Comparative Analysis of ARIMA, VAR, and Linear Regression Models for UAE GDP Forecasting

P. J. McCloskey[1]*, Rodrigo Malheiros Remor[1]

[1]MCC Economics & Finance, Abu Dhabi, United Arab Emirates

*Corresponding author: pj@mcceconomics.co.uk

ARTICLE HISTORY

PEER REVIEW STATEMENT:

This article underwent double-blind peer review by 3 independent reviewers.

HOW TO CITE

ABSTRACT

Forecasting GDP is crucial for economic planning and policymaking. This study compares the performance of three widely-used econometric models—ARIMA, VAR, and Linear Regression—using GDP data from the UAE. Employing a rolling forecast approach, we analyze the models' accuracy over different time horizons. Results indicate ARIMA's robust long-term forecasting capability, LR models perform better with short-term predictions, particularly when exogenous variable forecasts are accurate. These insights provide a valuable foundation for selecting forecasting models in the UAE's evolving economy, suggesting ARIMA's suitability for long-term outlooks and LR for short-term, scenario-based forecasts.

Keywords: *GDP forecasting, ARIMA, VAR, Linear Regression, UAE economy*

I. Introduction:

Gross Domestic Product (GDP) is a widely used measure of an economy's performance. It is the sum of everything that is produced within an economy during a given period (Mankiw, 2022). Many businesses and government entities rely on GDP as a key parameter in their decision making. Central banks, for example, use this metric in their macroeconomic models, while businesses guide their investment decisions by, among other factors, their expectations on the future of the economy. This means that forecasts of likely movements in GDP are an important metric for many organizations.

This importance is evidenced by the number of different forecasting econometric models that have been developed over the decades in academia and the private and public sectors. Researchers have proposed many different time-series models such as Vector Autoregressive (VAR) (Robertson and Tallman, 1999; Roush et al., 2017; Bäurle et al., 2020), Autoregressive Integrated Moving Average (ARIMA) (Muma and Karoki, 2022; Yao Ma, 2024; Abdullah Ghazo, 2021), Long Short-Term Memory (LSTM) (Ouaadi and Ibourk, 2022; Zhang et al., 2023), among others, to measure and forecast GDP. Macroeconomic models have also been used to this end, using techniques such as Linear Regression (LR) (Chen, 2023) and Principal Component Analysis (PCA) (Alkhareif, 2018).

In this paper, we explore and compare the performance of 3 of these more popular approaches that have been successfully deployed for different economies and are widely accepted in the literature, namely the VAR, ARIMA, and LR models. We use United Arab Emirates' (UAE) data to estimate these models and test their statistical properties and forecasting power, to determine which one is more suitable to the country. Our goal is to compare these three simple and inexpensive approaches, which can be easily implemented by any entity in their models and decision-making tools.

In the next section, we will explore the current literature on forecasting country GDP with these three methods. In section III, we explain each approach and estimate the best performing models. Section IV presents a comparison of their forecasting power. Finally, in section V we present our conclusions and suggest possible paths for future studies in this topic.

Literature Review

The academic literature has a wide range of work on the different methods to forecast GDP and other macroeconomic variables. Yao Ma (2024) and Abdullah Ghazo (2021) developed ARIMA models for GDP forecasting in China and Jordania. Robertson and Tallman (1999), Roush et al. (2017) and Bäurle et al. (2020) show that VAR models can be used with many different arrangements of variables. Conversely, Ziyuan Chen (2023) shows that LR models can also be used to forecast GDP, suggesting that time-series approaches are just one of several possible forecasting methods.

A. ARIMA Models

The ARIMA methodology was developed by Box and Jenkins in 1976. It continues to be largely utilized in efforts to forecast GDP, because of its simplicity and its position as a useful benchmark to compare other models.

Muma and Karoki (2022) conducted a meta-review of 10 ARIMA models developed over the previous decade that were used to model and forecast the GDP of 8 different countries. TABLE I. summarizes the studies that the authors selected.

TABLE I.   SELECTED PAPERS BY MUMA AND KAROKI

Author	Country of Focus	Specification
Agrawal (2018)	India	ARIMA (1, 1, 0); ARIMA (1, 1, 1)
Yang et al. (2016)	China	ARIMA (2, 2, 2)
Wabomba et al. (2016)	Kenya	ARIMA (2, 2, 2); ARIMA (1, 1, 0)
Hisham and Amin (2020)	Sudan	ARIMA (1, 1, 1)
Abonazel and Abd-Elftah (2019)	Egypt	ARIMA (1, 2, 1)
Sehgal, Bijoy & Deisting (2012)	Sudan	ARIMA (0, 1, 0)
Omekara, Okereke & Ehighibe (2016)	Nigeria	ARIMA (2, 1, 3)
Nyoni & Bonga (2019)	Rwanda	ARIMA (3, 1, 1)
Ondieki (2014)	Kenya	ARIMA (3, 1, 1); ARIMA (1, 1, 0)
Logubayom, Nasiru & Luguterah (2013)	Ghana	ARIMA (3, 1, 1); ARIMA (1, 1, 0)

Source: Muma and Karoki (2022)

The authors noted that ARIMA models were effective in accurately modelling and forecasting GDP in the analysed studies, and recommended an individualized approach to estimating these types of models for each economy. They argue that the model estimation should take into consideration the country's individual characteristics.

Yao Ma (2024) found a different ARIMA model than the one in TABLE I. for China, using annual GDP data from 1978 to 2022. Ma tested the specifications ARIMA (1,2,0) and ARIMA (0,2,0), and found the latter to be more statistically sound. Ma demonstrated that the model could be used to forecast

GDP growth and concluded that it had a high accuracy for short-term forecasts. It is likely that a change in economic conditions between the period studied by Ma (2024) and the period studied by Yang et al (2016), which includes the recent pandemic shock, is the main explanation for their different results.

Abdullah Ghazo (2021) developed ARIMA models for Jordania's GDP and Consumer Price Index (CPI) and found that the optimal specification for the production indicator was ARIMA (3,1,1). The author's results show that the model was accurate for short-term forecasts, but less so for the long term.

The evidence present in the literature shows that the ARIMA methodology is effective in measuring GDP and relatively accurate in forecasting in the short term. Given the wide sample of countries covered by the literature, an ARIMA model is a promising candidate for the UAE.

B. VAR Models

The VAR model was introduced by Christopher Sims in 1980. Since then, it has been a major tool for macroeconomic analysis and forecast, along with its variations, among which the Bayesian VAR (BVAR) and the Structural VAR (SVAR). Applications of VAR models to forecast GDP usually make use of other major macroeconomic variables, such as CPI and unemployment rates (Robertson and Tallman, 1999; World Bank, 2020), or the GDP components themselves, whether arrived at by expenditure, income or production approaches (Roush et al., 2017).

In the paper published by the World Bank (2020), several VAR specifications were tested to forecast the GDP of Moldova. The authors tested a total of 34 variables, including the GDP and other economic indicators from the country's main trade partners, to find the best specification. The authors forecasted 4 quarters ahead and used the Root Mean Square Error (RMSE) as their accuracy metric when comparing their best models' forecasting power and their performance relative to a benchmark random walk model for the GDP. According to this metric, the best performing VAR model was a VAR(2) which used the GDP of Saudi Arabia and that of Russia in its specification, along with a quarter over quarter variation of the Moldavian GDP, reflecting the high interrelationships these two economies. The RMSE for that model was averaged at 2.16 in the 4 periods.

Robertson and Tallman (1999) used domestic economic indicators in their VAR model for the United States (US) economy, namely the US CPI, unemployment rate, a commodity price index, the Effective Federal Funds Rate and the M2 money stock. The last two variables were included envisioning the usage of the model by the president of the Federal Reserve Bank of Atlanta,. The authors noted that the model's user and the forecast's purpose are important factors to decide how to specify the model and which approach to use.

The authors developed a monthly VAR(13), and used it to calculate quarterly and annual GDP forecasts on a rolling window of 11 years. The forecasts for the first 2 quarters presented an average RMSE of 3.05, while that for the first 2 years was 2.33. Their approach shows that different frequencies can also yield good results in VAR estimations.

Roush et al. (2017) found a quarterly VAR(4) to perform better for the US economy, among their tested models. The authors used an approach that focused on the expenditure components of GDP. They used in their model the real Personal Consumption Expenditure, real Government Consumption Expenditure and Gross Private Domestic Investment, as they directly relate to each of the domestic components of the GDP calculation. Also using quarterly data, they forecasted 6 periods ahead, concluding that due to the large confidence interval for farther quarters, the model is more useful to predict only one or two periods ahead.

Bäurle et al (2020) chose the production side of the GDP calculation to specify their model estimations for Switzerland and the euro area. Among other similar approaches, the authors estimated a quarterly VAR(4) for each of the areas, using their respective sectoral GDP, which measures each sectors Gross Value Added (GVA). Their VAR model presented an RSME of 1.86 over the first 2 quarters, and of 1.90 over the first 8 quarters for Switzerland, and 2.25 and 2.23 over the same windows for the euro zone.

In this paper, we will follow Bäurle's approach and use the sectoral GVA to estimate our VAR model, applying the production approach to calculate GDP.

C. Linear Regresion (LR)

Albeit less common, we can also find in the literature examples of LR being used not only to model GDP, but also to forecast it. These models usually make use of an underlying economic theory and rely on secondary forecasting models or the collection of external forecasts for the exogenous variables.

One recent example by Ziyuan Chen (2023) uses a multivariate linear regression model to forecast GDP,

supported by univariate linear regression models and the growth retardation model to forecast the exogenous variables. The author adopted the variables GDP, population, labour force population, education investment and fixed asset investment, basing the estimation on an augmented Cobb-Douglas Function, which includes population growth and human capital in the classical Capital and Labour model specification.

The first step of this forecast is to establish the future values of population, using the growth retardation model, to then feed them to the estimated model between labour force population and total population to forecast the former. After this calculation, the author estimates two univariate trend models, using the year as the exogenous variable and education investment and fixed asset investment as the dependent variables. The resulting models are then used to calculate the future values of these variables. Finally, the author employs these future values in the GDP model and calculates the GDP forecast for a 20-year period.

Due to no accuracy measures being calculated in the paper, it is difficult to stablish if this approach yields good forecasts. The comparative nature of this paper will lead us to go further in our analysis and calculate these metrics.

D. Comparing Models

Our paper contributes to expand the literature on comparisons of different estimation methods for GDP forecasting. We highlight 3 examples of similar comparisons.

Shahini and Haderi (2013) estimated four different models to forecast the quarterly GDP for Albania. TABLE II. shows the comparison of the authors' results. The presented metrics, namely Bias, Standard Error (SE),

Mean Squared Forecast Error (MSFE), Root of Mean Squared Forecast Error (RMSFE) and Mean Average Percentage Error (MAPE) evidently point to the VAR being the best approach to model and forecast GDP.

TABLE II.   COMPARISON OF AUTHORS' RESULTS

	ARIMA GDP	ARIMA SEC	BM	VAR
BIAS	129	316	-304	24
SE	1786	2498	1361	956
MSFE	3200224	6292809	1779018	902978
RMSFE	1789	2509	1334	950

| MAPE | 0.65 | 0.94 | 0.42 | 0.38 |

Source: Shahini and Haderi (2013)

Josué R. Andrianady (2023) conducted a comparison between ARIMA, VAR and MIDAS models' forecasts of Madagascar's GDP. found. Summarizes the accuracy of the three models the author estimated. In this case, the metrics point to the ARIMA model being the best one for forecasting GDP, indicating that the differences of the characteristics of Albania and Madagascar's economies prescribe different models for an optimal GDP forecast.

TABLE III. AUTHOR'S MODEL RESULTS

	ARIMA	VAR	MIDAS
MAE	49.79	72.26	67.7
MAPE	4.38	6.47	5.96
RMSE	58.03	87.63	83.68

Source: Josué R. Andrianady (2023)

Following the same line of research, Maccarrone et al. (2021) compared the K-Nearest Neighbour (KNN) machine learning algorithm to ARX, SARIMAX and Linear Regression (LR) models, while using AR and SARIMA as benchmarks for the time series models, using US GDP data for their estimations. According to the accuracy metric Average Mean Squared Error (MSE), the best econometric model the authors found was LR, with a performance second only to the Machine Learning model.

The evidence presented above shows that many models may be used to forecast GDP, and different economies may find better results in different models, depending on their individual characteristics and the data available for them. This Reinforces the importance of our effort to test which of these three approaches is better suited to forecast UAE's GDP.

III. Methodology

For this paper, we have selected our variables from a dataset with 426 variables, to estimate the models of interest. This dataset ranged from general macroeconomic variables (e.g. inflation, unemployment, GDP, etc.) to sector-specific variables (e.g. number of new business licenses, number of hotel guests, oil production, etc.). TABLE IV. shows the number of variables available, by data source and the country to which they belong.

TABLE I.   Selected papers by Muma and Karoki

Source	No. of Variables	Countries
Property finder	21	Dubai
Statistics Centre of Abu Dhabi (SCAD)	64	Abu Dhabi

|		
Abu Dhabi Securities Exchange (ADX)	1	Abu Dhabi
Arab Monetary Fund (AMF)	5	UAE
Atmia	3	UAE
Bloomberg	99	Abu Dhabi Dubai Kwuait Qatar Saudi Arabia Tadawul UAE USA World
BP	19	UAE World
Central Bank of UAE	21	UAE
CEIC data	3	UAE
Country economy	2	UAE
Enerdata	2	World
Federal Competitiveness and Statistics Center (FCSC)	44	UAE
US Federal Reserve Economic Data (FRED)	23	Dubai UAE USA World
Fxempire	1	Abu Dhabi
International Energy Agency (IEA)	6	UAE
Intenational Monetary Fund (IMF)	41	UAE
Macrotrends	4	UAE
International Organization of Petroleum-Exporting Countries (OPEC)	5	UAE
Statista	3	UAE
UAE Stats	27	UAE
World Bank	48	UAE
WTO	20	UAE

Due to data availability, the frequency of the variables summarized above is annual and all the models are estimated on this base, to ensure comparability. The variables used in each of our model estimations underwent transformations such as differencing, standardization or indexation, to avoid distorted results. The transformations are delineated on the appropriate sections below.

ARIMA Methodology

The ARIMA models, denoted ARIMA(p,d,q), are structured around three components. The first an Autoregressive component (AR), which specifies how many lags of the variable are going to be used to explain their current value.

This number is denoted p in the ARIMA notation. The second is the Integration component (I), which specifies how many times the variable is differenced, usually until it reaches stationarity. It is shown as d in the ARIMA notation. The third and last is the Moving Average component (MA), which specifies the arithmetic average of past residuals as parameters in the model. The residual lags used are given by q in the ARIMA notation.

A general ARIMA(p,d,q) is given by the equation:

$$\llbracket \Delta^d y \rrbracket_t = \beta_0 + \beta_1 \llbracket \Delta^d y \rrbracket_{(t-1)} + \beta_2 \llbracket \Delta^d y \rrbracket_{(t-2)} + \cdots + \beta_p \llbracket \Delta^d y \rrbracket_{(t-p)} + u_t + \theta_1 u_{(t-1)} + \theta_2 u_{(t-2)} + \cdots + \theta_q u_{(t-q)} \quad (1)$$

Where Δ denotes differencing, y_t is the variable of interest on period t, β_i and θ_j are the estimated parameters and u_t is the model residual for period t.

For this model, we collected real GDP data for the UAE from 1975 to 2023, in local currency (Arab Emirates Dirhams - AED). This variable was collected from the UAE Federal Competitiveness and Statistics Centre's (FCSC) data centre. Before estimating the model, we performed stationarity tests and analysed the data.

Starting with visual analysis, we plotted the Autocorrelation Function (ACF) for GDP. Figure 1 shows the results. The slower and constant reduction of the ACF over the GDP lags indicates that the variable is likely non-stationary.

Fig 1. Autocorrelation Function (ACF) for GDP

The Augmented Dickey-Fuller (ADF) unit root test result supports this conclusion.

Augmented Dickey-Fuller Test on GDP level
DF = -1.8841   Lag order = 3   p-value = 0.6204

After differencing GDP and redoing these calculations it seems that the new series became stationary at a 10% confidence level. Given that at a 5% confidence level we cannot reject the base hypothesis that the differenced series is nonstationary, it might be beneficial to difference the GDP series a second time. On the other hand, the ACF plot indicates that the series is stationary, with an autoregressive component AR(1).

Fig. 2. Autocorrelation Function (ACF) for the first difference of GDP

| ARIMA (3,1,1) | 928.9899 | 937.1779 |
| ARIMA (3,2,1) | 904.8624 | 912.917 |
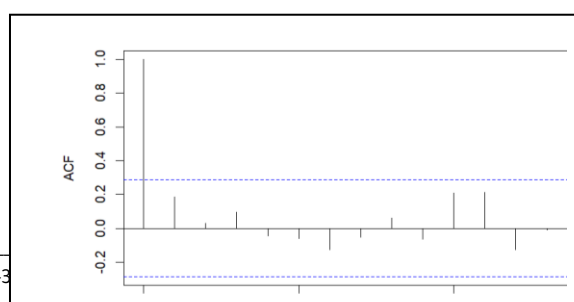
Augmented Dickey-Fuller Test on the first difference of GDP

DF = -3.2059   Lag order = 3   p-value = 0.0975

Given these apparently conflicting results, it may be beneficial to test a higher integration and additional autoregressive components within our ARIMA estimations, by creating and comparing the results of different ARIMA specifications.

Going back to the visual analysis, the Partial Autocorrelation Function (PACF) of the original GDP series, presented on Figure 3, indicates that the model may benefit from a Moving Average component MA(1).

Fig. 3.   Partial Autocorrelation Function (PACF) for f GDP
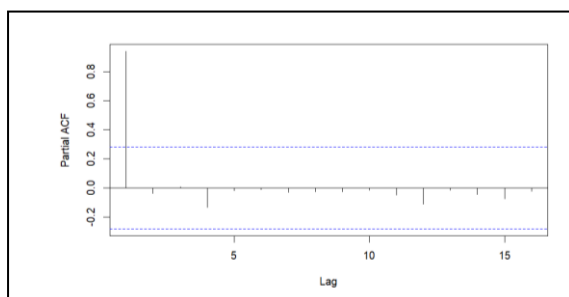
Given the results above and the models found in the literature, we decided to estimate 9 ARIMA specifications and use Akaike and Bayesian Information Criteria (AIC and BIC) to select which performs the best. To create a long rolling forecast period, we limited our train data to 1975 through 2013, leaving 10 years for a robust accuracy test. The specifications chosen along with their AIC and BIC are presented in TABLE V.

TABLE V. INFORMATION CRITERIA FOR ARIMA SPECIFICATIONS

	AIC	BIC
ARIMA (0,1,0)	936.4076	938.0452
ARIMA (1,1,0)	928.5899	931.8651
ARIMA (1,1,1)	926.1753	931.0881
ARIMA (0,2,0)	912.901	914.5119
ARIMA (1,2,0)	909.5503	912.7722
ARIMA (1,2,1)	901.4196	906.2524
ARIMA (2,2,1)	903.2941	909.7378

Based on both the AIC and the BIC, the specification ARIMA (1,2,1) seems to be the most well suited for the annual UAE GDP and is thus the one we chose to adopt.

VAR Methodology

VAR models, denoted VAR(p) are an extension of AR models (Roush et al., 2017), where every variable is considered and treated as endogenous. This means that for m variables, m models are estimated, each with a different variable as dependent and the p lags of itself and all the other variables as independent.

A general VAR(p) with m variables is represented by the system of equations:

$$y_{1,t} = \beta_{1,0} + \beta_{1,1}y_{1,t-1} + \cdots + \beta_{1,p}y_{1,t-p} + \cdots + \beta_{1,(m-1)p+1}y_{m,t-1} + \cdots + \beta_{1,mp}y_{m,t-p} + u_{1,t}$$

$$y_{2,t} = \beta_{2,0} + \beta_{2,1}y_{1,t-1} + \cdots + \beta_{2,p}y_{1,t-p} + \cdots + \beta_{2,(m-1)p+1}y_{m,t-1} + \cdots + \beta_{2,mp}y_{m,t-p} + u_{2,t}$$

$$\vdots$$

$$y_{m,t} = \beta_{m,0} + \beta_{m,1}y_{1,t-1} + \cdots + \beta_{m,p}y_{1,t-p} + \cdots + \beta_{m,(m-1)p+1}y_{m,t-1} + \cdots + \beta_{m,mp}y_{m,t-p} + u_{m,t}$$

Which can be simplified into the matrices:

$$\begin{bmatrix} y_{1,t} \\ y_{2,t} \\ \vdots \\ y_{m,t} \end{bmatrix}_{m \times 1}$$
$$= \begin{bmatrix} \beta_{1,0} & \beta_{1,1} & \beta_{1,2} & \cdots & \beta_{1,p} & \cdots & \beta_{1,mp} \\ \beta_{2,0} & \beta_{2,1} & \beta_{2,2} & \cdots & \beta_{2,p} & \cdots & \beta_{2,mp} \\ \vdots & \vdots & \vdots & \ddots & \vdots & \ddots & \vdots \\ \beta_{m,0} & \beta_{m,1} & \beta_{m,2} & \cdots & \beta_{m,p} & \cdots & \beta_{m,mp} \end{bmatrix}_{m \times (mp+1)}$$
$$* \begin{bmatrix} 1 \\ y_{1,t-1} \\ y_{1,t-2} \\ \vdots \\ y_{1,t-p} \\ y_{2,t-1} \\ \vdots \\ y_{m,t-p} \end{bmatrix}_{(mp+1) \times 1} + \begin{bmatrix} u_{1,t} \\ u_{2,t} \\ \vdots \\ u_{m,t} \end{bmatrix}_{m \times 1}$$

Or in matrix notation:
$$Y = BZ + U \quad (2)$$

Where Y is the mx1 matrix containing all dependent variables, B is the mx(mp+1) matrix containing all the model coefficients, Z is the (mp+1)x1 matrix containing the p lags of every variable in the model and U is the mx1 matrix containing all the residuals. When estimating a VAR model, it is necessary to ensure that all the variables used are stationary, as to avoid a spurious regression.

Following the work of Bäurle et al (2020), we used sectoral GVA along with GDP data for the UAE from 1975 to 2023 in constant 2014 prices and local currency (AED). We also

collected this data from the FCSC data centre. To ensure stationarity and maintain the interpretability of the model and the forecasts, we estimated the VAR models with the percentage change of the variables, calculated by:

$$\Delta y_t = \frac{y_t - y_{t-1}}{y_{t-1}} \qquad (3)$$

This changed the interpretation of our model, but the forecast accuracy was kept comparable after a re-transformation of the forecasted values later, back to GDP level.

Before estimating the model, we did a correlation analysis of each sector against GDP, to reduce the number of parameters and increase the degrees of confidence by eliminating sectors with too low of a correlation to GDP. We chose 20% as a threshold for this selection. 0shows the calculated correlations.

TABLE VI. SECTOR CORRELATIONS TO GDP

Sector	Correlation
Activities of households as employers	0.123
Social and Personal services	-0.145
Government Services Sector	0.150
Real estate and business services	0.313
Financial and insurance	0.219
Transport, Storage and Communication	0.294
Wholesale and retail trade and Hotels & Restaurants	0.543
Construction	0.240
Electricity, gas, and water supply; waste management	0.270
Manufacturing	0.496
Mining and quarrying (includes crude oil and natural gas)	0.641
Agriculture, forestry and fishing	-0.074

We then estimated a VAR(1) and VAR(2), also using data from 1976 to 2013. The results and their criteria are summarized below.

TABLE VII. INFORMATION CRITERIA FOR VAR SPECIFICATIONS

	AIC	BIC
VAR(1)	-627.23	-482.25
VAR(2)	-715.68	-444.9

While the VAR(1) has a lower BIC, VAR(2) has a lower AIC. This indicates that even though VAR(1) is better at explaining GDP, VAR(2) should be better at forecasting. Due to this ambiguity, and to ensure we are comparing the best results of each approach, we kept both models to be used for forecasting and used their accuracy metrics to determine which is best fitted for our purpose. This part of the analysis is outlined in section IV.

LR Methodology

Linear Regression establishes the linear relationship between the independent and the dependent variables through Ordinary Least Squares (OLS) (Stock and Watson, 2020). A general LR model with k exogenous variables is represented by the equation:

$$y = \beta_0 + \beta_1 x_1 + \beta_2 x_2 + \cdots + \beta_k x_k + u \qquad (4)$$

Where y is the dependent (endogenous) variable, x_i are the independent (exogenous) variables, β_i are the coefficients estimated by OLS and u is the residual term. To estimate a LR using time-series variables, we also need to ensure their stationarity to avoid spurious regressions.

Due to a lack of availability of past values of the variables considered for the model, we had to reduce our observation period to 1990 through 2021. To compensate for the reduction in observations, we have extended our model training period to 2016, leaving 5 years for the out-of-sample testing. TABLE VIII. presents key information on the pre-selected variables.

Table VIII. LR Variables Information

Variable	Unit	Available period	Explanation for selection
GDP	Million AED, 2014 constant prices	1975-2023	Target variable
Unemployment	% of Labour Force	1986-2022	Tends to correlate negatively with GDP (Mankiw, 2022)
Inflation	Index, 2014 = 100	1975-2022	Tends to correlate positively with GDP (Mankiw, 2022)
Interest Rate	%	1975-2022	Tends to correlate negatively with GDP (Mankiw, 2022)
Oil Production	Thousand Barrels per day	1975-2022	Part of the Oil sector GVA
Oil Consumption	Thousand Barrels per day	1975-2022	Large part of the country's

Global Oil Price	USD per Barrel	1990-2022	energy matrix (IRENA, 2024) May influence due to the weight of Oil in the UAE economy.
Exports	Million AED, 2014 constant prices	1982-2021	Component of expenditure calculation of GDP (Mankiw, 2022)
Imports	Million AED, 2014 constant prices	1982-2021	Component of expenditure calculation of GDP (Mankiw, 2022)

To avoid a multicollinearity issue, we have performed a correlation analysis to assess whether some variables had to be tested separately. We found that the only large correlation between the independent variables is approximately 84%, between "Exports" and the "Global Oil Prices", which means that aside from monitoring the behaviour of these variables, multicollinearity should not be a concern in our estimation.

The practical nature of our goal led us to adopt data mining principles to selecting the variables, as opposed to a purely theoretical approach. The model was estimated as a multivariate linear regression, using Ordinary Least Squares (OLS), making use of current and lagged values of each of the selected variables. Through multiple iterations of the model estimation, and through significance testing, we narrowed these variables down to the ones that held the most explanatory power and led to a more statistically sound model. A summary of the resulting model is presented below.

Fig. 4.   Resulting Model 1 using Ordinary Least Squares (OLS)

Regression on $\Delta log(GDP_t) \sim \Delta log(Interest\ Rates_t) + \Delta log(Oil\ Prod$
$\Delta log(Exports_t) + \Delta log(Interest\ Rates_{t-2})$

	Coefficient	SE	t value	p-value
Intercept	0.036694	0.005211	7.042	7.89E-07
Interest Rates	0.018461	0.007116	2.594	0.0173
Oil Production	0.195921	0.099538	1.968	0.0631
Exports	0.086828	0.03261	2.663	0.0149
Interest Rates$_{t-2}$	0.002105	0.007865	0.268	0.7917
Adjusted R^2	0.6146			
$F-statistic$	10.57 on 4 and 20 DF		$p-value$	9.099E-05

We noticed that despite the small t-value of the second lag of Interest Rate, it contributed heavily to the model, both in terms of explanatory power, as measured by the Adjusted R^2, and model significance, as measured by the F-statistic. Since our goal is to forecast GDP growth, and not necessarily explain it, we decided to test the forecast accuracy of two model specifications: the one presented above (Model 1) and another one dropping the second lag of Interest Rate and adding Imports, keeping only statistically significant variables at a 10% significance level. The second model's (Model 2) results are presented below.

Fig. 5.   Resulting Model 2 using Ordinary Least Squares (OLS)

Regression on $\Delta log(GDP_t) \sim \Delta log(Interest\ Rates_t) + \Delta log(Oil\ Proc$
$\Delta log(Exports_t) + \Delta log(Imports_t)$

	Coefficient	SE	t value	p-value
Intercept	0.041306	0.007238	5.706	9.71E-06
Interest Rates	0.1626	0.008816	1.844	0.07864
Oil Production	0.18282	0.100708	1.815	0.08313
Exports	0.201888	0.054467	3.707	0.00123
Imports	-0.134004	0.066212	-2.024	0.0553

IV. FORECAST RESULTS

The goal of this paper is to compare the forecasting power of these three approaches over shorter and longer horizons. For the short period, we calculated a one-year rolling forecast, meaning that we used each model to forecast one year ahead, re-estimated the model with the newer observations, and forecasted the following year, repeating this process throughout out testing window.

For the long period, we computed a five-year rolling forecast, meaning that we calculated the GDP forecast for the following 5 years after the model estimation, re-estimated the model adding one year of observations to the training dataset, and forecasted 5 years ahead, repeating the process throughout our testing window. For the ARIMA and VAR models, this process was performed 6 times, whereas for the LR model, due to the smaller test dataset, we could only repeat it 3 times at most.

For the LR model, since we wanted to estimate its accuracy in forecasting GDP and not in the forecasts of the exogenous variables, we assumed a "perfect prediction" of our explanatory variables, using their real-world values for calculating the GDP forecast. For a comprehensive assessment of the model's viability, we also used a "naive" 5-year moving average of each of the exogenous variables to understand the GDP forecasts it could achieve when there is no information available on expected values of the future of the explanatory variables. For the "perfect prediction", due to the data availability, we could only perform one 5-year forecast, while for the "naive prediction", we did the forecast through three 5-year windows.

Figure 4 shows the forecast results of each model for the

latest 5-year window (2019-2023) against real GDP. After the drop in GDP in 2020 due to the Covid-19 pandemic, our forecasts seem to match closely the inclination of the GDP curve, indicating that despite the tendency to overestimate the GDP levels, they seem to follow the variable's behaviour quite closely. The exception is the ARIMA model forecast, which continues following the pre-pandemic trend of the variable, leading to a closer forecast of the post-recovery period in 2022 and 2023. This suggests that the ARIMA has a better long-term accuracy, but may not be the best performer in the short-term.

If the 2020 pandemic caused a structural break in the annual GDP time-series instead of a temporary fluctuation, we should expect the behaviours and performances of each model to be impacted in different ways. Such a possibility will need to be tested once there are more observations available, and if found true, the model specifications should be re-tested in light of the new evidence, and re-estimated to account for the new behaviour of GDP, if necessary.

Fig. 6.   Forecasts vs Actual Value of GDP
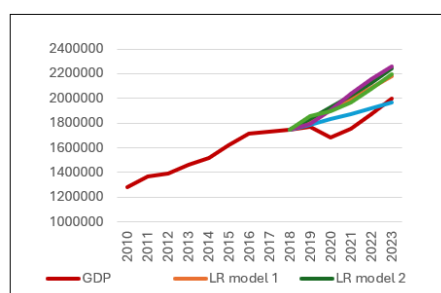
At each iteration of the forecasts, we calculated their Mean Absolute Percentage Error (MAPE), in order to track the consistency of the model's accuracy. The MAPE measures the average magnitude of the forecast error, as a percentage of the observed value of the variable. Its formula is given by equation 5. For the final comparison between the models, we calculated the average of their MAPE for all forecast periods.

$$MAPE = \frac{1}{n}\sum_{t=1}^{n}\frac{|y_t^F - y_t|}{y_t} * 100 \qquad (5)$$

The MAPE for each model on the 5-year forecast windows is presented in TABLE IX As we can see, the time-series models performed better in the 5-year rolling forecasts. Among the VARs, VAR(2) had more accuracy overall and more consistency in its accuracy over all iterations. The best forecasts were given by the ARIMA (1,2,1), which had the lowest average MAPE at 5.2%.

It is worth noting that the average MAPEs of the LR models and the time-series models are not directly comparable, as the number of iterations calculated is lower for the first group. However, comparing their range of results gives us a clear indication that the LR models' performance is overall worse in forecasting GDP in the longer term. For all the models, except the VARs, the higher MAPEs were

observed in the forecast period of 2017-2021. This could be an impactful factor in the LR models underperformance, as this period was the only iteration of the "perfect prediction" forecasts, and one of the three in the "naïve prediction" forecasts. In the VARs, the highest MAPEs were observed in the forecast of the period 2016-2020.

TABLE IX.   5-YEAR FORECASTS MAPES

Model	Lowest MAPE	Average MAPE	Highest MAPE	Forecast iterations
LR model 1 Perfect prediction	12.2%	12.2%	12.2%	1
LR model 1 Naive prediction	10.2%	12.9%	15.6%	3
LR model 2 Perfect prediction	15.8%	15.8%	15.8%	1
LR model 2 Naive prediction	11.8%	13.5%	15.7%	3
ARIMA(1,2,1)	3.8%	5.2%	9.0%	6
VAR(1)	3.6%	9.0%	20.0%	6
VAR(2)	3.0%	7.1%	11.7%	6

The 1-year rolling forecasts presented in TABLE X. show a different dynamic. While the ARIMA model still has more accuracy in terms of Average MAPE, we can see that the LR model 1 is more consistent in its accuracy, with the MAPE range of the "perfect prediction" being smaller than any other model. The difference between the results of the two prediction methods for the explanatory variables, however, shows that having accurate forecasts for each independent variable is very important for the model's performance.

The VAR models show the widest range in results, with the VAR(1) specification performing better than the VAR(2) on average. This indicates that the approach is accurate, but inconsistent, and thus does not form a very good basis for decision making, especially considering the better performance of other approaches both in the short and longer terms.

TABLE X. 1-YEAR FORECASTS MAPES

Model	Lowest MAPE	Average MAPE	Highest MAPE	Forecast iterations
LR model 1 Perfect prediction	2.2%	3.3%	4.7%	5
LR model 1 Naive prediction	1.2%	4.2%	10.0%	6
LR model 2 Perfect prediction	1.6%	4.1%	7.0%	5
LR model 2 Naive prediction	1.0%	4.2%	10.1%	6
ARIMA(1,2,1)	1.0%	3.0%	7.4%	10

VAR(1)	0.3%	3.9%	11.6%	10
VAR(2)	0.6%	5.8%	12.3%	10

V. CONCLUSION

Forecasting GDP is not an easy task. It is affected by many factors, and tends to be easily swayed by external shocks, which are often unforeseeable. Several models have been created and modified to this end over the years, and as computing technology evolves, the tendency is that new models continue to be developed. Still, it is important that we understand whether the models we already have available are sufficient to this task, and among them which ones perform better at the application for which they are adopted.

We tested three approaches that are well documented in the literature, to determine which performed better in forecasting the UAE's GDP, both in the short-term and long-term. We found that for 5-year windows, the ARIMA methodology, under the specification ARIMA (1,2,1) was the best performer, followed by the VAR methodology, under the specification VAR(2). Although both models present a higher accuracy, their disadvantage lies in the fact that they are backward-looking, and thus they don't respond to changes in the expected behaviour of economic factors.

The LR models could provide this flexibility in reflecting expected scenarios in their forecasts. The advantage of this flexibility can be seen in model 1's consistently high short-term accuracy, in the scenario where it is fed with perfect predictions of the explanatory variables. The difference in performance between the "Naive" and "Perfect" predictions-driven forecasts indicates that the performance of the explanatory variables forecasts is very important for this kind of model, which could present an issue if there is no way to access or perform accurate predictions on these variables.

Overall, our forecast results suggest the simultaneous use of different models for forward-looking decision making in the UAE. Specifically, the use of a LR model for short-term decisions, provided there is a good source for accurate predictions of the explanatory variables, and an ARIMA model for long-term decisions. This would provide the user with consistent metrics for their needs through many horizons.

Once the number of post-pandemic annual observations of GDP increases sufficiently, a study should be conducted to determine whether this event caused a structural break in the time-series or if it only led to a temporary shock. In case a structural break is determined to have occurred, all GDP forecasting models for the UAE should be re-tested and updated, including the ones presented in this paper. The new model estimations should place greater emphasis on the post-break behaviour of GDP.

Additionally, it would be beneficial to test which of the models estimated in this paper reacts most quickly to this break. This result could support the deployment of a specific model whenever a sudden break is believed to have occurred. This would lend the user more confidence in the forecast results over different economic conditions. Alternatively, testing the forecast performance of the models over steady-state periods and structural break periods separately may allow for a more thorough model selection which will depend not only on the forecast horizon, but also on the current state of the economy.

The adoption of alternative variables in the LR and VAR models, along with additional testing over larger time frames or at a higher frequency, should be considered in future studies. This will help assess whether their underperformance in the longer term is inherent to the approaches or if it is due to the specificities of these variables and time frame. Using higher frequencies will also allow for testing for a structural break in the GDP series sooner, as there will be more observations to use in the same time frame.

Different approaches and variables should also be tried and compared to the ones estimated here. Some suggestions would be LSTM models, PCA models, and Machine Learning approaches, all of which have little to no testing for forecasting UAE's GDP in the literature. Modifications of the models presented in this paper, such as ARIMAX, VARX, BVAR and LVAR, should also be tested in future studies.

Finally, since we have two different approaches performing better over different horizons, it would be beneficial to understand what their tipping point is, meaning at what exact window does one model surpass the other, on average. We suggest that this work be done once other models have already been tried, since there may be other approaches than perform better in both horizons.

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