

2. Measurement of Trend

Measurement of Trend

To measure trend we need to eliminate the other elements, mainly cyclical and seasonal since irregularity is hard to remove.

Methods of Measuring trend

1. Method of free-hand curve fitting (pretty much useless)
2. Method of moving averages
3. Method of mathematical curves

Note

if your data has cyclical and proper seasonality, method of moving average is the best. If your data doesn't have cyclical then method of mathematical curves is preferred.

Note

Method of mathematical curves is not focused on eliminating cyclical or seasonality but is the only method that is used for forecasting

Method of Moving Averages

In this method, a series of arithmetic means, each of k successive observations of the given data is computed and these means are referred to as the moving averages of period k . To begin with, we take the first k . for the next item, we exclude the 1st value and include the $(k + 1)^{\text{th}}$ value and so on. We repeat this process until we reach the last set of k values. Each mean is placed against the mid point of the interval it covers. If k is odd, the moving averages correspond to the tabulated times for which the time series is given. On the other hand, when k is even, each moving average falls midway between two tabulated time values, hence a subsequent two item moving average is computed to make the resultant moving average values correspond to the given times (this is called centering). The moving averages are the trend values for the corresponding items

Method of Mathematical Curves

1. Straight Line Trend (Linear Trend)

$$T_t = a + b \cdot t, \quad b \neq 0$$

2. Second Degree Polynomial (Parabolic Trend)

$$T_t = a + b \cdot t + c \cdot t^2, \quad c \neq 0$$

3. Exponential Curve

$$T_t = a \cdot b^t, \quad a > 0$$

4. Modified Exponential Curve

$$T_t = k + a \cdot b^t, \quad k > 0$$

5. Gompertz

$$T_t = k \cdot a^{b^t}, \quad k > 0$$

Linear Trend

Y_t = observed value of the time series at time t

$T_t = a + b \cdot t$ (Estimated from the graphical representation)

Method of Least Squares

$$S = \sum_t (Y_t - T_t)^2$$

[To be minimised w.r.t. a and b]

$$S = \sum_t (Y_t - a - b \cdot t)^2$$

$$\therefore \frac{\delta S}{\delta a} = 0$$

$$\Rightarrow -2 \sum_t (Y_t - a - b \cdot t) = 0$$

$$\Rightarrow \sum_t Y_t = n \cdot a + b \sum_t t$$

..(1)

$$\therefore \frac{\delta S}{\delta b} = 0$$

$$\Rightarrow -2 \sum_t (Y_t - a - b \cdot t) \cdot t = 0$$

$$\Rightarrow \sum_t t \cdot Y_t = a \sum_t t + b \sum_t t^2$$

..(2)

eq 1 and 2 are called the **normal equations**

Second Degree Polynomial (Parabolic Trend)

$$T_t = a + b \cdot t + c \cdot t^2$$

$$S = \sum_t (Y_t - a - b \cdot t - c \cdot t^2)^2$$

[To be minimised w.r.t. a, b and c]

Exponential Curve

Here the trend eq is given by

$$Y_t = a \cdot b^t, \quad a, b > 0$$

$$\therefore \log Y_t = \log a + t \log b$$

i.e. $\log Y_t$ is a linear function of t

Note that $\frac{Y_t}{Y_{t-1}} = b$, i.e. the **exponential curve** indicates a constant ratio of change

Note : if $0 < b < 1$, the value of Y_t gradually decays but if $b > 1$, the value of Y_t gradually increases

Fitting an exponential curve Let the trend eq be

$$T_t = a \cdot b^t$$

$$\Rightarrow \log T_t = \log a + t \log b$$

$$Y'_t = A + Bt$$

where

$$[Y'_t = \log T_t, A = \log a, B = \log b]$$

The normal equations are,

$$\Rightarrow \sum_t Y'_t = n \cdot A + B \sum_t t$$

..(1)

$$\Rightarrow \sum_t t \cdot Y_t = A \sum_t t + B \sum_t t^2$$

..(2)

Let \hat{A} and \hat{B} be the estimates from (1) and (2),

$$\therefore \hat{A} = \log \hat{a}$$

$$\Rightarrow \hat{a} = e^{\hat{A}}$$

and

$$\therefore \hat{B} = \log \hat{b}$$

$$\Rightarrow \hat{b} = e^{\hat{B}}$$

Hence the fitted trend equation is given by,

$$T_t = \hat{a} \cdot \hat{b}^t$$

Modified Exponential Curve

The **modified exponential curve** indicates an increasing or decreasing ratio of change. The curve is given as

$$Y_t = k + ab^t$$

Note that $\Delta Y_t = Y_{t+1} - Y_t = a(b^{t+1} - b^t)$

$$\therefore \frac{\Delta Y_t}{\Delta Y_{t-1}} = \frac{a(b^{t+1} - b^t)}{a(b^t - b^{t-1})} = \frac{b^t(b-1)}{b^{t-1}(b-1)} = b$$

Hence $\frac{\Delta Y_t}{\Delta Y_{t-1}}$ is constant for a modified exponential curve.

Fitting of Modified Exponential Curve The curve has 3 constants, k, a and b . Thus we need 3 equations for fitting the curve. To do this, we use the method of partial sums. First, we divide the observed series Y_t into 3 equal sections. Let the number of observations in each section be n ; i.e. the first section goes from 1 to n , the second from $(n+1)$ to $2n$ and the last section goes from $(2n+1)$ to $3n$. The subtotals for each section are denoted as S_1, S_2 & S_3 respectively.

$$\begin{aligned}
\therefore S_1 &= \sum_{t=1}^n k + a \cdot b^t \\
&= nk + a \sum b^t \\
&= nk + a [b^1 + b^2 + \dots b^n] \\
&= nk + ab [1 + b^1 + \dots b^{n-1}] \\
&= nk + ab \frac{(b^n - 1)}{b - 1}
\end{aligned}$$

Similarly,

$$\begin{aligned}
S_2 &= \sum_{t=n+1}^{2n} nk + a \cdot b^t \\
&= nk + a \sum b^t \\
&= nk + a [b^{n+1} + b^{n+2} + \dots b^{2n}] \\
&= nk + ab^{n+1} [1 + b^1 + \dots b^{n-1}] \\
&= nk + ab^{n+1} \frac{(b^n - 1)}{b - 1}
\end{aligned}$$

$$\begin{aligned}
S_3 &= \sum_{t=2n+1}^{3n} nk + a \cdot b^t \\
&= nk + a \sum b^t \\
&= nk + a [b^{2n+1} + b^{2n+2} + \dots b^{3n}] \\
&= nk + ab^{2n+1} [1 + b^1 + \dots b^{n-1}] \\
&= nk + ab^{2n+1} \frac{(b^n - 1)}{b - 1}
\end{aligned}$$

$$\begin{aligned}
\therefore S_2 - S_1 &= nk + ab^{n+1} \left[\frac{b^n - 1}{b - 1} \right] - nk - ab \left[\frac{b^n - 1}{b - 1} \right] \\
&= ab^{n+1} \left[\frac{b^n - 1}{b - 1} \right] - ab \left[\frac{b^n - 1}{b - 1} \right] \\
&= [ab^{n+1} - ab] \left[\frac{b^n - 1}{b - 1} \right] \\
&= [ab \cdot (b^n - 1)] \left[\frac{b^n - 1}{b - 1} \right] \\
&= ab \frac{(b^n - 1)^2}{b - 1}
\end{aligned}$$