



OECD System of Unit Labour Cost and Related Indicators: Report from the Annual Update to Seasonal Adjustment Models – July 2008

A. Introduction

1. Seasonal adjustment is a process by which changes that are due to seasonal or calendar influences are removed to produce a clearer picture of the underlying behaviour of a time series. Consequently, seasonally adjusted data is one of the main sources of information used by policy-makers, economists and business analysts when attempting to identify important features of economic series such as direction, turning points, and consistency between other economic indicators. The implementation of a seasonal adjustment procedure has many important features. In summary, it is the application of a theoretical framework which could be divided into ‘economic theory’ and ‘statistical theory’. This requires significant computer and human resources with sophisticated knowledge.
2. The OECD System of Unit Labour Cost and Related Indicators provides high quality quarterly Unit Labour Cost (ULC) estimates for raw, seasonally adjusted and trend data. Due to the inherently volatile nature of derived series such as ULC’s, the OECD encourages users to focus on the Trend-Cycle estimates provided. The ULC data is seasonally adjusted and Trend-Cycled using the TRAMO-SEATS package in the software Demetra¹; the Trend-Cycle series includes all non-seasonal and non-irregular movements in the underlying time series. This series can be regarded as a smoothed seasonally adjusted series, where the degree of smoothing is dependent on the underlying ARIMA model and will thus vary from series to series.
3. The OECD System of Unit Labour Cost and Related Indicators undertakes a comprehensive review of its seasonal adjustment methodology once a year in either July or August depending on resources. This timing has been chosen due to the extensive updating carried out by the Annual National Accounts team in the May and June months that impact directly on the ULC input data. This review will involve re-evaluating all series for model and outlier (additive outlier, transitory change, and level-shift) changes. For the remainder of the year, seasonal adjustment undertaken using TRAMO-SEATS in Demetra is done allowing the coefficients of the model to change but with the underlying ARIMA model locked. It should also be noted here, that after extensive investigation and testing it was decided best that for most series the level-shift operator be switched off. That is, level shifts which distort the continuity of the long time series are not allowed² unless a legitimate level shift due to an observed economic event has occurred (thus approximately 98% of ULC Seasonally Adjusted and Trend-Cycle series are free of level shift outliers).

¹http://circa.europa.eu/Public/irc/dsis/eurosam/library?l=/software/demetra_software/demetra_manuals&vm=detailed&sb=Title

² The TRAMO-SEATS package in its default mode tries to fit the best model. For long time series it may often implement a level shift outlier at certain places to obtain a better model fit before and after this level shift outlier. This is seen as undesirable for the continuity of long time series and thus is avoided where possible.



B. Summary of changes from the July 2008 update

4. When performing the review of models used for seasonal adjustment of the OECD ULC series, analysis is concentrated on the Trend-Cycle series. This is because the Trend-Cycle series are the headline ULC series' and an assumption could be made that changes in the Trend-Cycle series will be reflected in the seasonally adjusted series. In total 102 ARIMA models have changed (48% of the total) in the July 2008 update compared with the July 2007 update; and there are 82 cases where the number and timing of outliers have changed (39% of the total).
5. Using a revision cut-off for further investigation of greater than or less than 3% for any data point (index series) for the Trend-Cycle series', there were 42 series that met this threshold. All the revisions for these 42 can be explained either by a change in the ARIMA model or a change in the number and timing of outliers or both. Please note that all information relating to the new and old model, the outliers, the parameters, and the coefficients can be obtained directly from the OECD by emailing: stat.contact@oecd.org (attention: Frédéric Parrot). A change in the ARIMA model does not necessarily result in revisions to the series, and in some cases revisions are more impacted on by changes in outlier detection and changes in the raw data (which should be expected).
6. Of the 42 revisions above the threshold, the following series in Table 1 are considered by the OECD System of Unit Labour Cost and Related Indicators team to be of more importance and as such Table 1 outlines the new and old seasonal adjustment models, giving an indicator of the degree of revisions to the underlying time series and the likely reasons for these changes.
7. In Table 1, the following acronyms are used for the outliers, whose affects are removed from the trend-cycle series:
 - AO: Additive Outlier (abnormal value at one point of the series);
 - TC: Transitory Change (series of outliers with transitory effects on the level of the series).

The seasonally adjusted series are modelled according to a RegARIMA process in the form of $(p,d,q)(P,D,Q)$ where the triplet (P,D,Q) represents the seasonal part of the process and the triplet (p,d,q) represents its non-seasonal part.

Table 1. Series Revised in Annual Seasonal Adjustment Update.

Series	Old Seasonal Adjustment Model and Outliers	New Seasonal Adjustment Model and Outliers	Average Revision to Trend-Cycle; Level and Growth over last 5 years	Possible reason for the revision
Denmark – Trade, Transport and Communication	(1 0 0)(1 0 0) TC Q1.1988	Same model No outliers found	Level – 0.36 % Growth – new: 0.29%; previous: 0.35 %	Revisions to hours' data.
Finland – Business Services	(1 0 0)(0 1 0) AO Q1.1975, TC Q4.1980	(0 1 1)(0 1 0) TC Q1.1990, TC Q1.1991, TC Q1.1993, TC Q1.1994	Level – 0.30% Growth – new: 0.27%; previous: 0.30 %	Revisions to annual constant price Value added in the 1990s.
Luxembourg – Manufacturing	(0 1 1)(0 1 0) TC Q3.1999, AO Q3.2007	(0 1 0)(0 1 1) No outliers found	Level – 1.21% Growth – new: 1.49%; previous: 0.84 %	Additive outlier at the end of the series has disappeared, which explains divergence between previous and new trend.
Luxembourg – Trade, Transport and Communication	(1 1 0)(0 1 1) No outliers found	(1 0 0)(0 1 0) TC Q1.1996	Level – 0.34% Growth – new: 0.48%; previous: 0.60%	Revisions to annual constant price value added, compensation of employees and employment data, causing a Transitory change from Q1.1996
Poland – Construction	(0 1 1)(0 1 1) TC Q1.2004	(0 1 1)(0 1 0) AO Q1.2007	Level – 3.03% Growth – new: 0.64%; previous: 1.13 %	Generally very volatile series. New position of additive outlier at the end of the series, explains divergence between previous and new trend.
Slovak	(0 1 1)(0 1 1)	(1 0 0)(1 0 0)	Level – 3.70%	Generally very



Republic – Construction	No outliers found	TC Q3.1999	Growth – new: 2.59%; previous: 2.68%	volatile series. Large revisions to quarterly compensation of employees and constant price value added. New transitory change outlier from Q3-1999.
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OECD Unit labour Cost Indicators Team
Structural Economic Statistics Division
Statistics Directorate
OECD