Markov Chain

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April 2023

Contents

1 Introduction **2**

2 Markov Chain **3**
- 2.1 Definition . . . 3
- 2.2 Homogeneous Markov Chain . . . 3
- 2.3 Chapman-Kolmogorov Equations . . . 4
- 2.4 Classification of states . . . 7

3 Stationary Probability **10**
- 3.1 Linear Algebric Approach . . . 12

4 Some Example of Markov Chain **13**
- 4.1 The Simple Random Walk . . . 13
  - 4.1.1 Random Walk in Python . . . 14
- 4.2 The Gambler's Ruin Problem . . . 16
  - 4.2.1 Becoming infinitely rich or getting ruined . . . 17
  - 4.2.2 Gambler's Ruin Problem in python . . . 18

5 Application of Markov Chain **19**

Chapter 1

Introduction

Chapter 2

Markov Chain

2.1 Definition

Definition 2.1.1 (Markov Chain)**.** A discrete time stochastic process $\{X_n, n = 1, 2, 3, \ldots\}$ is defined to be *Discrete Time Markov Chain* or simply *Markov Chain* if it takes value the state space $\mathbf{S}$, and for every $n \geq 0$ it satisfy the property

$$\mathbf{P}(X_{n+1} = j | X_n = i, X_{n-1} = i_{n-1}, \ldots, X_0 = i_0) = \mathbf{P}(X_{n+1} = j | X_n = i) \tag{2.1}$$

Unless otherwise mentioned we take the state space $\mathbf{S}$ to be $\{0, 1, 2, 3, \ldots\}$. If $X_n = i$ we say that the process is in ith state at time n. In the definition eq. (2.1) may be interpreted as for Markov Chain, the conditional distribution of any future state X_{n+1}, given the past states $X_0, X_1, \ldots, X_{n-1}$ and the present state X_n, is independent of the past and only depend on the present state. This property is called *Markovian Property.* In other word for markov chain predicting the future we only need information about the present state.

Note: Notice that Assumption we are making for markov chain to forget the past as long as present in known is very strong assumption.

2.2 Homogeneous Markov Chain

Definition 2.2.1 (Homogeneous Markov Chain)**.** We say a markov chain $\{X_n, n \geq 0\}$ is homogeneous if $\mathbf{P}(X_{n+1} = j | X_n = i) = \mathbf{P}(X_2 = j | X_1 = i)$ $\forall n > 0$.

The quantity $\mathbf{P}(X_{n+1} = j | X_n = i)$ is called the *transition probability* from state i to state j. For homogeneous Markov Chain we can specify the transition probabilities $\mathbf{P}(X_{n+1} = j | X_n = i)$ by a sequence of value $p_{xy} = \mathbf{P}(X_{n+1} = y | X_n = x)$.

For the case of finite state Markov chain, say the state space is $\{1, 2, 3, \ldots\}$. Then the transition probabilities are p_{ij}, $1 \leq i, j \leq N$ for transition from state i to state j. The $N \times N$ matrix $P = (p_{ij})_{N \times N}$ is called The *Transition Matrix* of chain. Since probabilities are nonnegative and since the process must make a transition into some state, we have

$$P_{ij} \geq 0, \quad i, j \geq 0, \text{ and } \sum_{j=0}^{N} P_{ij} = 1, \quad \forall\ i = 0, 1, 2, \ldots.$$

For, infinite state markov chain the probability transition matrix will be infinite order. Then,

$$P = \begin{bmatrix} p_{00} & p_{01} & p_{02} & \cdots \\ p_{11} & P_{12} & p_{12} & \cdots \\ \vdots & \vdots & \vdots & \cdots \\ p_{i0} & \cdots & p_{ij} & \cdots \\ \vdots & \vdots & \vdots & \ddots \end{bmatrix}$$

Example 2.2.1 (Rain and sunny)**.** Suppose that whether it rains today depends on previous weather conditions only from the last two days. Specifically, suppose that if it has rained for the past two days, then it will rain tomorrow with probability 0.7; if it rained today but not yesterday, then it will rain tomorrow with probability 0.5; if it rained yesterday but not today, then it will rain tomorrow with probability 0.4; if it has not rained in the past two days, then it will rain tomorrow with probability 0.2.

We can transform it into a Markov chain by letting the state on any day be determined by the weather conditions during both that day and the preceding one. For instance, we can say that the process is in

State 0: if it rained both today and yesterday
State 1: if it rained today but not yesterday
State 2: if it rained yesterday but not today
State 3: if it rained neither today nor yesterday

The it will be 4-state Markov chain whose transition matrix will be,

$$P = \begin{bmatrix} 0.7 & 0 & 0.3 & 0 \\ 0.5 & 0 & 0.5 & 0 \\ 0 & 0.4 & 0 & 0.6 \\ 0 & 0.2 & 0 & 0.8 \end{bmatrix}$$

2.3 Chapman-Kolmogorov Equations

We have already defined the one step transition probabilities p_{ij}. We now define the n-step transition probabilities p_{ij}^n to be the probability that a process in state i will be in state j after n additional transitions. i.e.

$$p_{ij}^n = \mathbf{P}(X_{n+m} = j | X_m = i), \ n \geq 0, \ i, j \geq 0.$$

By definition of markov chain we get,

$$
\begin{aligned}
p_{ij}^{n+m} &= \mathbf{P}(X_{n+m} = j | X_0 = i) \\
&= \sum_{k=0}^{\infty} \mathbf{P}(X_{n+m} = j, X_n = k | X_0 = i) \text{ (By theorem of total probability)} \\
&= \sum_{k=0}^{\infty} \mathbf{P}(X_{n+m} = j | X_n = k, X_0 = i) \mathbf{P}(X_n = k | X_0 = i) \\
&= \sum_{k=0}^{\infty} \mathbf{P}(X_{n+m} = j | X_n = k) \mathbf{P}(X_n = k | X_0 = i) \\
&= \sum_{k=0}^{\infty} p_{kj}^{m} p_{ik}^{n}. \qquad (2.2)
\end{aligned}
$$

If we take $n = m = 1$. Then

$$p_{ij}^2 = \sum_{k=0}^{\infty} p_{kj} p_{ik} \qquad (2.3)$$

the above expression is (i, j) element of P^2 matrix then we see eq. (2.3) in matrix form,

$$P^2 = P * P$$

Hence, eq. (2.2) can also written in matrix form,

$$P^{n+m} = P^n * P^m$$

Where P^n & P^m are the n-step and m-step transition matrix respectively.

Example 2.3.1 (Transition matrix of 4-state Markov chain)**.** Consider the 4-state Markov chain depicted in fig. 2.1 When no probabilities are written over the arrows, as in this case, it means all arrows originating from a given state are equally likely. For example, there are 3 arrows originating from state 1, so the transitions $1 \to 3$, $1 \to 2$, and $1 \to 1$ all have probability 1/3. Therefore the transition matrix of the chain is.

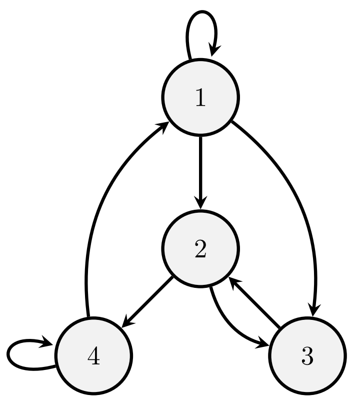

Figure 2.1: Example of A 4 state markov chain

$$
P = \begin{bmatrix}
\frac{1}{3} & \frac{1}{3} & \frac{1}{3} & 0 \\
0 & 0 & \frac{1}{2} & \frac{1}{2} \\
0 & 1 & 0 & 0 \\
\frac{1}{2} & 0 & 0 & \frac{1}{2}
\end{bmatrix}
$$

To compute the probability that the chain is in state 3 after 5 steps, starting at state 1, we would look at the (1,3) entry of P^5.

$$P^5 = \begin{bmatrix} \frac{853}{3888} & \frac{509}{1944} & \frac{52}{243} & \frac{395}{1296} \\ \frac{173}{864} & \frac{85}{432} & \frac{31}{108} & \frac{91}{288} \\ \frac{37}{144} & \frac{29}{72} & \frac{1}{9} & \frac{11}{48} \\ \frac{499}{2592} & \frac{395}{1296} & \frac{71}{324} & \frac{245}{864} \end{bmatrix}$$

so, $p_{13}^5 = \mathbf{P}(X_5 = 3|X_0 = 1) = \frac{52}{243}$.

To get the marginal distributions of $X_0, X_1, ...$, we need to specify not just the transition matrix, but also the initial conditions of the chain. This can be done by setting the initial state X_0 to be a particular state, or by randomly choosing X_0 according to some distribution. Let $(t_1, t_2, ..., t_N)$ be the PMF of X_0 displayed as a vector, that is, $t_i = \mathbf{P}(X_0 = i)$. Then the marginal distribution of the chain at any time can be computed from the transition matrix.

Proposition 2.3.1 (Marginal Distribution of X_n)**.** *Define $\mathbf{t} = (t_1, t_2, \ldots, t_n)$ by $t_i = \mathbf{P}(X_0 = i)$, and view $\mathbf{t}$ as a row vector. Then the marginal distribution of X_n is given by the vector $\mathbf{t}P^n$. That is the j-th component of $\mathbf{t}P^n$ is $\mathbf{P}(X_n = j)$.*

Proof. By the law of total probability we get,

$$\begin{aligned} \mathbf{P}(X_n = j) &= \sum_{i=0}^{N} \mathbf{P}(X_n, X_0 = i) \\ &= \sum_{i=0}^{N} \mathbf{P}(X_0 = i)\mathbf{P}(X_n = j|X_0 = i) \end{aligned}$$

$$= \sum_{i=0}^{N} t_i p_{ij}^n$$

Which is the j-th component of $\mathbf{t}P^n$. □

Example 2.3.2 (Marginal distribution of 4-state Markov chain)**.** Again consider the 4-state Markov chain in fig. 2.1. Suppose the initial conditions are $\mathbf{t} = (1/4, 1/4, 1/4, 1/4)$, Let X_n be the position of the chain at time n. Then distribution of X_1 is

$$\begin{aligned} \mathbf{t}P &= \begin{bmatrix} \frac{1}{4} & \frac{1}{4} & \frac{1}{4} & \frac{1}{4} \end{bmatrix} \begin{bmatrix} \frac{1}{3} & \frac{1}{3} & \frac{1}{3} & 0 \\ 0 & 0 & \frac{1}{2} & \frac{1}{2} \\ 0 & 1 & 0 & 0 \\ \frac{1}{2} & 0 & 0 & \frac{1}{2} \end{bmatrix} \\ &= \begin{bmatrix} \frac{5}{24} & \frac{1}{3} & \frac{5}{24} & \frac{1}{4} \end{bmatrix} \end{aligned}$$

The marginal distribution of X_5 is

$$\begin{aligned} \mathbf{t}P^5 &= \begin{bmatrix} \frac{1}{4} & \frac{1}{4} & \frac{1}{4} & \frac{1}{4} \end{bmatrix} \begin{bmatrix} \frac{853}{3888} & \frac{509}{1944} & \frac{52}{243} & \frac{395}{1296} \\ \frac{173}{864} & \frac{85}{432} & \frac{31}{108} & \frac{91}{288} \\ \frac{37}{144} & \frac{29}{72} & \frac{1}{9} & \frac{11}{48} \\ \frac{499}{2592} & \frac{395}{1296} & \frac{71}{324} & \frac{245}{864} \end{bmatrix} \\ &= \begin{bmatrix} \frac{707}{3254} & \frac{472}{1619} & \frac{101}{486} & \frac{1469}{5184} \end{bmatrix} \end{aligned}$$

2.4 Classification of states

Definition 2.4.1. We say that state j is *accessible* from state i, written as $i \to j$, If $p_{ij}^n > 0$ for some $n \in \mathbb{N}$.
We assume every state is accessible from itself since,

$$p_{ii}^0 = \mathbf{P}(X_0 = i | X_0 = i) = 1.$$

Definition 2.4.2. Two states i and j are said to *communicate* , written as $i \longleftrightarrow j$, if they are accessible from each other.
i.e.

$$i \longleftrightarrow j \implies i \to j \quad \& \ j \to i$$

Communication is an equivalence relation. That means that,

1. $i \longleftrightarrow i$.
2. if $i \longleftrightarrow j$ then $j \longleftrightarrow i$.
3. if $i \longleftrightarrow j$ and $j \longleftrightarrow k$ then $i \longleftrightarrow k$.

First two property is obvious for last one, let for some n, m in $\mathbb{N}$ then, $p_{ij}^n, p_{jk}^m > 0$ by assumption. By Chapman-Kolmogorov equatation.

$$p_{ik}^{n+m} = \sum_{r=0}^{\infty} p_{ir}^n p_{rk}^m \geq p_{ij}^n p_{jk}^m > 0.$$

Hence state k is accessible from state i. By same we can see tha converse.

Therefore, the states of a Markov chain can be partitioned into communicating classes such that only members of the same class communicate with each other. i.e. two states i & j belong to same class if and only if $i \longleftrightarrow j$.

Example 2.4.1. Consider the markov chain define in the picture fig. 2.2.

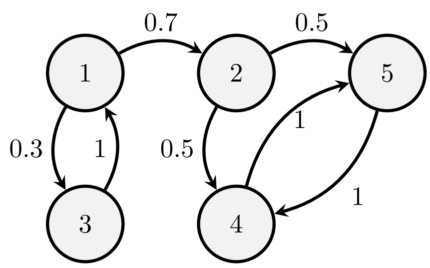

Figure 2.2

Here the classes are $\{1, 3\}, \{2\}, \{4, 5\}$

Definition 2.4.3 (Irreducible Markov chain)**.** A Markov chain is said to be irreducible if it has only one communicating class. That is, every state communicate with each other.
That is, for any states i, j there is some positive integer n such that the (i, j) entry of P^n is positive.

A Markov chain that is not irreducible called reducible.

For any state i and j define f_{ij}^n to be the probability that, starting from i, the first transition into j occurs at n time.
i.e.

$$f_{ij}^n = \mathbf{P}(X_n, X_k \neq j, k = 1, 2, \ldots n-1 | X_0 = i).$$

Let,

$$f_{ij} = \sum_{n=0}^{\infty} f_{ij}^{n}$$

Then, f_{ij} denote the probability of ever making a transition into step j when start from state i. If j is not accessible from i then f_{ij} will be zero.

Definition 2.4.4 (Recurrent and Transient state)**.** A state j of a Markov chain is said to be *recurrent* $f_{ii} = 1$ and *transient* if $f_{ii} < 0$.

In other word, if a Markov chain start in a recurrent state, there is a guarantee that it will visit that state again in the future (eventually return to that state with probability 1). Recurrent states are often considered "absorbing" because once the chain enter there, chain will stay there indefinitely.

In contrast, a transient state in a Markov chain is a state where, once you reach it, there is a positive probability that you will never return to that state. i.e. if you begin in a transient state, there's a chance you won't return there.

Corollary 2.4.0.1. *state i is recurrent if and only if $\sum_{n=0}^{\infty} p_{ii}^{n} = \infty$*

Proof. The state i is recurrent if and only if, starting in state i, the expected number of time periods that the process is in state i is infinite.
Let,

$$I_n = \begin{cases} 1, & \text{if } X_n = i \\ 0, & \text{if } X_n \neq i \end{cases}$$

we then have $\sum_{n=0}^{\infty} I_n$ represent the number of periods that the process is in state i Then,

$$\begin{aligned} E\left[\sum_{n=0}^{\infty} I_n | X_0 = i\right] &= \sum_{n=0}^{\infty} E[I_n | X_0 = i] \\ &= \sum_{n=0}^{\infty} \mathbf{P}(X_n = i | X_0 = i) \\ &= \sum_{n=0}^{\infty} p_{ii}^{n} \end{aligned}$$

Hence the result. □

Theorem 2.4.1. *If i is recurrent and $i \longleftrightarrow j$, then j is also recurrent.*

Proof. Let m and k be such that $p_{ij}^{k} > 0, p_{ji}^{m} > 0$. Now for any $n \geq 0$

$$p_{jj}^{m+n+k} \geq p_{ji}^{m} p_{ii}^{k} p_{ij}^{m}$$

This follows because the left-hand side of the preceding equation is the probability of going from $j \to j$ in $m+n+k$ steps, whereas the right-hand side is the probability of going from $j \to j$ in $m+n+k$ steps via a path that goes from $j \to i$ in m steps, then from $i \to i$ in n additional steps, then from $i \to$j in k additional steps. By summing the preceding over n. we obtain

$$\sum_{n=0}^{\infty} p_{jj}^{m+n+k} \geq p_{ji}^{m} p_{ii}^{k} \sum_{n=0}^{\infty} p_{ij}^{n} = \infty$$

where $\sum_{n=0}^{\infty} p_{ij}^{n} = \infty$ because state i is recurrent. Thus, j is also recurrent. □

Proposition 2.4.2. *In an irreducible Markov chain with a finite state space, all states are recurrent.*

Chapter 3

Stationary Probability

Consider a two-state Markov chain with transition probability matrix

$$P = \begin{bmatrix} 0.35 & 0.65 \\ 0.89 & 0.11 \end{bmatrix}$$

Then 2-step transition matrix will be

$$P^2 = \begin{bmatrix} 0.7010 & 0.2990 \\ 0.4094 & 0.5906 \end{bmatrix}$$

Then 8-step transition matrix will be

$$P^8 = \begin{bmatrix} 0.5810 & 0.4190 \\ 0.5737 & 0.4263 \end{bmatrix}$$

Once again 12-state transition matrix is,

$$P^{12} = \begin{bmatrix} 0.5782 & 0.4218 \\ 0.5776 & 0.4224 \end{bmatrix}$$

Note that The 8-step transition matrix is almost identical to 12-step transition matrix. So it seems that p_{ij}^n is converging to some value as $n \to \infty$ that is same for all i. In other words, In other word it seems to exist a limiting probability that the process will be in state j after a large number of transitions, and this value is independent of initial state. This limiting probability is known as stationary probability and the distribution of X_j^n as $n \to \infty$ is known as stationary distribution.

State i is said to have *period* d if $p_{ii}^n = 0$ whenever n is not divisible by d, and d is the largest integer with this property. A state with period 1 is said to be *aperiodic*. We denote period of i by $d(i)$.

If state i is recurrent, then it is said to be positive recurrent if, starting in state the expected time until the process returns to state i is finite. While there exist recurrent states that an not positive recurrent (such states are called null recurrent). Postie recurrent, aperiodic states are called *ergodic.*

Definition 3.0.1 (Stationary Distribution)**.** A probability distribution $\{p_j, j \geq 0\}$ is called stationary for the Markov chain if

$$p_j = \sum_{i=0}^{\infty} p_i p_{ij}, \ j \geq 0 \tag{3.1}$$

i.e. If $\mathbf{t} = (p_1, p_2, \ldots, p_j, \ldots)$ is a probability distribution vector and P is transition matrix, Then

$$\mathbf{t} = \mathbf{t}P. \tag{3.2}$$

From eq. (3.2) we see that 1 is a eigenvalue of transition matrix P and $\mathbf{t}$ is eigenvector corresponding to 1. Since in transition matrix such that $\sum_{j=0}^{\infty} p_{ij} = 1 \ \forall i$ i.e. sum of all elements of row is 1, 1 must be a eigenvalue.

Now the question aeries is eigenvector corresponding to 1 is a probability vector(sum of all component in 1) or not.

Theorem 3.0.1 (Existence and Uniqueness of Stationary Distribution)**.** *An irreducible aperiodic Markov chain belongs to one of the following two classes:*

1. *Either the state are all transient or all null recurrent; in this case $P_{ij}^n \to 0$ as $n \to \infty \ \forall i, j$ and there exist no stationary distribution.*
2. *Or else, all states are positive recurrent, i.e.*

$$\pi_j = \lim_{n\to\infty} p_{ij}^n > 0.$$

In this case, $\{\pi_j, j = 0, 1, \ldots\}$ is stationary distribution and there exist no other stationary distribution.

Proof. we will first proof (2), we have,

$$\sum_{j=0}^{M} p_{ij}^n \leq \sum_{j=0}^{\infty} p_{ij}^n = 1 \ \forall M.$$

Letting $n \to \infty$ we get,

$$\sum_{j=0}^{M} \pi_j \leq 1 \ \forall M.$$
$$\sum_{j=0}^{\infty} \pi_j \leq 1.$$

Now,

$$p_{ij}^{n+1} = \sum_{k=0}^{\infty} p_{ik}^n p_{kj} \geq \sum_{k=0}^{M} p_{ik}^n p_{kj} \ \forall M.$$

Letting $n \to \infty$ gives us,

$$\pi_j \geq \sum_{k=0}^{M} \pi_k p_{kj} \ \forall M,$$

i.e.

$$\pi_j \geq \sum_{k=0}^{\infty} \pi_k p_{kj}, \ \forall j \geq 0.$$

To show that the above is actually an equality, suppose the inequality is strict for some j. Then we obtain,

$$\sum_{j=0}^{\infty} \pi_j > \sum_{j=0}^{\infty}\sum_{k=0}^{\infty} \pi_k p_{jk} = \sum_{k=0}^{\infty} \pi_k \sum_{j=0}^{\infty} p_{kj} = \sum_{k=0}^{\infty} \pi_k.$$

which is contradiction. Therefore,

$$\pi_j = \sum_{k=0}^{\infty} \pi_k p_{kj}, \quad \forall j, \ldots$$

Potting $p_j = \pi_j / \sum_0^\infty \pi_k$, we see that $\{p_j, j = 0, 1, 2, \ldots\}$ is stationary distribution, and hence at least one stationary distribution exist. Now let $\{p_j, j = 0, 1, 2, \ldots\}$ be any stationary distribution. Then if $\{p_j, j = 0, 1, 2, \ldots\}$ is the probabolity distribution of X_0 then

$$\begin{aligned} p_j &= \mathbf{P}(X_n = j) \\ &= \sum_{i=0}^{\infty} \mathbf{P}(X_n = j | X_0 = i) \mathbf{P}(X_0 = i) \\ &= \sum_{i=0}^{\infty} p_{ij}^n p_i \end{aligned} \tag{3.3}$$

Then, from eq. (3.3) we see,

$$p_j \geq \sum_{i=0}^{M} p_{ij}^n p_i \quad \forall M.$$

Letting n and then M approach ∞ we get,

$$p_j \geq \sum_{i=0}^{\infty} \pi_j p_i = \pi_j.$$

Now we show that $p_j \leq \pi_j$ use eq. (3.3) and that fact that $p_{ij}^n \leq 1$ to obtain

$$p_j \leq \sum_{i=0}^{M} p_{ij}^n p_i + \sum_{i=M+1}^{\infty} p_i \ \forall M.$$

and letting $n \to \infty$ gives,

$$p_j \leq \sum_{i=0}^{M} \pi_j p_i + \sum_{i=M+1}^{\infty} p_i \ \forall M.$$

Since $\sum_0^\infty = 1$, we obtain upon letting $M \to \infty$ that

$$p_j \leq \sum_{i=0}^{\infty} \pi_j p_i = \pi_j. \tag{3.4}$$

If the state are transient or null recurrent and $\{p_j, j = 0, 1, 2, \ldots\}$ is a stationary distribution, then eq. (3.3) hold and $p_{ij}^n \to 0$, which is clearly impossible. Thus, for case (1), no stationary distribution exists and the proof is complete. □

Remark 1. It is quite intuitive that if the process is started with the limiting probabilities, then the resultant Markov chain is stationary. For in this case the Markov chain at time 0 is equivalent to an independent Markov chain with the same P matrix at time ∞. Hence the original chain at time t is equivalent to the second one at time $\infty + t = \infty$ therefore stationary.

3.1 Linear Algebric Approach

Chapter 4

Some Example of Markov Chain

4.1 The Simple Random Walk

The markov chain whose state space is the set of all integers $\mathbb{Z}$ and has transition probabilites

$$p_{i,i+1} = p = 1 - p_{i,i-1}, \quad i \in \mathbb{Z}.$$

where $0 < p < 1$, is called the simple random walk.

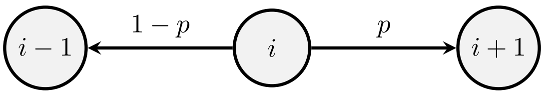

Figure 4.1: Simple Random Walk

One interpretation is that it represents the winnings of a gambler who on each play of the game either wine or loses one dollar.

Since all state clearly communicate it follows that from theorem 2.4.1 they are either all transient or all recurrent. So let us consider state 0 and attempt to determine if $\sum_{n=0}^{\infty} p_{00}^n$ if finite or not.

Since it is impossible to be back at the initial state after an odd number of transition, we must have,

$$p_{00}^{2n+1} = 0 \; \forall \geq 0.$$

On other hand, the gambler would be even after $2n$ trials if and only if he wens n games and lost n of games. It is like coin toss with probability of getting head is p ans tail in $1-p$. Then the desired probability is those binomial probability. Then we have,

$$p_{00}^n = \binom{2n}{n} p^n (1-p)^n = \frac{2n!}{n!n!} (p(1-p))^n, \quad n = 1, 2, 3, \ldots$$

by using an starling approximation, i.e.

$$n! \sim \sqrt{2\pi n} \left(\frac{n}{e}\right)^n.$$

we obtain

$$p_{00}^{2n} \sim \frac{[4p(1-p)]^n}{\sqrt{n\pi}}$$

we know if $a_n \sim b_n$, then $\sum_n a_n < \infty$ iff $\sum_n b_n < \infty$. Consequently $\sum_n p_{00}^n < \infty$ if and only if

$$\sum_{n=0}^{\infty} \frac{[4p(1-p)]^n}{\sqrt{n\pi}} < \infty$$

However, $4p(1-p) \leq 1$ with equality holding if and only if $p = \frac{1}{2}$. Hence $\sum_{n=1}^{\infty} p_{00}^n = \infty$ if and only if $p = \frac{1}{2}$. Thus, the chain is recurrent with $p = \frac{1}{2}$ and transient when $p \neq \frac{1}{2}$.

Hence if $p = 1/2$ then the process random walk visit state 0 again and again infinitely many time and if $p \neq 1/2$ it may or may not visit state 0.

If we consider random walk has $N+1$ step i.e. $\{0, 1, \ldots, N\}$ is state space of random walk. Then, The transition matrix will be.

$$P = \begin{bmatrix} 1-p & p & 0 & 0 & \ldots \\ 1-p & 0 & p & 0 & \ldots \\ 0 & 1-p & 0 & 1-p & \ldots \\ \vdots & \vdots & \vdots & \vdots & \ddots \end{bmatrix}_{(N+1)\times(N+1)}$$

considering $p_{00} = 1-p$ and $p_{NN} = p$ as those are last state.

Example 4.1.1. Consider a random walk with 4 state and $p = 0.6$.
Then, the transition probability will be,

$$P = \begin{bmatrix} 0.4 & 0.6 & 0 & 0 \\ 0.4 & 0 & 0.6 & 0 \\ 0 & 0.4 & 0 & 0.6 \\ 0 & 0 & 0.4 & 0.6 \end{bmatrix}$$

then 10000-step transition probability will be

$$P^{10000} = \begin{bmatrix} 0.1231 & 0.1846 & 0.2769 & 0.4154 \\ 0.1231 & 0.1846 & 0.2769 & 0.4154 \\ 0.1231 & 0.1846 & 0.2769 & 0.4154 \\ 0.1231 & 0.1846 & 0.2769 & 0.4154 \end{bmatrix}$$

hence, Stationary distribution will be

$$\pi = \begin{bmatrix} 0.1231 & 0.1846 & 0.2769 & 0.4154 \end{bmatrix}$$

As, $\pi = \pi P$

4.1.1 Random Walk in Python

We can visualize Random Walk with the help of python.

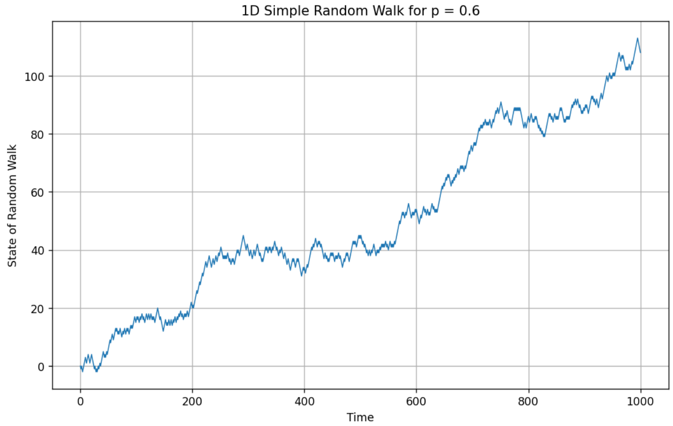

Figure 4.2: Random Walk for $p = 0.6$

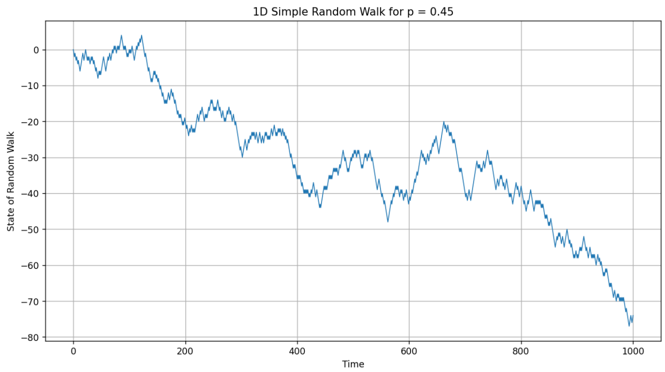

Figure 4.3: Random Walk for $p = 0.45$

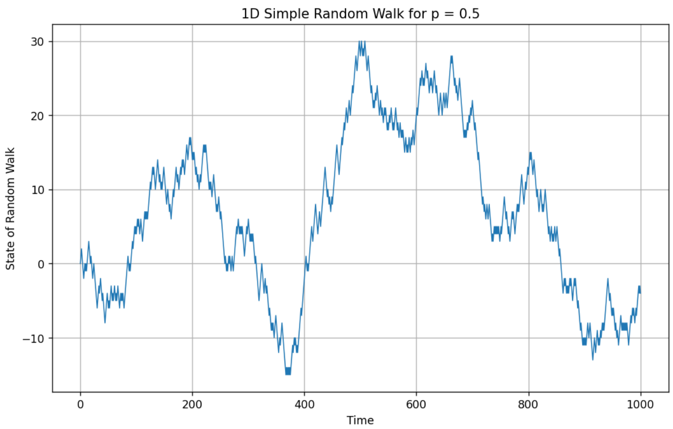

Figure 4.4: Random Walk for $p = 0.5$

4.2 The Gambler's Ruin Problem

Consider a gambler who starts with an initial fortune and then on each successive gamble either wins \$1 or loses \$1 independent of the past with probabilities p and $q = 1 - p$ respectively. The gambler's objective is to reach a total fortune of \$$N$, without first getting ruined (running out of money). If the gambler succeeds, then the gambler is said to win the game. In any case, the gambler stops playing after winning or getting ruined, whichever happens first. Let the gambler starts with \$$i$ where $0 < i < N$.

Let X_n denote the total fortune after the nth gamble. Then $X_0 = i$,
Then the process $\{X_n, n = 0, 1, 2, \ldots, N\}$ is a Markov chain With transition probabilities

$$\begin{aligned} p_{00} &= p_{NN} = 1, \\ p_{i,i+1} &= p = 1 - p_{i,i-1} \quad i = 1, 2, \ldots, N-1 \end{aligned}$$

This Markov chain has three classes, classes are $\{0\}$, $\{1, 2, \ldots, N-1\}$ & $\{N\}$ the first and third class being recurrent and second transient. Since all each transient state is only visited finitely often, it follows that after some finite amount of time, the gambler will either wins \$$N$ or go broke.

Since the game stops when either $X_n = 0$ or $X_n = N$, let

$$\tau_i = \min n \geq 0 : X_n \in \{0, N\} | X_0 = i$$

denote the time at which the game stops when $X_0 = i$. If $X_{\tau_i} = N$, then the gambler wins of $X_{\tau_i} = 0$ gambler is ruin.

Let $P_i = \mathbf{P}(X_{\tau_i} = N)$ denotes the probability that the gambler wins when $X_0 = i$ clearly $P_0 = 0$ and $P_N = 1$ by definition, (Here $f_{00} = 1$ and $f_{NN} = 1$ then state 0 and N is absorbing state.) we next proceed to compute P_i, $1 \leq i \leq N-1$. By conditioning on the outcome of the initial play of the game, we obtain,

$$P_i = pP_{i+1} + qP_{i-1}, \quad i = 1, 2, \ldots, N-1,$$

Since, $p + q = 1$ we get,

$$\begin{aligned} pP_i + qP_i &= pP_{i+1} + qP_{i-1} \\ P_{i+1} - P_i &= \frac{q}{p}(P_i - P_{i-1}), \quad 0 < i < N, \end{aligned}$$

In particular, $P_2 - p_1 = (q/p)(P_1 - P_0) = (q/p)P_1$ (since, $P_0 = 0$) So that,
$P_3 - P_2 = (q/p)(P_2 - P_1) = (q/p)^2 P_1$, And hence,

$$P_{i+1} - P_i = \left(\frac{q}{p}\right)^i P_1 \quad 0 < i < N.$$

$$P_{i+1} - P_1 = \sum_{k=1}^{i} (P_{k+1} - P_k)$$

$$P_{i+1} - P_1 = \sum_{k=1}^{i} \left(\frac{q}{p}\right)^k P_1$$

$$P_{i+1} = P_1 + \sum_{k=1}^{i} \left(\frac{q}{p}\right)^k P_1 = P_1 \sum_{k=0}^{i} \left(\frac{q}{p}\right)$$

$$= \begin{cases} P_1 \frac{1-\left(\frac{q}{p}\right)^{i+1}}{1-\left(\frac{q}{p}\right)} & \text{if } p \neq q; \\ P_1(i+1) & \text{if } p = q = 0.5 \end{cases} \tag{4.1}$$

Choosing $i = N - 1$ we get and using $P_N = 1$ we get,

$$1 = P_N = \begin{cases} P_1 \frac{1-\left(\frac{q}{p}\right)^{N}}{1-\left(\frac{q}{p}\right)} & \text{if } p \neq q; \\ P_1 N & \text{if } p = q = 0.5 \end{cases}$$

Hence we get, $P_1 = 1/N$ when $p = q = 0.5$ and $P_1 = \frac{1-(q/p)}{1-(q/p)^N}$ Then,

$$P_i = \begin{cases} \frac{1-\left(\frac{q}{p}\right)^{i}}{1-\left(\frac{q}{p}\right)^N}, & \text{it } p \neq q; \\ \frac{i}{N} & \text{if } p = q = 0.5 \end{cases} \tag{4.2}$$

4.2.1 Becoming infinitely rich or getting ruined

If $p > 0.5$, Then $\frac{q}{p} < 1$ from eq. (4.2) we get,

$$\lim_{N\to\infty} P_i = 1 - \left(\frac{q}{p}\right)^i > 0$$

i.e. if $p > 0.5$, there is a positive probability that the gambler will never get ruined but instead will become infinitely rich as $N \to \infty$.

If $p \leq 0.5$ then $\frac{q}{p} \geq 1$ thus from eq. (4.2)

$$\lim_{N\to\infty} P_i = 0, \quad p \leq 0.5$$

i.e. if $p \leq 0.5$ (each gamble is not in his favor), then with probability one the gambler will get ruined $N \to \infty$.

Example 4.2.1 (Random walk hitting probabilities)**.** Ellen bought a share of stock for \$10, and it is believed that the stock price moves (day by day) as a simple random walk with $p = 0.55$. What is the probability that Ellen's stock reaches the high value of \$15 before the low value of \$5?

What is the probability that Ellen will become infinitely rich?

Solution: Let us define, $P(a) = \mathbf{P}(X_n \text{ hits } a \text{ before hitting } b)$

We want calculate the probability that the stock goes up by 5 before going down by 5.

By letting $a = 5$ and $b = 5$ and $N = a + b = 10$, we can imagine a gambler who started with \$5 and want to win \$5 before going broke. So we can compute $P(a)$ by casting the problem into the framework of the gamblers ruin problem: $P(a) = P_5$ and $N = 10$. Then,

$$P(5) = P_5 = \frac{1 - \left(\frac{0.45}{0.55}\right)^5}{1 - \left(\frac{0.45}{0.55}\right)^{10}} = \frac{1 - (0.82)^5}{1 - (0.85)^{10}} = 0.73$$

To see Ellen will ever be infinity rich we make $N \to \infty$ and started gamblers ruin problem at \$10 then,

$$\lim_{N\to\infty} P_{10} = 1 - (q/p)^{10} = 1 - (0.82)^{10} = 0.86$$

4.2.2 Gambler's Ruin Problem in python

We can nicely make a simulation of Gambler's ruin problem.

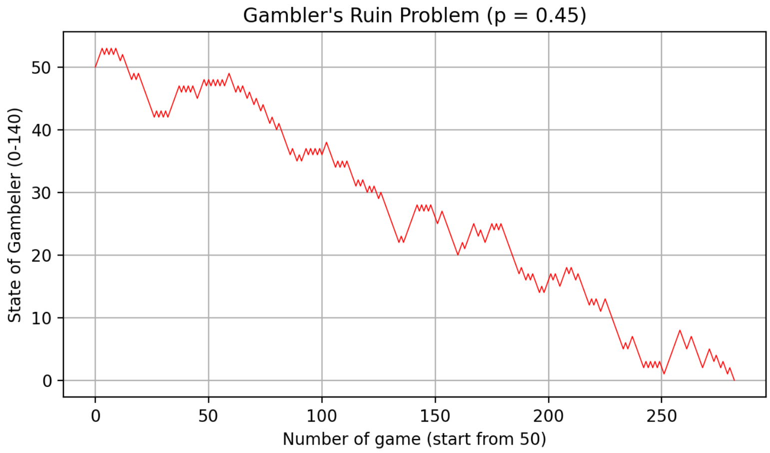

Figure 4.5: Gambler's Ruin Problem with $(p = 0.45)$

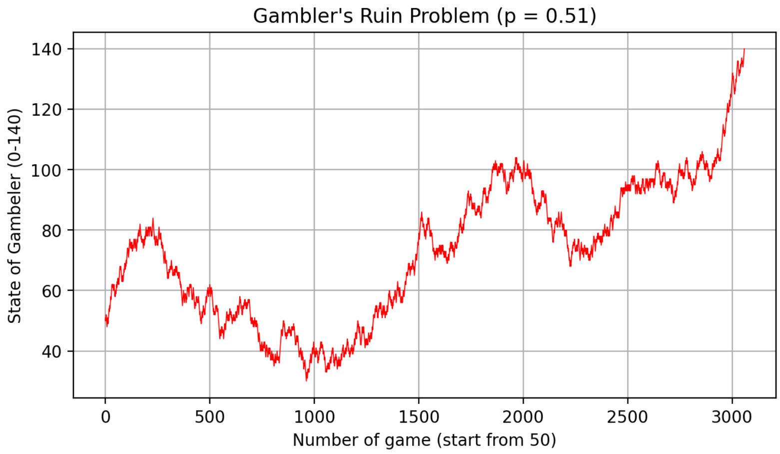

Figure 4.6: Gambler's Ruin Problem with $(p = 0.51)$

Chapter 5

Application of Markov Chain