

IS DSGE-VAR A USEFUL METHODOLOGY FOR CARIBBEAN FORECASTERS AND POLICYMAKERS?

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ABSTRACT

This study determines the extent to which, a small Caribbean economy can use a vector autoregressive (VAR) representation of a Dynamic Stochastic General Equilibrium (DSGE) model with informed priors of the economy to better forecast key economic variables. The empirical findings indicate that the DSGE-VAR produces superior forecasts to both the Bayesian VAR and unconstrained VAR methods used, especially as the analysis goes further into the forecasting horizon. The salient policy implication of this study is that a more robust forecasting performance can be achieved from a model with an informed prior distribution on the economy, even more than traditional methodologies such as unconstrained VAR with OLS-like estimates and Bayesian methods. It is therefore prudent that policymakers and central bankers consider the DSGE-VAR methodology as a robust way of accurately forecasting estimates for key economic variables which are usually critical components in understanding the economy.

Keywords: *Bayesian VAR, Dynamic Stochastic General Equilibrium Models, VAR*