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A Dynamic Factor Model for World Trade Growth

Working paper

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Abstract

This paper reviews the main monthly indicators that could help forecasting world trade and compares different type of forecasting models using these indicators. In particular it develops dynamic factor models (DFM) which have the advantage of handling larger datasets of information than bridge models and allowing for the inclusion of numerous monthly indicators on a national and world-wide level such as financial indicators, transportation and shipping indices, supply and orders variables and information technology indices. The comparison of the forecasting performance of the DFMs with more traditional bridge equation models as well as autoregressive benchmarking models shows that, the dynamic factor approach seems to perform better, especially when a large set of indicators is used, but also that the marginal gains in adding indicators seems to diminish after a certain stage.

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