

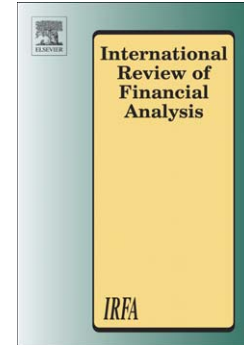
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Forecasting the Price of Gold Using Dynamic Model Averaging

Goodness Aye^a, Rangan Gupta^a, Shawkat Hammoudeh^b, Won Joong Kim^c

Abstract

We develop several models to examine possible predictors of the return of gold, which embrace six global factors (business cycle, nominal, interest rate, commodity, exchange rate and stock price) extracted from a recursive principal component analysis (PCA) and two uncertainty and stress indices (the Kansas City Fed's financial stress index and the U.S. Economic policy uncertainty index). Specifically, by comparing alternative predictive models, we show that the dynamic model averaging (DMA) and dynamic model selection (DMS) models outperform linear models (such as the random walk) as well as the Bayesian model averaging (BMA) model. The DMS is the best predictive model overall across all forecast horizons. Generally, all the predictors show strong predictive power at one time or another though at varying magnitudes, while the exchange rate factor and the Kansas City Fed's financial stress index appear to be strong at almost all horizons and sub-periods. However, the forecasting prowess of the exchange rate is supreme.

JEL Classification codes: C11, C53, F37, F47, Q02

Keywords: Bayesian, state space models, gold, macroeconomic fundamentals, forecasting

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