

Econ 721 - Econometrics III

Instructor:

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	Office Hours:	Wed 10:00am - 12:00noon (or by appointment)
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Lecture:

Tues/Thurs 5:00 - 6:15 pm, Tydings Hall Room 2108

Course Overview:

This course covers selected topics in econometrics and statistics. Particular attention is paid to methods for analyzing non-stationary economic time series and methods which are useful for studying large dimensional data sets. Throughout this course, there will be a focus on understanding the statistical properties of the methods being discussed.

Prerequisite:

Students are presumed to have had at least a one-semester course in mathematical statistics at the level of R.V.Hogg, A.Craig, and J.W.McKean, *Introduction to Mathematical Statistics* (6th Edition) as well as a strong background in linear algebra. Students are also assumed to have knowledge of the material covered in Econ 623 and

Econ 624, including basic knowledge of asymptotic theory and of the linear regression model.

Academic Integrity:

Academic integrity is a foundation for learning. The University has approved a Code of Academic Integrity available on the web at <http://www.jpo.umd.edu/aca/code.html>. The Code prohibits students from cheating in exams, plagiarizing, submitting the same paper for credit in two courses without authorization, buying papers, submitting fraudulent documents, and forging signatures.

Students with Disability

A student, who has a documented disability and who wishes to receive accommodation or services from the University's Disabilities Support Service (DSS), must first complete a registration process which involves meeting with one of the senior staff members at DSS and providing the appropriate documentation. An appointment with DSS can be scheduled by calling (301) 314-7682.

Principle Texts:

Hamilton, J.D. (1994). *Time Series Analysis*, Princeton University Press.
(ISBN: 978-0-691-04289-3)

Additional References in Econometrics and Statistics:

Anderson, T. W. (1971). *The Statistical Analysis of Time Series*, New York: Wiley.

Anderson, T.W. (2003). *An Introduction to Multivariate Statistical Analysis*, (3rd Edition) New York: Wiley.

Box, G. E. P. and G. M. Jenkins (1976). *Time Series Analysis: Forecasting and Control*, (2nd Edition), San Francisco: Holden Day.

- Brillinger, D. R. (1981). *Time Series: Data Analysis and Theory*, (2nd Edition), San Francisco: Holden Day.
- Brockwell, P. J. and R. A. Davis (1993). *Time Series: Theory and Methods*, (2nd Edition) New York: Springer-Verlag.
- Campbell, J., A. Lo, C. MacKinlay (1996). *The Econometrics of Financial Markets*, Princeton University Press.
- Canova, F. (2007). *Methods for Applied Macroeconomic Research*, Princeton University Press.
- Fuller, W. A. (1976). *Introduction to Statistical Time Series*, New York: Wiley.
- Granger, C. W. T. and P. Newbold (1987). *Forecasting Economic Time Series*, (2nd Edition), New York: Academic Press.
- Grenander, U. and M. Rosenblatt (1957). *Statistical Analysis of Stationary Time Series*, New York: Wiley.
- Hannan, E. J. (1970). *Multiple Time Series*, New York: Wiley.
- Hannan, E. J. and M. Deistler (1988). *Statistical Theory of Linear Systems*, New York: Wiley.
- Harvey, A. C. (1993). *Time Series Models*, (2nd Edition), Cambridge: MIT Press.
- Harvey, A.C. (1989). *Forecasting, Structural Time Series Models, and the Kalman Filter*, Cambridge: Cambridge University Press.
- Hayashi, F. (2000). *Econometrics*, Princeton: Princeton University Press.
- Johnston, J. and J. DiNardo (1997). *Econometric Methods*, 4th Edition, McGraw Hill.

G. G. Judge, et al. (1985). *The Theory and Practice of Econometrics*, 2nd Edition, John Wiley & Sons.

Lutkepohl, H. (1993). *Introduction to Multiple Time Series Analysis*, (2nd Edition), New York: Springer-Verlag.

Priestley, M. B. (1981). *Spectral Analysis and Time Series*, New York: Academic Press.

Reinsel, G. C. (1993). *Elements of Multivariate Time Series Analysis*, New York: Springer-Verlag.

Tsay, R.S. (2010). *Analysis of Financial Time Series*, John Wiley & Sons.

Whittle, P. (1984). *Prediction and Regulation*, (2nd Edition) Oxford: Blackwell.

White, H. (2000). *Asymptotic Theory for Econometricians*, Revised Edition, Academic Press.

Some Useful References in Probability:

The following books are good references for the asymptotic theory presented in this course.

Billingsley, P. (1968). *Convergence of Probability Measures*, New York: Wiley.

Hall, P. and C. C. Heyde (1980). *Martingale Limit Theory and Its Application*, New York: Academic Press.

Ibragimov, I. A. and Y. V. Linnik (1971). *Independent and Stationary Sequences of Random Variables*, Groningen: Wolters - Noordhoff.

Stout, W. F. (1974). *Almost Sure Convergence*, New York: Academic Press.

Pollard, D. (1984). *Convergence of Stochastic Processes*, New York: Springer-Verlag.

Course Outline and Reading List

1. Some Methods of Multivariate Data Analysis

- a. Principal Components
 - b. Canonical Correlation
 - c. Factor Models
 - d. EM Algorithm
- Tsay (2010): Chapter 9
 - Anderson (2003): Chapters 11-14.
 - Bai, J. and S. Ng (2002). “Determining the Number of Factors in Approximate Factor Models,” *Econometrica*, 70, 191-221.
 - Bai, J. (2003). “Inferential Theory for Factor Models of Large Dimensions,” *Econometrica*, 71, 135-171.
 - Bernanke, B.S. and J.Boivin (2003). Monetary Policy in a Data-Rich Environment,” *Journal of Monetary Economics*, 50, 525-546.
 - Bernanke, B. S., J. Boivin, and P. Eliasch (2005). “Measuring the Effects of Monetary Policy: A Factor-augmented Vector Autoregressive (FAVAR) Approach,” *Quarterly Journal of Economics*, 120, 384-387.
 - Forni, M., M. Hallin, M. Lippi, and L. Reichlin (2000). “The Generalized Factor Model: Identification and Estimation,” *Review of Economics and Statistics*, 82, 540-552.
 - Stock, J.H. and M.W.Watson (2010). “Dynamic Factor Models,” Working Paper, Department of Economics, Harvard University.
 - Stock, J. and M. Watson (2002). “Macroeconomic Forecasting Using Diffusion Indexes,” *Journal of Business and Economic Statistics*, 20, 147-162.
 - Dempster, A.P., N.M. Laird, and D.B.Rubin (1977). “Maximum Likelihood from Incomplete Data via the EM Algorithm,” *Journal of the Royal Statistical Society, Series B*, 39, 1-38.

2. Topics in Trending/Persistent Time Series (Univariate Case)

2a. Processes with Deterministic Time Trends

- Hamilton (1994): Chapter 16

2b Functional Limit Theory and Asymptotics for Integrated Processes

- Hamilton (1994): Chapter 17, Sec. 17.2-17.3; Chapter 18, Sec. 18.1.
- Billingsley (1958): Chapters 2 and 3.

2c. Unit Root Processes: Estimation and Hypothesis Testing

- Hamilton (1994): Chapter 17, Sec 17.1, 17.4-17.9.
- Andrews, D. W. K. (1993). "Exactly Median - Unbiased Estimation of First Order Autoregressive / Unit Root Models," *Econometrica*, 61, 139-165.
- Dickey, D. A. and W. A. Fuller (1979). "Distribution of the Estimators for Autoregressive Time Series with a Unit Root," *Journal of the American Statistical Association*, 74, 427-431.
- Dickey, D. A. and W. A. Fuller (1981). "Likelihood Ratio Statistics for Autoregressive Time Series with a Unit Root," *Econometrica*, 49, 1057-1072.
- Elliot, G., T.J.Rothenberg, and J.H.Stock (1996). "Efficient Tests for an Autoregressive Unit Root," *Econometrica*, 64, 813-836.
- Mikusheva, A. (2007). "Uniform Inference in Autoregressive Models," *Econometrica*, 75, 1411-1452.
- Nelson, C.R. and C.I. Plosser (1982). "Trends and Random Walks in Macroeconomic Time Series," *Journal of Monetary Economics*, 129-162.
- Phillips, P. C. B. (1987). "Time Series Regression with a Unit Root," *Econometrica*, 55, 277-302.
- Phillips, P. C. B. and P. Perron (1987). "Testing for a Unit Root in Time Series Regression," *Biometrika*, 75, 335-346.
- Phillips, P.C.B. and V. Solo (1992). "Asymptotics for Linear Processes," *Annals of Statistics*, 20, 971-1001.
- Stock, J. H. (1991). "Confidence Intervals for the Largest Autoregressive Root in U. S. Macroeconomic Time Series," *Journal of Monetary Economics*, 28, 435-459.
- Stock, J.H. (1994). "Unit Roots and Trend Breaks," *Handbook of Econometrics Vol IV*, sections 1-4.

3. Topics in Trending/Persistent Time Series (Multivariate Case)

3a. Spurious Regression

- Hamilton (1994): Chapter 18, Sec. 18.
- Granger, C. W. J. and P. Newbold (1974). "Spurious Regression in Econometrics," *Journal of Econometrics*, 2, 111-120.
- Phillips, P. C. B. (1986). "Understanding Spurious Regressions in Econometrics," *Journal of Econometrics*, 33, 311-340.

3b Cointegration: Estimation, Testing, and Cointegrating Rank Determination

- Hamilton (1994): Chapter 18, Sec.18.1-18.2; Chapter 19, Sec. 19.1-19.3; Chapter 20.
- Tsay (2010): Chapter 8
- Chao, J.C. and P.C.B. Phillips (1999). "Bayesian Model Selection in Partially Nonstationary Vector Autoregressive Processes with Reduced Rank Structure," *Journal of Econometrics*, 91, pp. 227-271.
- Engle, R. F. and C. W. J. Granger (1987). "Cointegration and Error Correction: Representation, Estimation, and Testing," *Econometrica*, 55, 251-276.
- Johansen, S. (1988). "Statistical Analysis of Cointegrating Vectors," *Journal of Economic Dynamics and Control*, 12, 231-254.
- Johansen, S. (1991). "Estimation and Hypothesis Testing of Cointegrating Vectors in Gaussian Vector Autoregressive Models," *Econometrica*, 59, 1551-1580.
- Johansen, S. (1992). "Determination of Cointegrating Rank in the Presence of a Linear Trend," *Oxford Bulletin of Economics and Statistics*, 54, 383-397.
- Park, J. Y. and P. C. B. Phillips (1988). "Statistical Inference in Regressions with Integrated Processes: Part I," *Econometric Theory*, 4, 468-498.
- Park, J. Y. and P. C. B. Phillips (1989). "Statistical Inference in Regressions with Integrated Processes: Part II," *Econometric Theory*, 5, 95-132.
- Phillips, P. C. B. and S. Ouliaris(1990). "Asymptotic Properties of Residual Based Tests for Cointegration," *Econometrica*, 58, 165-193.
- Phillips, P. C. B. (1991). "Optimal Inference in Cointegrated Systems," *Econometrica*, 59, 238-306.
- Phillips, P. C. B. (1995). "Fully Modified Least Squares and Vector Autoregression," *Econometrica*, 53, 1023-1078.
- Stock, J.H. (1987). "Asymptotic Properties of Least Squares Estimators of Cointegrating Vectors," *Econometrica*, 55, 1035-1056,

4. Bayesian and Shrinkage Methods

- a. Bayes Methods
 - b. James-Stein and Empirical Bayes Estimation
 - c. Lasso
- Judge, et al. (1985): Chapters 3.4, 22.6
 - Doan, T., R. Litterman, and C.A.Sims (1984). "Forecasting and Conditional Projection Using Realistic Prior Distributions," *Econometric Reviews*, 3, 1-100.
 - Litterman, R. (1986). "Forecasting with Bayesian Vector Autoregression: Five Years of Experience," *Journal of Business and Economic Statistics*, 4, 25-38.
 - Phillips, P.C.B. (1996). "Econometric Model Determination," *Econometrica*, 64, 763-812.
 - Tibshirani, R. (1996). "Regression Shrinkage and Selection via the Lasso," *Journal of the Royal Statistical Society, Series B*, 58, 267-288.
 - Knight, K. and W. Fu (2000). "Asymptotics for Lasso-type Estimators," *Annals of Statistics*, 28, 1356-1378.
 - Knox, T., J.H.Stock, and M.W.Watson (2000). "Empirical Bayes Forecasts of One Time Series Using Many Predictors," Working Paper, Kennedy School of Government, Harvard University.
 - Belloni, A. and V. Chernozhukov (2010). "Post- ℓ_1 -Penalized Estimators in High-Dimensional Linear Regression Models," MIT Department of Economics Working Paper.
 - Chib, S. and E. Greenberg (1995). "Understanding the Metropolis-Hastings Algorithm," *American Statistician*, 49, 327-335.
 - Chib, S. and E. Greenberg (1996). "Markov Chain Monte Carlo Simulation Methods in Econometrics," *Econometric Theory*, 12, 409-431.
 - Chib, S. "Markov Chain Monte Carlo Methods: Computation and Inference." In *Handbook of Econometrics*, Vol 5. Edited by J. J. Heckman and E. Leamer. Amsterdam: Elsevier Science.

5. State Space Models and Kalman Filtering

- Hamilton (1994): Chapter 13.
- Tsay (2010): Chapter 11
- Canova (2007): Chapter 6.
- Harvey (1989): Chapters 3 and 4.

6. Multiple Hypothesis Testing

- a. Family-wise Error Rate and Bonferroni's Inequality
 - b. False Discovery Rate (FDR)
- Benjamini, Y. And Y. Hochberg (1995). "Controlling the False Discovery Rate: A Practical and Powerful Approach to Multiple Testing," *Journal of the Royal Statistical Society, Series B*, 57, 289-300.
 - Storey, J. D. (2002). "A Direct Approach to False Discovery Rates," *Journal of the Royal Statistical Society, Series B*, 64, 479-498.
 - Storey, J.D. (2004). "The Positive False Discovery Rate: A Bayesian Interpretation and the q-Value," *Annals of Statistics*, 31, 2013-2035.
 - Barras, L., O. Scaillet, and R. Wermers (2010). "False Discoveries in Mutual Fund Performance: Measuring Luck in Estimated Alphas," *Journal of Finance*, 65, 179-216.

7. Methods of Forecasting

- a. Principles of Forecasting
 - b. Forecast Evaluation
 - c. Bayesian and Frequentist Model Averaging
 - d. Bagging
- Hamilton (1994): Chapter 4
 - Diebold, F.X. and R.S.Mariano (1995). "Comparing Predictive Accuracy," *Journal of Business and Economic Statistics*, 13, 253-263.
 - West, K.D. (1996). "Asymptotic Inference about Predictive Ability," *Econometrica*, 64, 1067-1084.

- White, H. (2000). “A Reality Check for Data Snooping,” *Econometrica*, 68, 1097-1126.
- Giacomini, R. and H.White (2006). “Tests of Conditional Predictive Ability,” *Econometrica*, 74, 1545-1578.
- Hoeting, J., D. Madigan, A.R.Raftery, C.T.Volinsky (1999). “Bayesian Model Averaging: A Tutorial,” *Statistical Science*, 14, 382-401.
- Hansen, B.E. (2007). “Least Squares Model Averaging,” *Econometrica*, 75, 1175-1189.
- Hansen, B.E. (2008). “Least Squares Forecast Averaging,” *Journal of Econometrics*, 146, 342-350.
- Sala-i-Martin, X., G. Doppelhofer, and R. Miller (2004). “Determinants of Long-Term Growth: A Bayesian Averaging of Classical Estimates (BACE) Approach,” *American Economic Review*, 94, 813-835.
- Wright, J.H. (2008). “Bayesian Model Averaging and Exchange Rate Forecasting,” *Journal of Econometrics*, 146, 329-341.
- Inoue, A. and L.Kilian (2008). “How Useful Is Bagging in Forecasting Economic Time Series: A Case Study of U.S. CPI Inflation,” *Journal of the American Statistical Association*, 103, 511-522.

8. High-Frequency Data Analysis and Market Microstructure

- a. Ordered Probit Model of Price Changes
 - b. Decomposition Model of Price Changes
 - c. Autoregressive Conditional Duration (ACD) Model
- Tsay (2010): Chapter 5
 - Campbell, Lo, and MacKinlay (1996): Chapter 3
 - Hausman, J., A. Lo, and C. MacKinlay (1992). “An Ordered Probit Analysis of Transaction Stock Prices,” *Journal of Financial Economics*, 31, 319-379.
 - Rydberg, T.H. and N. Shephard (2003). “Dynamics of Trade-by-Trade Price Movements: Decomposition and Models,” *Journal of Financial Econometrics*, 1, 2-25.
 - Engle, R.F. and J. R. Russell (1998). “Autoregressive Conditional Duration: A New Model for Irregularly Spaced Transaction Data,” *Econometrica*, 66, 1127-1162.
 - Russell, J.R. and R.F.Engle (2009). “Analysis of High-Frequency Data,” in Y. Ait-Sahalia and L.P.Hansen (Eds.) *Handbook of Financial Econometrics*, Vol 1, 383-426.

9. ARCH/GARCH and Stochastic Volatility Models

- a. AutoRegressive Conditional Heteroskedasticity (ARCH)
 - b. Generalized ARCH (GARCH)
 - c. Other Extensions of the ARCH Model
 - d. Stochastic Volatility Model
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- Tsay (2010): Chapter 2
 - Hamilton (1994): Chapter 21
 - Bollerslev, T. (1986). "Generalized Autoregressive Conditional Heteroskedasticity," *Journal of Econometrics*, 31, 307-327.
 - Bollerslev, T., R.Y. Chou, and K.F.Kroner (1992). "ARCH Modelling in Finance: A Review of the Theory and Empirical Evidence," *Journal of Econometrics*, 52, 5-59.
 - Engle, R. F. and T. Bollerslev (1986). "Modelling the Persistence of Conditional Variances," *Econometric Reviews*, 5, 1-50.
 - Bollerslev, T., R.F.Engle, and D.B.Nelson (1994). "ARCH Model," in *Handbook of Econometrics 4*, Engle, R.F. and D.L.McFadden (Eds.) New York: Elsevier Science; 2961-3031.
 - Engle, R.F. (1982). "Autoregressive Conditional Heteroskedasticity with Estimates of the Variance of United Kingdom Inflation," *Econometrica*, 50, 987-1007.
 - Engle, R.F. (2001). "GARCH 101: An Introduction to the Use of ARCH/GARCH Models in Applied Econometrics," *Journal of Economic Perspectives*, 15, 157-168.
 - Engle, R.F. (2002). "New Frontiers for ARCH Models," *Journal of Applied Econometrics*, 17, 425-446.
 - Engle, R.F. (2004). "Risk and Volatility: Econometric Models and Financial Practice," *American Economic Review*, 94, 405-420.
 - Poon, S.-H. and C.W.J. Granger (2003). "Forecasting Volatility in Financial Markets: A Review," *Journal of Economic Literature*, 41, 478-539.
 - Ait-Sahalia, Y. and R. Kimmel (2007). "Maximum Likelihood Estimation of Stochastic Volatility Models," *Journal of Financial Economics*, 83, 413-452.
 - Andersen, T.G., T. Bollerslev, and F.X.Diebold (2002). "Parametric and Nonparametric Volatility Measurement," in: *Handbook of Financial Econometrics*, Ait-Sahalia, Y. and L.P.Hansen (Eds.) Amsterdam: North-Holland.

- Andersen, T.G., T.Bollerslev, F.X.Diebold, and P. Labys (2003). "Modeling and Forecasting Realized Volatility," *Econometrica*, 71, 579-625.
- Barndorff-Nielsen, O.E. and N. Shephard (2004). "Econometric Analysis of Realized Covariation: High Frequency Based Covariance, Regression, and Correlation in Financial Economics," *Econometrica*, 72, 885-925.
- Broto, C. and E.Ruiz (2004). "Estimation Methods for Stochastic Volatility Models: A Survey," *Journal of Economic Surveys*, 18, 613-649.
- Jacquier, E., N. G. Polson and P. E. Rossi (1994). "Bayesian Analysis of Stochastic Volatility Models," *Journal of Business and Economic Statistics*, 12, pp. 371-89.
- Kim, S., N.Shephard, and S.Chib (1998). "Stochastic Volatility Likelihood Inference and Comparison with ARCH Models," *Review of Economic Studies*, 65, 361-393.

Grading for Econ 721:

The course grade will be based on a term paper. The paper should be some application of one or more of the methods covered in class, and it is due by 5:00pm on Tuesday, December 20.