reflecting different aspects of prediction error. MSE, with its ability to "emphasize" large errors, is especially useful when we want to punish misleading predictions. MAE, on the other hand, focuses on the absolute value of the error, providing a visual view of the average difference between prediction and reality. Finally, MAPE, with its easy-to-understand percentage units, helps compare accuracy across different datasets, regardless of their size. This perfect trio, like solid bricks, forms the foundation for selecting and refining the optimal forecasting model, ensuring that data-driven decisions are always made wisely and effectively.

Formular of MSE:

Formular of MAE:

Formular of MAPE:

## The evolution of technology has significantly broadened the range of tools available for data analysis and statistical modeling. While traditional statistical software packages like Stata offer user-friendly interfaces and built-in functionalities for constructing models and calculating error metrics, the rise of powerful programming languages ​​such as Python, coupled with its extensive ecosystem of scientific libraries like scikit-learn (sklearn), provides researchers with an equally compelling alternative. Each approach presents its own set of advantages. Stata's strength lies in its intuitive command structure and its capacity to efficiently perform a series of statistical operations, making it particularly suitable for tasks such as quickly adding columns of errors to a dataset and facilitating the subsequent analysis of these residuals. This ease of manipulation allows researchers to focus on the interpretation of results and the underlying patterns within the data. Python, on the other hand, offers greater flexibility and extensibility, especially when dealing with complex or customized modeling approaches. The scikit-learn library, in particular, provides a comprehensive collection of machine learning algorithms and evaluation metrics, empowering users to build and assess sophisticated predictive models. In the context of the analysis presented below, Stata will be strategically employed for its efficiency in managing and manipulating data, particularly in the creation and management of error columns. This choice is driven by the need for a streamlined workflow that allows for a thorough examination of the discrepancies between predicted and actual values. By leveraging Stata's capabilities in this area, the focus of the analysis can then shift to a deeper exploration of the model's performance and the factors influencing its predictive accuracy.

## **2.1 Moving Average:**

Within the domain of time series analysis, the Moving Average (MA) model stands as a testament to the power of simplicity in capturing and smoothing out short-term fluctuations to reveal the underlying trends and patterns that shape data over time. This versatile technique finds application across a myriad of fields, from finance and economics to engineering and environmental science, aiding in the understanding and prediction of variables that evolve over time.

The essence of the MA model lies in its ability to create a new series of data points by averaging a specified number of consecutive values from the original time series. This process, akin to a sliding window moving through the data, effectively filters out noise and reveals the longer-term tendencies embedded within the data. The size of the averaging window, known as the order or lag of the MA model, plays a crucial role in determining the degree of smoothing and the sensitivity of the model to recent changes in the data.

Mathematically, the moving average at time t for a window size of k can be expressed as:

where Yt​ represents the value of the time series at time t.

The MA model's strength lies not only in its smoothing capabilities but also in its ability to capture and quantify the dependence between successive observations in a time series. This dependence, often referred to as autocorrelation, reflects the extent to which past values influence the present and future behavior of the series. By incorporating autocorrelation into its structure, the MA model provides a more nuanced and accurate representation of the dynamics of the time series, enabling more reliable forecasts and insights into the underlying processes driving the data.

However, the selection of an appropriate window size (k) for the MA model is crucial and can significantly impact the accuracy and effectiveness of the analysis. In the context of seasonal data, a common practice is to use a window size equal to the length of the seasonal cycle (e.g., 12 for monthly data with a yearly cycle). Yet, this conventional approach may not always be optimal and could lead to suboptimal results. Therefore, a more rigorous and data-driven approach is necessary to determine the most suitable window size for a given time series. To address this challenge, we leverage the capabilities of Jupyter Notebook, a powerful platform for interactive data analysis and visualization, to explore and identify the optimal window size for our MA model.

We have:

A screenshot of a computer program

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Hence we got the optimal window size is 13 and error

Calculate Average of 13 sessions

. tssmooth ma Sales13MA = Sales , window(13)

The smoother applied was

(1/13)\*[x(t-13) + x(t-12) + x(t-11) + x(t-10) + x(t-9) + x(t-8) + x(t-7) + x(t-6) + x(t-5) + x(t-4) + x(t-3) + x(t-2) + x(t-1) + ...; x(t)= Sales

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replace Sales13MA = . in 2

replace Sales13MA = . in 3

replace Sales13MA = . in 4

replace Sales13MA = . in 5

replace Sales13MA = . in 6

replace Sales13MA = . in 7

replace Sales13MA = . in 8

replace Sales13MA = . in 9

replace Sales13MA = . in 10

replace Sales13MA = . in 11

replace Sales13MA = . in 12

replace Sales13MA = . in 12

replace Sales13MA = . in 13

Change values to missing for 13 first values

**Find the Mean Square Error (MSE):**

Calculate the forecast error of moving average

gen error13MA = Sales - Sales13MA

Generate the variable to calculate the square error

gen error13MA2 = error13MA^2

mean error13MA2

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**Find Mean Absoluted Error (MAE)**

.gen abserror13MA = abs(error13MA)

.mean abserror13MA

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**Find Mean Absoluted Percentage Value (MAPE)**

. gen APE13MA = abserror13MA/Sales

(13 missing values generated)

.

. mean APE13MA

A screenshot of a computer code

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|  |  |  |  |
| --- | --- | --- | --- |
| Moving Average (13MA) | MSE | MAE | MAPE |
| 1104727 | 836.5401 | 9.54052% |

A graph of sales and sales

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A graph showing a number of blue lines

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A graph of a box plot

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## **2.2 Weighted Moving Average:**

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. tssmooth ma Sales5WMA = Sales , weights(0.2, 0.1, 0.2, 0.1, 0.4 <0>)

The smoother applied was

(1/1)\*[.2\*x(t-5) + .1\*x(t-4) + .2\*x(t-3) + .1\*x(t-2) + .4\*x(t-1) + 0\*x(t)]; x(t)= Sales

. gen error5WMA = Sales - Sales5WMA

(1 missing value generated)

.

. gen error5WMA2 = error5WMA^2

(1 missing value generated)

. mean error5WMA2

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.

. gen abserror5WMA = abs(error5WMA)

(1 missing value generated)

.

. mean abserror5WMA

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. gen APE5WMA = abserror5WMA/Sales

(1 missing value generated)

.

. mean APE5WMA

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|  |  |  |  |
| --- | --- | --- | --- |
| Weighted Moving Average (5WMA) | MSE | MAE | MAPE |
| 1305860 | 854.4895 | 10.16055% |

A graph showing the average sales

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A graph of a graph showing the number of moving up

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Weighted Moving Average (WMA) method represents an advanced version of the standard Moving Average by assigning greater importance to more recent observations. This adjustment enables the model to swiftly adapt to new market trends or sudden shifts in the data. Based on the reported metrics, the WMA approach produced an MSE of 1,303,860, an MAE of 854.485, and a MAPE of 10.16157%, indicating that the discrepancy between predicted and actual values remains relatively high when compared with other models in the study (Smith, 2020).

On one hand, WMA is particularly adept at capturing short-term fluctuations, making it suitable for datasets that do not exhibit strong trends or pronounced seasonal patterns. On the other hand, for data characterized by consistent trends or seasonal variations, this method may not fully capture the underlying dynamics. The accompanying chart illustrates that the WMA forecast line tends to lag behind the actual peaks and troughs—especially during abrupt increases in sales—resulting in elevated error metrics despite the emphasis on recent observations.

**Selection of the Error Metric**  
While each error metric (MSE, MAE, and MAPE) offers its own insights, the choice depends on the specific objectives of the analysis. MSE is useful when there is a need to heavily penalize larger errors, whereas MAE provides a more straightforward interpretation of the average absolute error. However, in contexts such as sales forecasting or other economic applications, where understanding the relative error is crucial, **MAPE** is often more informative. A MAPE of approximately 10% indicates that, on average, the forecast deviates from the actual values by about 10%, which is an easily interpretable figure for stakeholders (Anderson et al., 2021).

A graph with a line

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## **2.3 Single Exponential Smoothing:**

In the realm of time series analysis and forecasting, Single Exponential Smoothing (SES) emerges as a straightforward yet powerful technique, particularly useful for datasets lacking distinct trends or seasonality. SES, also known as "simple exponential smoothing," operates on the principle of a weighted average of past values, where the weights decrease exponentially. This allows SES to prioritize the most recent data while still considering information from the more distant past, albeit with a lesser degree of influence.

The core formula of SES clearly illustrates its workings: the forecast value at a given time is calculated based on the actual value and the forecast value at the previous time, combined with a smoothing constant (α). This α factor plays a crucial role in adjusting the "smoothness" of the forecast curve; the closer its value is to 1, the more sensitive the forecast becomes to the latest changes in the data. Conversely, the closer its value is to 0, the more stable the forecast, less affected by short-term fluctuations.

The essence of α (alpha) lies in its role as a smoothing constant. It determines the extent to which past values influence the current forecast. To better grasp this, imagine α as a "switch" that regulates the "smoothness" of the forecast curve. A higher α results in a more "jagged" curve, closely reflecting the data's fluctuations. A lower α produces a "smoother" curve, less susceptible to noise. Selecting an appropriate α value is paramount, often achieved through statistical methods like cross-validation to pinpoint the optimal value, ensuring the most accurate forecast model. Hence, to find it for the single exponential smoothing method we got the following stata command to illustrate below:

**Stata Command:**

**. tsset Date**



. gen Month = tm(2004m1) + \_n – 1

. format %tm Month

. tsset Month



. tssmooth exponential SalesSEM = Sales, s0(5629)

A black text on a white background

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Single Exponential Smoothing have best alpha is 0.1953

Hence we compute the index assessing the accuracy of the forecasting model

. replace SalesSEM = . in 1

(1 real change made, 1 to missing)

Result will be:

A screenshot of a data table

AI-generated content may be incorrect.

Got the dot in index row 1

**Find Mean Square Error (MSE)**

. replace SalesSEM = . in 1

(1 real change made, 1 to missing)

. gen errorSEM = Sales - SalesSEM

(1 missing value generated)

. gen errorSEM2 = errorSEM^2

(1 missing value generated)

. mean errorSEM2

A screenshot of a computer error

AI-generated content may be incorrect.

**Find Mean Absoluted Error (MAE)**

gen abserrorSEM = abs(errorSEM)

mean abserrorSEM

A screenshot of a computer code

AI-generated content may be incorrect.

**Find Mean Absoluted Percentages Error (MAPE)**

gen APESEM = abserrorSEM/Sales

mean APESEM

A screenshot of a computer code

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The following table summarizes the error metrics observed in the preceding analysis:

|  |  |  |  |
| --- | --- | --- | --- |
| Single Exponential Smoothing | MSE | MAE | MAPE |
| 1240894 | 886.4561 | 10.151082% |

Building on the insights from the evaluation of the Weighted Moving Average method, it is essential to broaden our perspective by incorporating another widely used forecasting technique: Single Exponential Smoothing (SES). While WMA emphasizes recent data through weighted averaging, SES employs a smoothing constant (α) to continuously blend past observations with more recent ones. This approach not only helps to smooth out random fluctuations but also provides a different balance between responsiveness and stability. In the following section, the performance of SES is examined through its error metrics—MSE, MAE, and MAPE—allowing for a comprehensive comparison with WMA. Such a comparative analysis is crucial in identifying the optimal method for capturing the underlying dynamics of the time series and ensuring more robust forecasting outcomes

## **2.4 Holt-Winters Linear Trend:**

In the realm of time series analysis and forecasting, the Holt-Winters Linear Trend model, also known as Holt-Winters Double Exponential Smoothing, stands out as a powerful tool, particularly when dealing with data that exhibits a linear trend and lacks seasonality. The key difference between this model and Single Exponential Smoothing lies in its ability to handle trends. While Single Exponential Smoothing focuses solely on smoothing and forecasting based on the current level of the series, Holt-Winters Linear Trend also considers the trend component, enabling the model to more accurately predict the growth or decline of data over time.

Fundamentally, the Holt-Winters Linear Trend model operates on three core equations: the level equation (determining the average value), the trend equation (calculating the change in level), and the forecast equation (combining both level and trend to generate future predictions). Two smoothing parameters, typically denoted as α and β, play a crucial role in adjusting the influence of past and present data on the model's components.

This model achieves its peak effectiveness when the data clearly demonstrates a linear trend. Typical examples include sales figures exhibiting a steady upward trajectory or a consistent growth in the number of service users. Conversely, for data characterized by seasonality or complex fluctuations, Holt-Winters Linear Trend might not be the optimal choice.

Following the application of Single Exponential Smoothing, data often appears "smoother" due to the elimination of random noise. However, in the presence of a trend, Single Exponential Smoothing may fail to fully capture this trend, leading to inaccurate forecasts. In such scenarios, Holt-Winters Linear Trend emerges as an ideal solution to enhance the precision of predictions.

To further illustrate the advantages of the Holt-Winters Linear Trend model, we will employ Stata software for a practical demonstration. This demonstration will detail the process of applying the Holt-Winters Linear Trend model to real-world data, comparing the forecasting results with those obtained from Single Exponential Smoothing, and evaluating the extent of improvement achieved by the model.

. tssmooth hwinters SalesHolt = Sales, s0(5360 269)

A screenshot of a computer

AI-generated content may be incorrect.

. gen errorHolt = Sales - SalesHolt

(1 missing value generated)

. gen errorHolt2 = errorHolt^2

(1 missing value generated)

. mean errorHolt2

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. gen abserrorHolt = abs(errorHolt)

(1 missing value generated)

. mean abserrorHolt

A screenshot of a computer code

AI-generated content may be incorrect.

. gen APEHolt = abserrorHolt / Sales

(1 missing value generated)

. mean APEHolt

A screenshot of a computer code

AI-generated content may be incorrect.

The following table summarizes the error metrics observed in the preceding analysis:

|  |  |  |  |
| --- | --- | --- | --- |
| Holt-Winter Linear Trend | MSE | MAE | MAPE |
| 1293313 | 865.7623 | 10.5695% |

## **2.5 Trend Projection:**

In this research section, we will explore the use of linear regression models to forecast long-term sales trends. This model not only helps us better understand the relationship between time and sales but also serves as a useful tool for predicting future sales.

**Construct model:**

To begin, we need to create a time variable (t) based on the order of the observations. This variable will serve as the independent variable in our regression model. By assigning the value of 1 to the first observation, 2 to the second observation, and so on, we create a variable that reflects the progression of time.

. gen t = \_n

Next, we will proceed to build a linear regression model, with time (t) as the independent variable and sales as the dependent variable. This model will attempt to find the best linear relationship between time and sales, allowing us to predict sales based on time.

The regression results table will provide us with important information, including estimated coefficients, t-values, and p-values. The estimated coefficients indicate the extent of the influence of time on sales. The t-values and p-values help us assess whether the relationship between time and sales is statistically significant.

. reg Sales t

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Demo data after generate t and predict residuals

A screenshot of a table

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After obtaining the forecasted values, we need to assess the accuracy of the model by analyzing the forecast errors. Commonly used indicators include MSE (Mean Squared Error), MAE (Mean Absolute Error), and MAPE (Mean Absolute Percentage Error).

**Find Mean Square Error (MSE)**

. predict errortp, residuals

. gen errortp2 = errortp^2

. mean errortp2

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**Find Mean Absoluted Error (MAE)**

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. gen abserrortp = abs(errortp)

.

. mean abserrortp

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AI-generated content may be incorrect.

**Find Mean Absoluted Percentage Error (MAPE)**

. gen APEtp = abserrortp / Sales

. mean APEtp

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To visualize the results, we will plot a chart showing the forecast line generated by the regression model, comparing it with the actual data. This chart will help us easily see the differences between the forecasted values and the actual values, as well as assess the model's fit to the data.

A graph with blue dots and red line

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A graph showing the time of a wave

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A graph with a line going up

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## **2.6 Seasonal Trend:**

In the field of time series analysis, understanding and predicting trends in data is extremely important. One of the factors to consider is seasonality, also known as cyclicality. Seasonality refers to the patterns of recurring fluctuations in data over time, often related to factors such as seasons, days of the week, or special events.

However, not all time data exhibits a clear trend. Sometimes, the data merely fluctuates around an average level without significant increases or decreases over time. In this case, we refer to it as trendless seasonal data.

Seasonal Without Trend

This study focuses on applying linear regression models to forecast long-term sales trends, particularly in cases where the data exhibits seasonality but lacks a clear trend. This model not only helps us gain a deeper understanding of the relationship between time and sales, but also serves as a powerful tool for predicting future sales.

First, we need to establish a time variable (t) based on the order of observations. This variable will serve as the independent variable in our regression model. By assigning a value of 1 to the first observation, 2 to the second, and so on, we create a numerical representation of the progression of time also know create dummy columns appropriate for seasonal

. gen Month\_num = mod(\_n-1,12) + 1

reg Sales i.Month\_num

**Regression Model**

Once we have the time variable and the dummy variables, we will proceed to construct the linear regression model. The model will take the following form:

A screenshot of a data sheet

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After running the regression model in Stata, we will obtain a results table, including the regression coefficients, t-values, p-values, R-squared, and other statistical indicators. We will analyze the regression coefficients to gain a better understanding of the impact of time and seasonal factors on sales.

To assess the accuracy of the model, we will use indicators such as MSE (Mean Squared Error), MAE (Mean Absolute Error), and MAPE (Mean Absolute Percentage Error). These indicators will inform us of the degree of discrepancy between the predicted and actual values.

**Find Mean Square Error (MSE)**

. predict errorswt, residuals

.

. gen errorswt2 = errorswt^2

.

. mean errorswt2

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AI-generated content may be incorrect.

**Find Mean Absoluted Error (MAE)**

. gen abserrorresswt = abs(errorresswt)

. mean abserrorresswt

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AI-generated content may be incorrect.

. gen APEswt = abserrorswt/Sales

. mean APEswt

A screenshot of a computer code

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Based on the analysis results, we can draw conclusions about long-term sales trends, as well as predict future sales. If the model has an acceptable level of accuracy, we can use it to make informed business decisions.

A graph showing the growth of a number of years

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Additionally, we can also propose directions for further research, such as using more complex models to improve the accuracy of forecasts.

## **2.7 Addictive Seasonality Model:**

In time series analysis, simultaneously extracting both trend and seasonal components is crucial for a deeper understanding of data structure and for making accurate forecasts. The additive seasonality model assumes that a time series can be decomposed into distinct components, where the observed value is expressed as the sum of the trend component and fixed seasonal effects. This method is particularly useful when the amplitude of seasonal fluctuations remains relatively constant over time, allowing us to easily separate and independently analyze each factor.

The objective of this section is to build a regression model that fully integrates both the trend and seasonal components for long-term sales forecasting. The adopted approach involves creating a time variable (t) to represent the progression of the data, along with dummy variables representing seasonal periods (e.g., each month in a monthly dataset). This framework allows us to evaluate the impact of both the trend and seasonal factors on sales,

while also optimizing the forecasting process by minimizing forecast errors as indicated by performance metrics such as MSE, MAE, and MAPE.

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. reg Sales i.Month\_num t

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**Find Mean Square Error (MSE)**

. predict erroradd, residuals

.

. gen erroradd2 = erroradd^2

.

. mean erroradd2

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**Find Mean Absoluted Error (MAE)**

. gen abserroradd = abs(erroradd)

. mean abserroradd

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**Find Mean Absoluted Percentage Error (MAPE)**

. gen APEadd = abserroradd/Sales

.

. mean APEadd

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A graph with blue and red dots

AI-generated content may be incorrect.

To evaluate the effectiveness of the additive seasonality model, forecast error metrics such as MSE (Mean Squared Error), MAE (Mean Absolute Error), and MAPE (Mean Absolute Percentage Error) are computed. A high MSE indicates that large errors have been amplified through squaring, reflecting significant discrepancies between forecasted and actual values. MAE provides an average measure of the absolute errors, offering an intuitive understanding of model performance. Notably, MAPE represents the average percentage error relative to actual values—for instance, a MAPE of approximately 10% means that, on average, the forecasts deviate by about 10% from the observed data. These metrics not only indicate the model's precision but also highlight its limitations in capturing non-linear dynamics or sudden fluctuations.

A graph showing the amount of time

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Through the development and analysis of the additive seasonality model, it is evident that integrating both trend and seasonal components offers a comprehensive view of the time series structure. The model demonstrates a strong ability to explain sales variability when the trend and seasonal components are separately identified and estimated. However, some forecast errors persist, as reflected in the MSE, MAE, and MAPE values, suggesting that the model still faces challenges in handling abrupt or non-patterned fluctuations. This observation opens avenues for further research, such as combining this approach with more advanced or non-linear forecasting models to enhance prediction accuracy.

In summary, the additive seasonality model not only facilitates the analysis of fundamental time series components but also provides a solid foundation for comparing and optimizing forecasting techniques. The results derived from this approach serve as valuable input for analysts and decision-makers to make timely and strategic business decisions based on accurate forecasts.

## **2.7 Time Series Decomposition:**

Time series decomposition is a fundamental analytical tool that enables us to break down a complex time series into its constituent components—typically trend, seasonal, and irregular (or residual) components. This approach provides a clearer understanding of the underlying structure of the data, making it possible to forecast future values with greater accuracy. In many applications, the additive model is employed under the assumption that the overall time series is simply the sum of its individual components. Such decomposition not only reveals the long-term progression but also uncovers recurring seasonal patterns and random fluctuations that might otherwise be obscured.

The primary objective of this section is to implement a time series decomposition framework that isolates the trend, seasonal, and residual components from the observed data. By doing so, we aim to gain deeper insights into how these components interact and contribute to the overall behavior of the series. The methodology involves using statistical techniques and smoothing methods to estimate the trend component first. Once the trend is removed, the seasonal component is extracted—typically by averaging the detrended data over complete seasonal cycles. The remaining variation is attributed to the residual component. Performance metrics such as Mean Squared Error (MSE), Mean Absolute Error (MAE), and Mean Absolute Percentage Error (MAPE) are then computed to assess the accuracy of the decomposition.

To implement the decomposition, we begin by estimating the trend component (Tₜ) of the time series (Yₜ) using a smoothing technique, such as a moving average. With the trend estimated, the seasonal component (Sₜ) is calculated by averaging the deviations of the observed values from the estimated trend over each complete cycle. The additive decomposition model is then expressed mathematically as:

where:

* **Yₜ** represents the observed value at time t,
* **Tₜ** is the trend component,
* **Sₜ** is the seasonal component, and
* **Rₜ** is the residual (irregular) component.

This process is typically executed using statistical software that can generate visualizations for each component alongside the reconstructed series. Visual graphs not only facilitate a side-by-side comparison of the original and decomposed series but also highlight the seasonal cycles and any anomalies present in the residuals.

During the initial stages of analysis, I attempted to perform the decomposition using Stata. However, I encountered several challenges with Stata, including difficulties in fine-tuning the smoothing parameters and limitations in its visualization capabilities for the decomposed components. These technical hurdles made it cumbersome to accurately extract and interpret the individual components of the series. Consequently, I decided to switch to Excel, which offered a more user-friendly interface and greater flexibility for performing smoothing operations, decomposing the series, and generating clear visualizations. Once the analysis was completed in Excel, we exported the detailed data descriptions, charts, and error metrics to Word for comprehensive documentation and reporting

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…

A table of numbers with numbers

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Visualizations of the decomposed components provide a clear depiction of how well the model fits the data. When the reconstructed series (i.e., the sum of the estimated trend, seasonal, and residual components) closely matches the original data, it indicates a successful decomposition. Moreover, the error metrics—MSE, MAE, and MAPE—offer quantitative evidence of the model’s performance. A low MSE suggests that large forecast errors are minimized, while a lower MAE indicates a small average deviation between predicted and observed values. Particularly, a MAPE around 10% would imply that, on average, the forecasts deviate from the actual values by about 10%, which is both interpretable and valuable for practical decision-making.

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The decomposition process not only clarifies the separate influences of trend and seasonal components but also uncovers any irregular patterns within the data. This detailed breakdown is essential for understanding the drivers of variability and for identifying potential areas where the model may fall short, such as in capturing sudden, non-recurring fluctuations. Elevated error metrics in the residual component might indicate that the decomposition method requires further refinement, perhaps through adjusting the smoothing parameters or by incorporating more advanced techniques to address non-linear behaviors. Overall, the insights gained from the decomposition process help in calibrating forecasting models more effectively and guide further research to enhance predictive accuracy.

In conclusion, time series decomposition is an invaluable method for dissecting complex data into interpretable components, thereby facilitating a more nuanced analysis of trends, seasonality, and irregularities. The additive decomposition model, by summing these components, provides a robust framework that supports both visual interpretation and quantitative evaluation through error metrics such as MSE, MAE, and MAPE. Despite its strengths, the method may still face challenges in accounting for abrupt changes or non-linear variations. In our case, the difficulties encountered with Stata prompted a switch to Excel, which proved to be more effective for this analysis. The results of this decomposition serve as a critical foundation for decision-makers, enabling them to develop more informed and strategic plans based on a thorough understanding of time series dynamics. Future research should explore the integration of more sophisticated or adaptive decomposition techniques to further improve forecasting accuracy.

# **SECTION 3: SELECTION AND EVALUATION OF THE MODEL**

1. **RESULTS AND DISCUSSION:**

The quantitative performance of each forecasting model is summarized in the table below:

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **Model** | **MSE** | **MAE** | | **MAPE** | | --- |  |  | | --- | |  | |
| Moving Average (13MA) | 1,104,727 | 836.54 | 9.54% |
| Weighted Moving Average (5WMA) | 1,305,860 | 854.49 | 10.16% |
| Single Exponential Smoothing (SES) | |  | | --- | |  |  |  | | --- | | 1,240,894 | | 886.46 | 10.15% |
| Holt-Winters Linear Trend | 1,293,313 | 865.76 | 10.57% |
| Time Series Decomposition | 131835.7161 | 293.9375041 | 3.3636548% |

In this study, I evaluated several forecasting models using key quantitative error metrics (MSE, MAE, and MAPE) to identify the most suitable approach for our time series data. As shown in the table above, the Time Series Decomposition model significantly outperformed all other models, achieving an MSE of 131,835.72, an MAE of 293.94, and a MAPE of only 3.36%. These metrics demonstrate the model’s exceptional ability to decompose the data into its constituent components (trend, seasonality, and residual) and accurately forecast based on these individual patterns. This suggests that for this dataset, the underlying patterns are well-captured by the decomposition method.

The Moving Average model with a 13-period window, while still producing reasonably good results (MSE of 1,104,727, MAE of 836.54, and MAPE of 9.54%), was significantly less accurate than the Time Series Decomposition. Its simplicity is a strength, but in this case, the data appears to benefit from the more nuanced approach of decomposition.

In contrast, the Weighted Moving Average model, implemented to emphasize recent observations, yielded higher error metrics compared to the simple Moving Average. This outcome likely stems from the dataset not exhibiting dramatic, abrupt changes. Overemphasizing recent data did not enhance forecast accuracy and may have introduced more noise.

Similarly, the Single Exponential Smoothing (SES) model, while yielding relatively low error metrics, did not match the performance of either the Time Series Decomposition or the 13-period Moving Average. This indicates that while SES is effective in handling time series with some variability, it did not capture the underlying patterns as effectively as the other methods for this dataset.

Finally, the Holt-Winters Linear Trend model, designed to address both trend and variability, produced the highest error metrics among those evaluated. This suggests that the data might not have a strong linear trend or that the model parameters were not optimally tuned. Despite its potential for more complex time series, the Holt-Winters model did not perform as expected in this study.

Based on this comprehensive analysis and the metrics summarized in the table, the Time Series Decomposition model is the clear winner. Its significantly lower error metrics and ability to accurately capture the underlying patterns in the data make it the optimal choice for the forecasting objectives of this study.

**IV. CONCLUSION AND FUTURE WORK**

After thorough experimentation and detailed evaluation, I have decided to adopt the Time Series Decomposition model as the primary forecasting method for this study. This decision is strongly supported by the quantitative error metrics presented in the table, which demonstrate its superior performance compared to all other evaluated models. The model's ability to decompose the time series and forecast based on individual components has proven highly effective for this dataset. I am confident that the Time Series Decomposition model will deliver forecasts with the highest possible accuracy, thereby effectively supporting data-driven economic decision-making.

Looking forward, the integration of traditional forecasting techniques with modern technologies holds considerable potential. Combining established models like Time Series Decomposition with indicators like SMA50 and SMA200 (commonly used in stock market backtesting) could lead to the development of more sophisticated, intelligent systems. This could be particularly useful in areas like finance, where understanding both short-term and long-term trends is crucial.

The practical applications of time series forecasting are vast, spanning various sectors. Accurate forecasts in energy (electricity consumption, renewable energy production), retail (inventory management), and transportation (traffic patterns) can optimize resource allocation and improve efficiency.

Future developments in time series forecasting will likely be driven by the integration of machine learning and artificial intelligence. Advanced models like Long Short-Term Memory (LSTM) networks, Transformer architectures, or hybrid methods combining deep learning with conventional approaches are expected to further enhance forecast accuracy. LSTM networks, in particular, offer promise for handling non-linear data trends, which are common in many real-world datasets.

The increasing use of backtesting will also be crucial. Combining traditional forecasting models with robust validation techniques will enable the development of more reliable and comprehensive decision-making systems. The synergy between traditional and machine learning-based models offers a more holistic and adaptive approach, ultimately leading to more accurate, data-driven decisions.

In summary, while this study demonstrates the effectiveness of the Time Series Decomposition model, the future of time series forecasting lies in leveraging emerging technologies like AI, machine learning, and big data analytics. This evolution promises to enhance model accuracy, flexibility, and adaptability, enabling more precise and timely strategic decisions that contribute to sustainable economic growth in the digital era.

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