

# **Data Science II with python (Class notes)**

**STAT 303-2**

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# Preface

These are class notes for the course STAT303-2. This is not the course text-book. You are required to read the relevant sections of the book as mentioned on the course website.

The course notes are currently being written, and will continue to being developed as the course progresses (just like the course textbook last quarter). Please report any typos / mistakes / inconsistencies / issues with the class notes / class presentations in your comments [here](#). Thank you!

**Part I**

**Linear regression**

# 1 Simple Linear Regression

```
import pandas as pd
import numpy as np
import statsmodels.formula.api as smf
import seaborn as sns
import matplotlib.pyplot as plt
```

**Develop a simple linear regression model that predicts car price based on engine size.** Datasets to be used: *Car\_features\_train.csv*, *Car\_prices\_train.csv*

```
trainf = pd.read_csv('./Datasets/Car_features_train.csv')
trainp = pd.read_csv('./Datasets/Car_prices_train.csv')
train = pd.merge(trainf, trainp)
train.head()
```

	carID	brand	model	year	transmission	mileage	fuelType	tax	mpg	engineSize	price
0	18473	bmw	6 Series	2020	Semi-Auto	11	Diesel	145	53.3282	3.0	37980
1	15064	bmw	6 Series	2019	Semi-Auto	10813	Diesel	145	53.0430	3.0	33980
2	18268	bmw	6 Series	2020	Semi-Auto	6	Diesel	145	53.4379	3.0	36850
3	18480	bmw	6 Series	2017	Semi-Auto	18895	Diesel	145	51.5140	3.0	25998
4	18492	bmw	6 Series	2015	Automatic	62953	Diesel	160	51.4903	3.0	18990

```
#Using the ols function to create an ols object. 'ols' stands for 'Ordinary least squares'
ols_object = smf.ols(formula = 'price~engineSize', data = train)
```

```
#Using the fit() function of the 'ols' class to fit the model
model = ols_object.fit()
```

```
#Printing model summary which contains among other things, the model coefficients
model.summary()
```



Table 1.2: OLS Regression Results

Dep. Variable:	price	R-squared:	0.390
Model:	OLS	Adj. R-squared:	0.390
Method:	Least Squares	F-statistic:	3177.
Date:	Thu, 19 Jan 2023	Prob (F-statistic):	0.00
Time:	16:44:04	Log-Likelihood:	-53949.
No. Observations:	4960	AIC:	1.079e+05
Df Residuals:	4958	BIC:	1.079e+05
Df Model:	1		
Covariance Type:	nonrobust		

	coef	std err	t	P> t	[0.025	0.975]
Intercept	-4122.0357	522.260	-7.893	0.000	-5145.896	-3098.176
engineSize	1.299e+04	230.450	56.361	0.000	1.25e+04	1.34e+04

Omnibus:	1271.986	Durbin-Watson:	0.517
Prob(Omnibus):	0.000	Jarque-Bera (JB):	6490.719
Skew:	1.137	Prob(JB):	0.00
Kurtosis:	8.122	Cond. No.	7.64

The model equation is:  $\text{car price} = -4122.0357 + 12990 * \text{engineSize}$

### Visualize the regression line

```
sns.regplot(x = 'engineSize', y = 'price', data = train, color = 'orange', line_kws={"color": "red", "dash": [5, 5]})
plt.xlim(-1, 7)
#Note that some of the engineSize values are 0. They are incorrect, and should ideally be
```

(-1.0, 7.0)



**Predict the car price for the cars in the test dataset.** Datasets to be used:  
*Car\_features\_test.csv*, *Car\_prices\_test.csv*

```
testf = pd.read_csv('./Datasets/Car_features_test.csv')
testp = pd.read_csv('./Datasets/Car_prices_test.csv')
```

```
#Using the predict() function associated with the 'model' object to make predictions of car price
pred_price = model.predict(testf)#Note that the predict() function finds the predictor 'engineSize'
```

**Make a visualization that compares the predicted car prices with the actual car prices**

```
sns.scatterplot(x = testp.price, y = pred_price)
#In case of a perfect prediction, all the points must lie on the line x = y.
sns.lineplot(x = [0,testp.price.max()], y = [0,testp.price.max()],color='orange') #Plotting the line x = y
plt.xlabel('Actual price')
plt.ylabel('Predicted price')
```

```
Text(0, 0.5, 'Predicted price')
```



The prediction doesn't look too good. This is because we are just using one predictor - engine size. We can probably improve the model by adding more predictors when we learn multiple linear regression.

**What is the RMSE of the predicted car price?**

```
np.sqrt(((testp.price - pred_price)**2).mean())
```

```
12995.1064515487
```

The root mean squared error in predicting car price is around \$13k.

**What is the residual standard error based on the training data?**

```
np.sqrt(model.mse_resid)
```

```
12810.109175214136
```

The residual standard error on the training data is close to the RMSE on the test data. This shows that the performance of the model on unknown data is comparable to its performance

on known data. This implies that the model is not overfitting, which is good! In case we overfit a model on the training data, its performance on unknown data is likely to be worse than that on the training data.

### Find the confidence and prediction intervals of the predicted car price

```
#Using the get_prediction() function associated with the 'model' object to get the intervals
intervals = model.get_prediction(testf)

#The function requires specifying alpha (probability of Type 1 error) instead of the confidence level
intervals.summary_frame(alpha=0.05)
```

	mean	mean_se	mean_ci_lower	mean_ci_upper	obs_ci_lower	obs_ci_upper
0	34842.807319	271.666459	34310.220826	35375.393812	9723.677232	59961.937406
1	34842.807319	271.666459	34310.220826	35375.393812	9723.677232	59961.937406
2	34842.807319	271.666459	34310.220826	35375.393812	9723.677232	59961.937406
3	8866.245277	316.580850	8245.606701	9486.883853	-16254.905974	33987.396528
4	47831.088340	468.949360	46911.740050	48750.436631	22700.782946	72961.393735
...	...	...	...	...	...	...
2667	47831.088340	468.949360	46911.740050	48750.436631	22700.782946	72961.393735
2668	34842.807319	271.666459	34310.220826	35375.393812	9723.677232	59961.937406
2669	8866.245277	316.580850	8245.606701	9486.883853	-16254.905974	33987.396528
2670	21854.526298	184.135754	21493.538727	22215.513869	-3261.551421	46970.604017
2671	21854.526298	184.135754	21493.538727	22215.513869	-3261.551421	46970.604017

Show the regression line predicting car price based on engine size for test data. Also show the confidence and prediction intervals for the car price.

```
interval_table = intervals.summary_frame(alpha=0.05)

sns.scatterplot(x = testf.engineSize, y = pred_price,color = 'orange', s = 10)
sns.lineplot(x = testf.engineSize, y = pred_price, color = 'red')
sns.lineplot(x = testf.engineSize, y = interval_table.mean_ci_lower, color = 'blue')
sns.lineplot(x = testf.engineSize, y = interval_table.mean_ci_upper, color = 'blue',label='Confidence interval')
sns.lineplot(x = testf.engineSize, y = interval_table.obs_ci_lower, color = 'green')
sns.lineplot(x = testf.engineSize, y = interval_table.obs_ci_upper, color = 'green')
plt.legend(labels=["Regression line","Confidence interval", "Prediction interval"])
```

<matplotlib.legend.Legend at 0x26a3a32c550>



## 2 Multiple Linear Regression

```
import pandas as pd
import numpy as np
import statsmodels.formula.api as smf
import seaborn as sns
import matplotlib.pyplot as plt
```

Develop a multiple linear regression model that predicts car price based on engine size, year, mileage, and mpg. Datasets to be used: *Car\_features\_train.csv*, *Car\_prices\_train.csv*

```
trainf = pd.read_csv('./Datasets/Car_features_train.csv')
trainp = pd.read_csv('./Datasets/Car_prices_train.csv')
train = pd.merge(trainf, trainp)
train.head()
```

	carID	brand	model	year	transmission	mileage	fuelType	tax	mpg	engineSize	price
0	18473	bmw	6 Series	2020	Semi-Auto	11	Diesel	145	53.3282	3.0	37980
1	15064	bmw	6 Series	2019	Semi-Auto	10813	Diesel	145	53.0430	3.0	33980
2	18268	bmw	6 Series	2020	Semi-Auto	6	Diesel	145	53.4379	3.0	36850
3	18480	bmw	6 Series	2017	Semi-Auto	18895	Diesel	145	51.5140	3.0	25998
4	18492	bmw	6 Series	2015	Automatic	62953	Diesel	160	51.4903	3.0	18990

```
#Using the ols function to create an ols object. 'ols' stands for 'Ordinary least squares'
ols_object = smf.ols(formula = 'price~year+mileage+mpg+engineSize', data = train)
model = ols_object.fit()
model.summary()
```

Table 2.2: OLS Regression Results

Dep. Variable:	price	R-squared:	0.660
Model:	OLS	Adj. R-squared:	0.660
Method:	Least Squares	F-statistic:	2410.

Table 2.2: OLS Regression Results

Date:	Tue, 27 Dec 2022	Prob (F-statistic):	0.00
Time:	01:07:25	Log-Likelihood:	-52497.
No. Observations:	4960	AIC:	1.050e+05
Df Residuals:	4955	BIC:	1.050e+05
Df Model:	4		
Covariance Type:	nonrobust		

	coef	std err	t	P> t	[0.025	0.975]
Intercept	-3.661e+06	1.49e+05	-24.593	0.000	-3.95e+06	-3.37e+06
year	1817.7366	73.751	24.647	0.000	1673.151	1962.322
mileage	-0.1474	0.009	-16.817	0.000	-0.165	-0.130
mpg	-79.3126	9.338	-8.493	0.000	-97.620	-61.006
engineSize	1.218e+04	189.969	64.107	0.000	1.18e+04	1.26e+04

Omnibus:	2450.973	Durbin-Watson:	0.541
Prob(Omnibus):	0.000	Jarque-Bera (JB):	31060.548
Skew:	2.045	Prob(JB):	0.00
Kurtosis:	14.557	Cond. No.	3.83e+07

The model equation is: estimated car price = -3.661e6 + 1818 \* year -0.15 \* mileage - 79.31 \* mpg + 12180 \* engineSize

**Predict the car price for the cars in the test dataset.** Datasets to be used: *Car\_features\_test.csv*, *Car\_prices\_test.csv*

```
testf = pd.read_csv('./Datasets/Car_features_test.csv')
testp = pd.read_csv('./Datasets/Car_prices_test.csv')
```

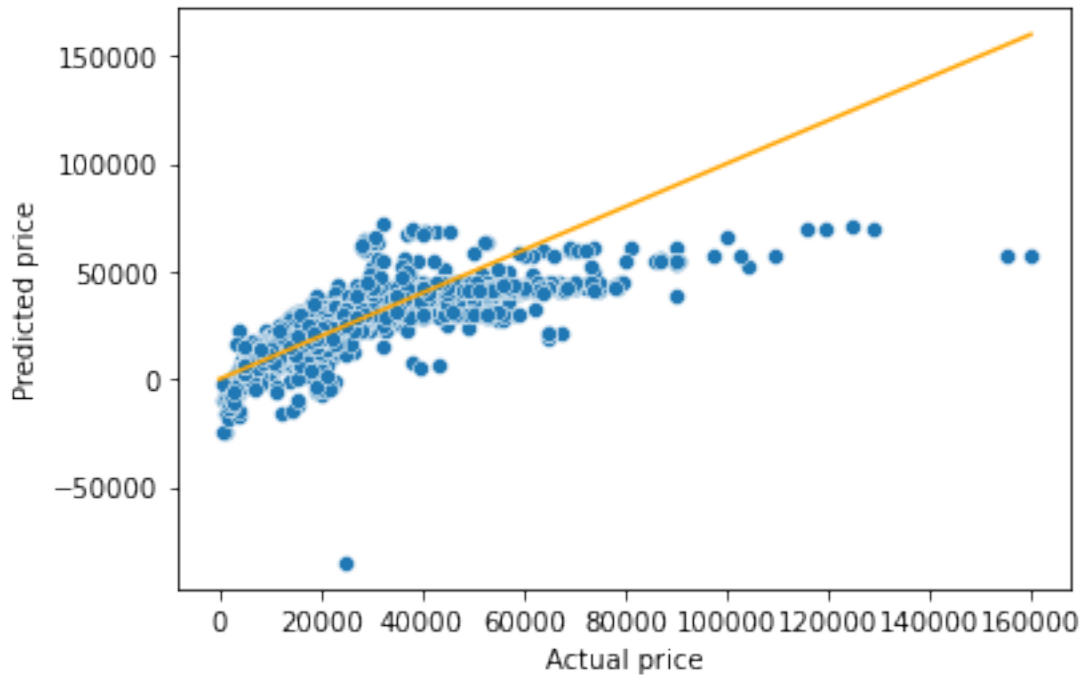
```
#Using the predict() function associated with the 'model' object to make predictions of car price
pred_price = model.predict(testf)#Note that the predict() function finds the predictor 'engineSize'
```

**Make a visualization that compares the predicted car prices with the actual car prices**

```
sns.scatterplot(x = testp.price, y = pred_price)
#In case of a perfect prediction, all the points must lie on the line x = y.
sns.lineplot(x = [0,testp.price.max()], y = [0,testp.price.max()],color='orange') #Plotting the line x = y
```

```
plt.xlabel('Actual price')
plt.ylabel('Predicted price')
```

```
Text(0, 0.5, 'Predicted price')
```



The prediction looks better as compared to the one with simple linear regression. This is because we have four predictors to help explain the variation in car price, instead of just one in the case of simple linear regression. Also, all the predictors have a significant relationship with price as evident from their p-values. Thus, all four of them are contributing in explaining the variation. Note the higher values of R2 as compared to the one in the case of simple linear regression.

**What is the RMSE of the predicted car price?**

```
np.sqrt(((testp.price - pred_price)**2).mean())
```

9956.82497993548

**What is the residual standard error based on the training data?**

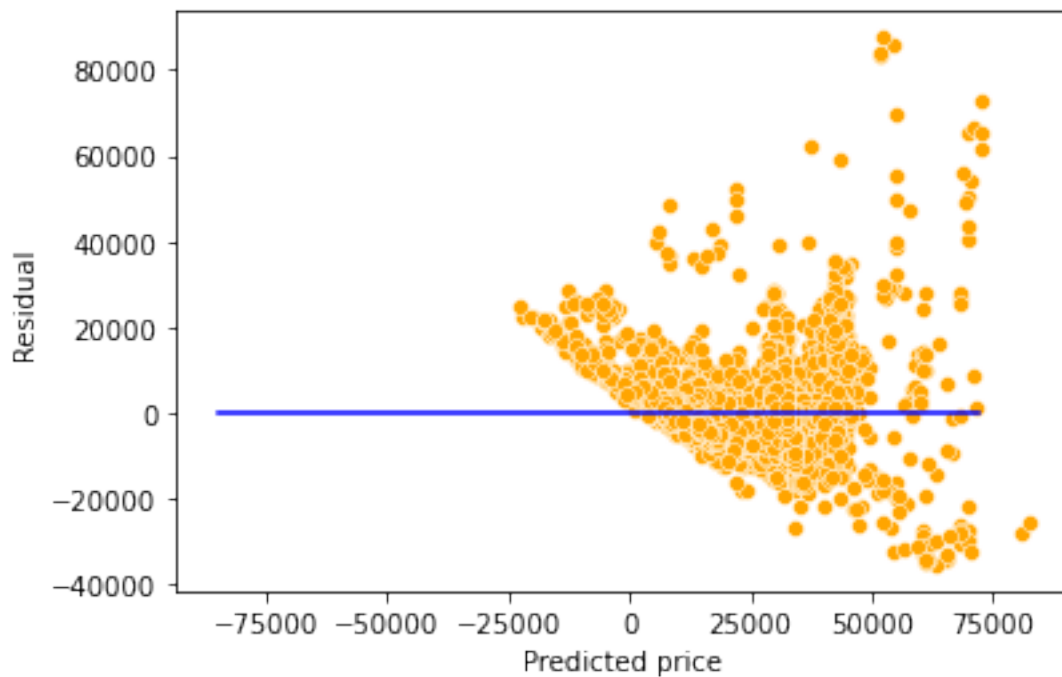


```
np.sqrt(model.mse_resid)
```

9563.74782917604

```
sns.scatterplot(x = model.fittedvalues, y=model.resid,color = 'orange')
sns.lineplot(x = [pred_price.min(),pred_price.max()],y = [0,0],color = 'blue')
plt.xlabel('Predicted price')
plt.ylabel('Residual')
```

```
Text(0, 0.5, 'Residual')
```



Will the explained variation (R-squared) in car price always increase if we add a variable?

Should we keep on adding variables as long as the explained variation (R-squared) is increasing?

```
#Using the ols function to create an ols object. 'ols' stands for 'Ordinary least squares'
np.random.seed(1)
```

```

train['rand_col'] = np.random.rand(train.shape[0])
ols_object = smf.ols(formula = 'price~year+mileage+mpg+engineSize+rand_col', data = train)
model = ols_object.fit()
model.summary()

```

Table 2.5: OLS Regression Results

Dep. Variable:	price	R-squared:	0.661
Model:	OLS	Adj. R-squared:	0.660
Method:	Least Squares	F-statistic:	1928.
Date:	Tue, 27 Dec 2022	Prob (F-statistic):	0.00
Time:	01:07:38	Log-Likelihood:	-52497.
No. Observations:	4960	AIC:	1.050e+05
Df Residuals:	4954	BIC:	1.050e+05
Df Model:	5		
Covariance Type:	nonrobust		

	coef	std err	t	P> t	[0.025	0.975]
Intercept	-3.662e+06	1.49e+05	-24.600	0.000	-3.95e+06	-3.37e+06
year	1818.1672	73.753	24.652	0.000	1673.578	1962.756
mileage	-0.1474	0.009	-16.809	0.000	-0.165	-0.130
mpg	-79.2837	9.338	-8.490	0.000	-97.591	-60.976
engineSize	1.218e+04	189.972	64.109	0.000	1.18e+04	1.26e+04
rand_col	451.1226	471.897	0.956	0.339	-474.004	1376.249

Omnibus:	2451.728	Durbin-Watson:	0.541
Prob(Omnibus):	0.000	Jarque-Bera (JB):	31040.331
Skew:	2.046	Prob(JB):	0.00
Kurtosis:	14.552	Cond. No.	3.83e+07

Adding a variable with random values to the model (*rand\_col*) increased the explained variation (R-squared). This is because the model has one more parameter to tune to reduce the residual squared error (RSS). However, the p-value of *rand\_col* suggests that its coefficient is zero. Thus, using the model with *rand\_col* may give poorer performance on unknown data, as compared to the model without *rand\_col*. This implies that it is not a good idea to blindly add variables in the model to increase R-squared.

## 3 Variable interactions and transformations

```
import pandas as pd
import numpy as np
import statsmodels.formula.api as smf
import seaborn as sns
import matplotlib.pyplot as plt

trainf = pd.read_csv('./Datasets/Car_features_train.csv')
trainp = pd.read_csv('./Datasets/Car_prices_train.csv')
testf = pd.read_csv('./Datasets/Car_features_test.csv')
testp = pd.read_csv('./Datasets/Car_prices_test.csv')
train = pd.merge(trainf, trainp)
train.head()
```

	carID	brand	model	year	transmission	mileage	fuelType	tax	mpg	engineSize	price
0	18473	bmw	6 Series	2020	Semi-Auto	11	Diesel	145	53.3282	3.0	37980
1	15064	bmw	6 Series	2019	Semi-Auto	10813	Diesel	145	53.0430	3.0	33980
2	18268	bmw	6 Series	2020	Semi-Auto	6	Diesel	145	53.4379	3.0	36850
3	18480	bmw	6 Series	2017	Semi-Auto	18895	Diesel	145	51.5140	3.0	25998
4	18492	bmw	6 Series	2015	Automatic	62953	Diesel	160	51.4903	3.0	18990

Until now, we have assumed that the association between a predictor  $X_j$  and response  $Y$  does not depend on the value of other predictors. For example, the multiple linear regression model that we developed in Chapter 2 assumes that the average increase in price associated with a unit increase in `engineSize` is always \$12,180, regardless of the value of other predictors. However, this assumption may be incorrect.

### 3.0.1 Variable interaction between continuous predictors

We can relax this assumption by considering another predictor, called an interaction term. Let us assume that the average increase in `price` associated with a one-unit increase in `engineSize` depends on the model `year` of the car. In other words, there is an interaction between `engineSize` and `year`. This interaction can be included as a predictor, which is the

product of `engineSize` and `year`. Note that there are several possible interactions that we can consider. Here the interaction between `engineSize` and `year` is just an example.

```
#Considering interaction between engineSize and year
ols_object = smf.ols(formula = 'price~year*engineSize+mileage+mpg', data = train)
model = ols_object.fit()
model.summary()
```

Table 3.2: OLS Regression Results

Dep. Variable:	price	R-squared:	0.682
Model:	OLS	Adj. R-squared:	0.681
Method:	Least Squares	F-statistic:	2121.
Date:	Tue, 24 Jan 2023	Prob (F-statistic):	0.00
Time:	15:28:11	Log-Likelihood:	-52338.
No. Observations:	4960	AIC:	1.047e+05
Df Residuals:	4954	BIC:	1.047e+05
Df Model:	5		
Covariance Type:	nonrobust		

	coef	std err	t	P> t	[0.025	0.975]
Intercept	5.606e+05	2.74e+05	2.048	0.041	2.4e+04	1.1e+06
year	-275.3833	135.695	-2.029	0.042	-541.405	-9.361
engineSize	-1.796e+06	9.97e+04	-18.019	0.000	-1.99e+06	-1.6e+06
year:engineSize	896.7687	49.431	18.142	0.000	799.861	993.676
mileage	-0.1525	0.008	-17.954	0.000	-0.169	-0.136
mpg	-84.3417	9.048	-9.322	0.000	-102.079	-66.604

Omnibus:	2330.413	Durbin-Watson:	0.524
Prob(Omnibus):	0.000	Jarque-Bera (JB):	29977.437
Skew:	1.908	Prob(JB):	0.00
Kurtosis:	14.423	Cond. No.	7.66e+07

Note that the R-squared has increased as compared to the model in Chapter 2 since we added a predictor.

The model equation is:

$$price = \beta_0 + \beta_1 * year + \beta_2 * engineSize + \beta_3 * (year * engineSize) + \beta_4 * mileage + \beta_5 * mpg, \quad (3.1)$$

or

$$price = \beta_0 + \beta_1 * year + (\beta_2 + \beta_3 * year) * engineSize + \beta_4 * mileage + \beta_5 * mpg, \quad (3.2)$$

or

$$price = \beta_0 + \beta_1 * year + \tilde{\beta} * engineSize + \beta_4 * mileage + \beta_5 * mpg, \quad (3.3)$$

Since  $\tilde{\beta}$  is a function of **year**, the association between **engineSize** and **price** is no longer a constant. A change in the value of **year** will change the association between **price** and **engineSize**.

Substituting the values of the coefficients:

$$price = 5.606e5 - 275.3833 * year + (-1.796e6 + 896.7687 * year) * engineSize - 0.1525 * mileage - 84.3417 * mpg \quad (3.4)$$

Thus, for cars launched in the year 2010, the average increase in price for one liter increase in engine size is  $-1.796e6 + 896.7687 * 2010 \approx \$6,500$ , assuming all the other predictors are constant. However, for cars launched in the year 2020, the average increase in price for one liter increase in engine size is  $-1.796e6 + 896.7687 * 2020 \approx \$15,500$ , assuming all the other predictors are constant.

Similarly, the equation can be re-arranged as:

$$price = 5.606e5 + (-275.3833 + 896.7687 * engineSize) * year - 1.796e6 * engineSize - 0.1525 * mileage - 84.3417 * mpg \quad (3.5)$$

Thus, for cars with an engine size of 2 litres, the average increase in price for a one year newer model is  $-275.3833 + 896.7687 * 2 \approx \$1500$ , assuming all the other predictors are constant. However, for cars with an engine size of 3 litres, the average increase in price for a one year newer model is  $-275.3833 + 896.7687 * 3 \approx \$2400$ , assuming all the other predictors are constant.

```
#Computing the RMSE of the model with the interaction term
pred_price = model.predict(testf)
np.sqrt(((testp.price - pred_price)**2).mean())
```

9423.598872501092

Note that the RMSE is lower than that of the model in Chapter 2. This is because the interaction term between `engineSize` and `year` is significant and relaxes the assumption of constant association between price and engine size, and between price and year. This added flexibility makes the model better fit the data. Caution: Too much flexibility may lead to overfitting!

Note that interaction terms corresponding to other variable pairs, and higher order interaction terms (such as those containing 3 or 4 variables) may also be significant and improve the model fit & thereby the prediction accuracy of the model.

### 3.0.2 Including qualitative predictors in the model

Let us develop a model for predicting `price` based on `engineSize` and the qualitative predictor `transmission`.

```
#checking the distribution of values of transmission
train.transmission.value_counts()
```

```
Manual      1948
Automatic   1660
Semi-Auto   1351
Other        1
Name: transmission, dtype: int64
```

Note that the *Other* category of the variable *transmission* contains only a single observation, which is likely to be insufficient to train the model. We'll remove that observation from the training data. Another option may be to combine the observation in the *Other* category with the nearest category, and keep it in the data.

```
train_updated = train[train.transmission!='Other']

ols_object = smf.ols(formula = 'price~engineSize+transmission', data = train_updated)
model = ols_object.fit()
model.summary()
```

Table 3.5: OLS Regression Results

Dep. Variable:	price	R-squared:	0.459
Model:	OLS	Adj. R-squared:	0.458
Method:	Least Squares	F-statistic:	1400.

Table 3.5: OLS Regression Results

Date:	Tue, 24 Jan 2023	Prob (F-statistic):	0.00
Time:	15:28:21	Log-Likelihood:	-53644.
No. Observations:	4959	AIC:	1.073e+05
Df Residuals:	4955	BIC:	1.073e+05
Df Model:	3		
Covariance Type:	nonrobust		

	coef	std err	t	P> t	[0.025	0.975]
Intercept	3042.6765	661.190	4.602	0.000	1746.451	4338.902
transmission[T.Manual]	-6770.6165	442.116	-15.314	0.000	-7637.360	-5903.873
transmission[T.Semi-Auto]	4994.3112	442.989	11.274	0.000	4125.857	5862.765
engineSize	1.023e+04	247.485	41.323	0.000	9741.581	1.07e+04

Omnibus:	1575.518	Durbin-Watson:	0.579
Prob(Omnibus):	0.000	Jarque-Bera (JB):	11006.609
Skew:	1.334	Prob(JB):	0.00
Kurtosis:	9.793	Cond. No.	11.4

Note that there is no coefficient for the *Automatic* level of the variable **Transmission**. If a car doesn't have *Manual* or *Semi-Automatic* transmission, then it has an *Automatic* transmission. Thus, the coefficient of *Automatic* will be redundant, and the dummy variable corresponding to *Automatic* transmission is dropped from the model.

The level of the categorical variable that is dropped from the model is called the baseline level. Here *Automatic* transmission is the baseline level. The coefficients of other levels of **transmission** should be interpreted with respect to the baseline level.

**Q:** Interpret the intercept term

**Ans:** For the hypothetical scenario of a car with zero engine size and *Automatic* transmission, the estimated mean car price is  $\approx \$3042$ .

**Q:** Interpret the coefficient of **transmission[T.Manual]**

**Ans:** The estimated mean price of a car with manual transmission is  $\approx \$6770$  less than that of a car with *Automatic* transmission.

Let us visualize the developed model.

```

#Visualizing the developed model
plt.rcParams["figure.figsize"] = (9,6)
sns.set(font_scale = 1.3)
x = np.linspace(train_updated.engineSize.min(),train_updated.engineSize.max(),100)
ax = sns.lineplot(x = x, y = model.params['engineSize']*x+model.params['Intercept'], color='red')
sns.lineplot(x = x, y = model.params['engineSize']*x+model.params['Intercept']+model.params['Automatic'], color='blue')
sns.lineplot(x = x, y = model.params['engineSize']*x+model.params['Intercept']+model.params['Manual'], color='green')
plt.legend(labels=["Automatic","Semi-Automatic", "Manual"])
plt.xlabel('Engine size (in litre)')
plt.ylabel('Predicted car price')
ax.yaxis.set_major_formatter('${x:,.0f}')

```



Based on the developed model, for a given engine size, the car with a semi-automatic transmission is estimated to be the most expensive on average, while the car with a manual transmission is estimated to be the least expensive on average.

**Changing the baseline level:** By default, the baseline level is chosen as the one that comes first if the levels are arranged in alphabetical order. However, you can change the baseline level by specifying one explicitly.



Internally, statsmodels uses the patsy package to convert formulas and data to the matrices that are used in model fitting. You may refer to this [section](#) in the patsy documentation to specify a particular level of the categorical variable as the baseline.

For example, suppose we wish to change the baseline level to *Manual* transmission. We can specify this in the formula as follows:

```
ols_object = smf.ols(formula = 'price~engineSize+C(transmission, Treatment("Manual"))', data = data)
model = ols_object.fit()
model.summary()
```

Table 3.8: OLS Regression Results

Dep. Variable:	price	R-squared:	0.459
Model:	OLS	Adj. R-squared:	0.458
Method:	Least Squares	F-statistic:	1400.
Date:	Tue, 24 Jan 2023	Prob (F-statistic):	0.00
Time:	15:28:39	Log-Likelihood:	-53644.
No. Observations:	4959	AIC:	1.073e+05
Df Residuals:	4955	BIC:	1.073e+05
Df Model:	3		
Covariance Type:	nonrobust		

	coef	std err	t	P> t	[0.025	0.975
Intercept	-3727.9400	492.917	-7.563	0.000	-4694.275	-2761.605
C(transmission, Treatment("Manual"))[T.Automatic]	6770.6165	442.116	15.314	0.000	5903.873	7637.359
C(transmission, Treatment("Manual"))[T.Semi-Auto]	1.176e+04	473.110	24.867	0.000	1.08e+04	1.27e+04
engineSize	1.023e+04	247.485	41.323	0.000	9741.581	10518.419

Omnibus:	1575.518	Durbin-Watson:	0.579
Prob(Omnibus):	0.000	Jarque-Bera (JB):	11006.609
Skew:	1.334	Prob(JB):	0.00
Kurtosis:	9.793	Cond. No.	8.62

### 3.0.3 Including qualitative predictors and their interaction with continuous predictors in the model

Note that the qualitative predictor leads to fitting 3 parallel lines to the data, as there are 3 categories.

However, note that we have made the constant association assumption. The fact that the lines are parallel means that the average increase in car price for one litre increase in engine size does not depend on the type of transmission. This represents a potentially serious limitation of the model, since in fact a change in engine size may have a very different association on the price of an automatic car versus a semi-automatic or manual car.

This limitation can be addressed by adding an interaction variable, which is the product of **engineSize** and the dummy variables for semi-automatic and manual transmissions.

```
#Using the ols function to create an ols object. 'ols' stands for 'Ordinary least squares'
ols_object = smf.ols(formula = 'price~engineSize*transmission', data = train_updated)
model = ols_object.fit()
model.summary()
```

Table 3.11: OLS Regression Results

Dep. Variable:	price	R-squared:	0.479
Model:	OLS	Adj. R-squared:	0.478
Method:	Least Squares	F-statistic:	909.9
Date:	Sun, 22 Jan 2023	Prob (F-statistic):	0.00
Time:	22:55:55	Log-Likelihood:	-53550.
No. Observations:	4959	AIC:	1.071e+05
Df Residuals:	4953	BIC:	1.072e+05
Df Model:	5		
Covariance Type:	nonrobust		

	coef	std err	t	P> t	[0.025	0.975]
Intercept	3754.7238	895.221	4.194	0.000	1999.695	5509.753
transmission[T.Manual]	1768.5856	1294.071	1.367	0.172	-768.366	4305.538
transmission[T.Semi-Auto]	-5282.7164	1416.472	-3.729	0.000	-8059.628	-2505.805
engineSize	9928.6082	354.511	28.006	0.000	9233.610	1.06e+04
engineSize:transmission[T.Manual]	-5285.9059	646.175	-8.180	0.000	-6552.695	-4019.117
engineSize:transmission[T.Semi-Auto]	4162.2428	552.597	7.532	0.000	3078.908	5245.578

Omnibus:	1379.846	Durbin-Watson:	0.622
Prob(Omnibus):	0.000	Jarque-Bera (JB):	9799.471
Skew:	1.139	Prob(JB):	0.00
Kurtosis:	9.499	Cond. No.	30.8

The model equation for the model with interactions is:

Automatic transmission:  $price = 3754.7238 + 9928.6082 * engineSize$ ,  
 Semi-Automatic transmission:  $price = 3754.7238 + 9928.6082 * engineSize + (-5282.7164 + 4162.2428 * engineSize)$ ,  
 Manual transmission:  $price = 3754.7238 + 9928.6082 * engineSize + (1768.5856 - 5285.9059 * engineSize)$ , or

Automatic transmission:  $price = 3754.7238 + 9928.6082 * engineSize$ ,  
 Semi-Automatic transmission:  $price = -1527 + 7046 * engineSize$ ,  
 Manual transmission:  $price = 5523 + 4642 * engineSize$ ,

**Q:** Interpret the coefficient of manual transmission, i.e., the coefficient of `transmission[T.Manual]`.

**A:** For a given engine size, the estimated mean **price** of a car with *Manual* transmission is  $\approx$   $\backslash$ \$1768 more than the estimated mean **price** of a car with *Automatic* transmission.

**Q:** Interpret the coefficient of the interaction between engine size and manual transmission, i.e., the coefficient of `engineSize:transmission[T.Manual]`.

**A:** For a unit (or a litre) increase in `engineSize`, the increase in estimated mean **price** of a car with *Manual* transmission is  $\approx$   $\backslash$ \$5285 less than the increase in estimated mean **price** of a car with *Automatic* transmission.

```
#Visualizing the developed model with interaction terms
plt.rcParams["figure.figsize"] = (9,6)
sns.set(font_scale = 1.3)
x = np.linspace(train_updated.engineSize.min(),train_updated.engineSize.max(),100)
ax = sns.lineplot(x = x, y = model.params['engineSize']*x+model.params['Intercept'], label
plt.plot(x, (model.params['engineSize']+model.params['engineSize:transmission[T.Semi-Auto]
plt.plot(x, (model.params['engineSize']+model.params['engineSize:transmission[T.Manual]'))
plt.legend(loc='upper left')
plt.xlabel('Engine size (in litre)')
plt.ylabel('Predicted car price')
ax.yaxis.set_major_formatter('${x:,.0f}')
```



Note the interaction term adds flexibility to the model.

The slope of the regression line for semi-automatic cars is the largest. This suggests that increase in engine size is associated with a higher increase in car price for semi-automatic cars, as compared to other cars.

### 3.1 Variable transformations

So far we have considered only a linear relationship between the predictors and the response. However, the relationship may be non-linear.

Consider the regression plot of `price` on `mileage`.

```
ax = sns.regplot(x = train_updated.mileage, y =train_updated.price,color = 'orange', line_
plt.xlabel('Mileage')
plt.ylabel('Predicted car price')
ax.yaxis.set_major_formatter('${x:,.0f}')
ax.xaxis.set_major_formatter('{x:,.0f}')
```



```
#R-squared of the model with just mileage
model = smf.ols('price~mileage', data = train_updated).fit()
model.rsquared
```

0.22928048993376182

From the first scatterplot, we see that the relationship between `price` and `mileage` doesn't seem to be linear, as the points do not lie on a straight line. Also, we see the regression line (or the curve), which is the best fit line doesn't seem to fit the points well. However, `price` on average seems to decrease with `mileage`, albeit in a non-linear manner.

### 3.1.1 Quadratic transformation

So, we guess that if we model price as a quadratic function of `mileage`, the model may better fit the points (or the curve may better fit the points). Let us transform the predictor `mileage` to include  $mileage^2$  (i.e., perform a quadratic transformation on the predictor).

```
#Including mileage squared as a predictor and developing the model
ols_object = smf.ols(formula = 'price~mileage+I(mileage**2)', data = train_updated)
model = ols_object.fit()
model.summary()
```

Table 3.14: OLS Regression Results

Dep. Variable:	price	R-squared:	0.271
Model:	OLS	Adj. R-squared:	0.271
Method:	Least Squares	F-statistic:	920.6
Date:	Sun, 22 Jan 2023	Prob (F-statistic):	0.00
Time:	23:26:05	Log-Likelihood:	-54382.
No. Observations:	4959	AIC:	1.088e+05
Df Residuals:	4956	BIC:	1.088e+05
Df Model:	2		
Covariance Type:	nonrobust		

	coef	std err	t	P> t	[0.025	0.975]
Intercept	3.44e+04	332.710	103.382	0.000	3.37e+04	3.5e+04
mileage	-0.5662	0.017	-33.940	0.000	-0.599	-0.534
I(mileage ** 2)	2.629e-06	1.56e-07	16.813	0.000	2.32e-06	2.94e-06

Omnibus:	2362.973	Durbin-Watson:	0.325
Prob(Omnibus):	0.000	Jarque-Bera (JB):	22427.952
Skew:	2.052	Prob(JB):	0.00
Kurtosis:	12.576	Cond. No.	4.81e+09

Note that in the formula specified within the `ols()` function, the `I()` operator isolates or insulates the contents within `I(...)` from the regular formula operators. Without the `I()` operator, `mileage**2` will be treated as the interaction of `mileage` with itself, which is `mileage`. Thus, to add the square of `mileage` as a separate predictor, we need to use the `I()` operator.

Let us visualize the model fit with the quadratic transformation of the predictor - `mileage`.

```
#Visualizing the regression line with the model consisting of the quadratic transformation
pred_price = model.predict(train_updated)
ax = sns.scatterplot(x = 'mileage', y = 'price', data = train_updated, color = 'orange')
sns.lineplot(x = train_updated.mileage, y = pred_price, color = 'blue')
plt.xlabel('Mileage')
```

```
plt.ylabel('Predicted car price')
ax.yaxis.set_major_formatter('${x:,.0f}')
ax.xaxis.set_major_formatter('{x:,.0f}')
```



The above model seems to better fit the data (as compared to the model without transformation) at least upto mileage around 125,000. The  $R^2$  of the model with the quadratic transformation of mileage is also higher than that of the model without transformation indicating a better fit.

### 3.1.2 Cubic transformation

Let us see if a cubic transformation of mileage can further improve the model fit.

```
#Including mileage squared and mileage cube as predictors and developing the model
ols_object = smf.ols(formula = 'price~mileage+I(mileage**2)+I(mileage**3)', data = train_u
model = ols_object.fit()
model.summary()
```

Table 3.17: OLS Regression Results

Dep. Variable:	price	R-squared:	0.283
Model:	OLS	Adj. R-squared:	0.283
Method:	Least Squares	F-statistic:	652.3
Date:	Sun, 22 Jan 2023	Prob (F-statistic):	0.00
Time:	23:33:27	Log-Likelihood:	-54340.
No. Observations:	4959	AIC:	1.087e+05
Df Residuals:	4955	BIC:	1.087e+05
Df Model:	3		
Covariance Type:	nonrobust		

	coef	std err	t	P> t	[0.025	0.975]
Intercept	3.598e+04	371.926	96.727	0.000	3.52e+04	3.67e+04
mileage	-0.7742	0.028	-27.634	0.000	-0.829	-0.719
I(mileage ** 2)	6.875e-06	4.87e-07	14.119	0.000	5.92e-06	7.83e-06
I(mileage ** 3)	-1.823e-11	1.98e-12	-9.199	0.000	-2.21e-11	-1.43e-11

Omnibus:	2380.788	Durbin-Watson:	0.321
Prob(Omnibus):	0.000	Jarque-Bera (JB):	23039.307
Skew:	2.065	Prob(JB):	0.00
Kurtosis:	12.719	Cond. No.	7.73e+14

```
#Visualizing the model with the cubic transformation of mileage
pred_price = model.predict(train_updated)
ax = sns.scatterplot(x = 'mileage', y = 'price', data = train_updated, color = 'orange')
sns.lineplot(x = train_updated.mileage, y = pred_price, color = 'blue')
plt.xlabel('Mileage')
plt.ylabel('Predicted car price')
ax.yaxis.set_major_formatter('${x:,.0f}')
ax.xaxis.set_major_formatter('{x:,.0f}')
```





Note that the model fit with the cubic transformation of `mileage` seems slightly better as compared to the models with the quadratic transformation, and no transformation of `mileage`, for mileage up to 180k. However, the model should not be used to predict car prices of cars with a mileage higher than 180k.

Let's update the model created earlier (in the beginning of this chapter) to include the transformed predictor.

```
#Model with an interaction term and a variable transformation term
ols_object = smf.ols(formula = 'price~year*engineSize+mileage+mpg+I(mileage**2)', data = t
model = ols_object.fit()
model.summary()
```

Table 3.20: OLS Regression Results

Dep. Variable:	price	R-squared:	0.702
Model:	OLS	Adj. R-squared:	0.702
Method:	Least Squares	F-statistic:	1947.
Date:	Sun, 22 Jan 2023	Prob (F-statistic):	0.00
Time:	23:42:13	Log-Likelihood:	-52162.

Table 3.20: OLS Regression Results

No. Observations:	4959	AIC:	1.043e+05
Df Residuals:	4952	BIC:	1.044e+05
Df Model:	6		
Covariance Type:	nonrobust		

	coef	std err	t	P> t	[0.025	0.975]
Intercept	1.53e+06	2.7e+05	5.671	0.000	1e+06	2.06e+06
year	-755.7419	133.791	-5.649	0.000	-1018.031	-493.453
engineSize	-2.022e+06	9.72e+04	-20.803	0.000	-2.21e+06	-1.83e+06
year:engineSize	1008.6993	48.196	20.929	0.000	914.215	1103.184
mileage	-0.3548	0.014	-25.973	0.000	-0.382	-0.328
mpg	-54.7450	8.896	-6.154	0.000	-72.185	-37.305
I(mileage ** 2)	1.926e-06	1.04e-07	18.536	0.000	1.72e-06	2.13e-06

Omnibus:	2355.448	Durbin-Watson:	0.562
Prob(Omnibus):	0.000	Jarque-Bera (JB):	38317.404
Skew:	1.857	Prob(JB):	0.00
Kurtosis:	16.101	Cond. No.	6.40e+12

Note that the R-squared has increased as compared to the model with just the interaction term.

```
#Computing RMSE on test data
pred_price = model.predict(testf)
np.sqrt(((testp.price - pred_price)**2).mean())
```

9074.494088619422

Note that the prediction accuracy of the model has further increased, as the RMSE has reduced. The transformed predictor is statistically significant and provides additional flexibility to better capture the trend in the data, leading to an increase in prediction accuracy.

## 4 Model assumptions

*Note that in this course, lecture notes are not sufficient, you must read the book for better understanding. Lecture notes are just implementing the concepts of the book on a dataset, but not explaining the concepts elaborately.*

Consider the model with interactions and transformation developed previously.

```
import pandas as pd
import numpy as np
import statsmodels.formula.api as smf
import seaborn as sns
import matplotlib.pyplot as plt

trainf = pd.read_csv('./Datasets/Car_features_train.csv')
trainp = pd.read_csv('./Datasets/Car_prices_train.csv')
testf = pd.read_csv('./Datasets/Car_features_test.csv')
testp = pd.read_csv('./Datasets/Car_prices_test.csv')
train = pd.merge(trainf, trainp)
train.head()
```

	carID	brand	model	year	transmission	mileage	fuelType	tax	mpg	engineSize	price
0	18473	bmw	6 Series	2020	Semi-Auto	11	Diesel	145	53.3282	3.0	37980
1	15064	bmw	6 Series	2019	Semi-Auto	10813	Diesel	145	53.0430	3.0	33980
2	18268	bmw	6 Series	2020	Semi-Auto	6	Diesel	145	53.4379	3.0	36850
3	18480	bmw	6 Series	2017	Semi-Auto	18895	Diesel	145	51.5140	3.0	25998
4	18492	bmw	6 Series	2015	Automatic	62953	Diesel	160	51.4903	3.0	18990

```
ols_object = smf.ols(formula = 'price~(year+engineSize+mileage+mpg)**2+I(mileage**2)', data=train)
model = ols_object.fit()
model.summary()
```

Table 4.2: OLS Regression Results

Dep. Variable:	price	R-squared:	0.732
Model:	OLS	Adj. R-squared:	0.731
Method:	Least Squares	F-statistic:	1229.
Date:	Wed, 25 Jan 2023	Prob (F-statistic):	0.00
Time:	11:36:00	Log-Likelihood:	-51911.
No. Observations:	4960	AIC:	1.038e+05
Df Residuals:	4948	BIC:	1.039e+05
Df Model:	11		
Covariance Type:	nonrobust		

	coef	std err	t	P> t	[0.025	0.975]
Intercept	-1.282e+06	7.14e+05	-1.795	0.073	-2.68e+06	1.18e+05
year	632.3954	353.865	1.787	0.074	-61.338	1326.128
engineSize	-1.465e+06	1.61e+05	-9.129	0.000	-1.78e+06	-1.15e+06
mileage	56.4581	3.811	14.815	0.000	48.987	63.929
mpg	-2.951e+04	9550.775	-3.089	0.002	-4.82e+04	-1.08e+04
year:engineSize	735.8074	79.532	9.252	0.000	579.890	891.725
year:mileage	-0.0281	0.002	-14.898	0.000	-0.032	-0.024
year:mpg	14.6915	4.731	3.105	0.002	5.417	23.966
engineSize:mileage	-0.0808	0.011	-7.143	0.000	-0.103	-0.059
engineSize:mpg	-120.5780	11.384	-10.592	0.000	-142.896	-98.260
mileage:mpg	0.0026	0.000	5.173	0.000	0.002	0.004
I(mileage ** 2)	3.495e-07	1.56e-07	2.236	0.025	4.31e-08	6.56e-07

Omnibus:	1958.631	Durbin-Watson:	0.542
Prob(Omnibus):	0.000	Jarque-Bera (JB):	44560.042
Skew:	1.349	Prob(JB):	0.00
Kurtosis:	17.434	Cond. No.	1.73e+13

```
np.sqrt(model.mse_resid)
```

```
8502.851955843495
```

```
pred_price = model.predict(testf)
np.sqrt(((testp.price - pred_price)**2).mean())
```

8708.676318160937

```
#Computing MAE on test data
pred_price = model.predict(testf)
(np.abs(testp.price - pred_price)).mean()
```

5395.006622253402

Let us check if this model satisfies the assumptions of the linear regression model

## 4.1 Non-linearity of data

We have assumed that there is a linear relationship between the predictors and the response. Residual plots, which are scatter plots of residuals vs fitted values, can be used to identify non-linearity. Fitted values are the values estimated by the model on training data, denoted by  $\hat{y}_i$ , and residuals are given by  $e_i = y_i - \hat{y}_i$ .

```
#Plotting residuals vs fitted values
plt.rcParams["figure.figsize"] = (9,6)
sns.set(font_scale=1.25)
ax = sns.scatterplot(x = model.fittedvalues, y=model.resid,color = 'orange')
sns.lineplot(x = [pred_price.min(),pred_price.max()],y = [0,0],color = 'blue')
plt.xlabel('Fitted values')
plt.ylabel('Residuals')
ax.yaxis.set_major_formatter('${x:,.0f}')
ax.xaxis.set_major_formatter('${x:,.0f}')
```



The model seems to satisfy this assumption, as we do not observe a strong pattern in the residuals around the line  $\text{Residuals} = 0$ . Residuals are distributed more or less in a similar manner on both sides of the blue line for all fitted values.

For the model to satisfy the linearity assumption perfectly, the points above the line ( $\text{Residuals} = 0$ ), should be mirror image of the points below the line, i.e., the blue line in the above plot should act as a mirror.

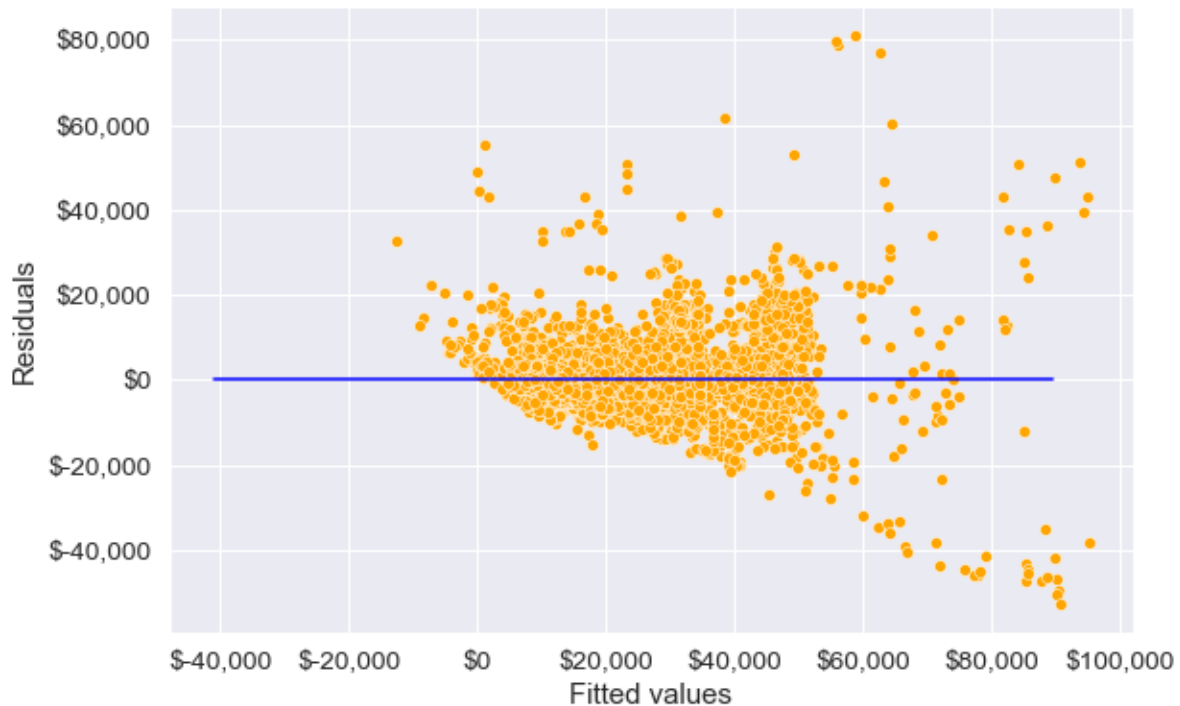
**What to do if there is non-linear association** (page 94 of book): If the residual plot indicates that there are non-linear associations in the data, then a simple approach is to use non-linear transformations of the predictors, such as  $\log X$ ,  $\sqrt{X}$ , and  $X^2$ , in the regression model.

## 4.2 Non-constant variance of error terms

The variance of the error terms is assumed to be constant, i.e.,  $\text{Var}(\epsilon_i) = \sigma^2$ , and this assumption is used while deriving the standard errors of the regression coefficients. The standard errors in turn are used to test the significant of the predictors, and obtain their confidence interval. Thus, violation of this assumption may lead to incorrect inference. Non-constant variance of error terms, or violation of the constant variance assumption, is called *heteroscedasticity*.

This assumption can be checked by plotting the residuals against fitted values.

```
#Plotting residuals vs fitted values
ax = sns.scatterplot(x = model.fittedvalues, y=model.resid,color = 'orange')
sns.lineplot(x = [pred_price.min(),pred_price.max()],y = [0,0],color = 'blue')
plt.xlabel('Fitted values')
plt.ylabel('Residuals')
ax.yaxis.set_major_formatter('${x:,.0f}')
ax.xaxis.set_major_formatter('${x:,.0f}')
```



We see that the variance of errors seems to increase with increase in the fitted values. In such a case a log transformation of the response can resolve the issue to some extent. This is because a log transformation will result in a higher shrinkage of larger values.

```
#Model with an interaction term and a variable transformation term
ols_object = smf.ols(formula = 'np.log(price)~(year+engineSize+mileage+mpg)**2+I(mileage**2)')
model_log = ols_object.fit()
model_log.summary()
```

Table 4.5: OLS Regression Results

Dep. Variable:	np.log(price)	R-squared:	0.803
Model:	OLS	Adj. R-squared:	0.803
Method:	Least Squares	F-statistic:	1834.
Date:	Wed, 25 Jan 2023	Prob (F-statistic):	0.00
Time:	11:37:55	Log-Likelihood:	-1173.8
No. Observations:	4960	AIC:	2372.
Df Residuals:	4948	BIC:	2450.
Df Model:	11		
Covariance Type:	nonrobust		

	coef	std err	t	P> t	[0.025	0.975]
Intercept	-238.2125	25.790	-9.237	0.000	-288.773	-187.652
year	0.1227	0.013	9.608	0.000	0.098	0.148
engineSize	13.8349	5.795	2.387	0.017	2.475	25.195
mileage	0.0005	0.000	3.837	0.000	0.000	0.001
mpg	-1.2446	0.345	-3.610	0.000	-1.921	-0.569
year:engineSize	-0.0067	0.003	-2.324	0.020	-0.012	-0.001
year:mileage	-2.67e-07	6.8e-08	-3.923	0.000	-4e-07	-1.34e-07
year:mpg	0.0006	0.000	3.591	0.000	0.000	0.001
engineSize:mileage	-2.668e-07	4.08e-07	-0.654	0.513	-1.07e-06	5.33e-07
engineSize:mpg	0.0028	0.000	6.842	0.000	0.002	0.004
mileage:mpg	7.235e-08	1.79e-08	4.036	0.000	3.72e-08	1.08e-07
I(mileage ** 2)	1.828e-11	5.64e-12	3.240	0.001	7.22e-12	2.93e-11

Omnibus:	711.515	Durbin-Watson:	0.498
Prob(Omnibus):	0.000	Jarque-Bera (JB):	2545.807
Skew:	0.699	Prob(JB):	0.00
Kurtosis:	6.220	Cond. No.	1.73e+13

Note that the coefficient of *year* turns out to be significant (at 5% significance level), unlike in the previous model. Intuitively, the coefficient of *year* should have been significant, as *year* has the highest linear correlation of 50% with car *price*.

Although the R-squared has increased as compared to the previous model, violation of this assumption does not cause bias in the regression coefficients. Thus, there may not be a large improvement in the model fit, unless we add predictor(s) to address heteroscedasticity.

Let us check the constant variance assumption again.



```
#Plotting residuals vs fitted values
sns.scatterplot(x = (model_log.fittedvalues), y=(model_log.resid),color = 'orange')
sns.lineplot(x = [model_log.fittedvalues.min(),model_log.fittedvalues.max()],y = [0,0],col
plt.xlabel('Fitted values')
plt.ylabel('Residuals')
```

```
Text(0, 0.5, 'Residuals')
```



Now we observe that the constant variance assumption is satisfied. Let us see the RMSE of this model on test data.

```
#Computing RMSE on test data
pred_price_log = model_log.predict(testf)
np.sqrt(((testp.price - np.exp(pred_price_log))**2).mean())
```

```
9094.209503063496
```

Note that the RMSE of the log-transformed model has increased as compared to the model without transformation. Does it mean the log-transformed model is less accurate?

```
#Computing MAE on test data
pred_price_log = model_log.predict(testf)
((np.abs(testp.price - np.exp(pred_price_log))).mean())
```

5268.398904745121

Although the RMSE has increased a bit for the log-transformed model, the MAE has reduced. This means the log-transformed model does a bit worse on reducing relatively large errors, but does better in reducing the absolute errors on an average.

```
#Comparing errors of the log-transformed model with the previous model
err = np.abs(testp.price - pred_price)
err_log = np.abs(testp.price - np.exp(pred_price_log))
sns.scatterplot(x = err,y = err_log, color = 'orange')
sns.lineplot(x = [0,100000], y = [0,100000], color = 'blue')
np.sum(err_log<err)/len(err)
```

0.5572604790419161



For 56% of the cars, the log transformed makes a more accurate prediction than the previous model, which is another criterion based on which the log-transformed model is more accurate. However, the conclusion based on RMSE is different. This is because RMSE can be influenced by a few large errors. Thus, RMSE, though sometimes appropriate than other criteria, should not be used as the sole measure to compare the accuracy of models.

```
#Visualizing the distribution of price and log(price)
fig = plt.figure()
fig.subplots_adjust(hspace=0.4, wspace=0.2)
sns.set(rc = {'figure.figsize':(20,12)})
sns.set(font_scale = 2)
ax = fig.add_subplot(2, 2, 1)
sns.histplot(train.price,kde=True)
ax.set(xlabel='price', ylabel='Count')
ax = fig.add_subplot(2, 2, 2)
sns.histplot(np.log(train.price),kde=True)
ax.set(xlabel='log price', ylabel='Count')
```

```
[Text(0.5, 0, 'log price'), Text(0, 0.5, 'Count')]
```



We can see that the log transformation shrunk the higher values of price, making its distribution closer to normal.

Note that heteroscedasticity can also occur due to model misspecification, i.e., in case of missing predictor(s). Some of the cars are too expensive, which makes the **price** distribution skewed. Perhaps, the price of expensive cars could be better explained by the car **model**, a predictor that is missing in the current model.

## 5 Potential issues

*Note that in this course, lecture notes are not sufficient, you must read the book for better understanding. Lecture notes are just implementing the concepts of the book on a dataset, but not explaining the concepts elaborately.*

Let us continue with the car price prediction example from the previous chapter.

```
import pandas as pd
import numpy as np
import statsmodels.formula.api as smf
import seaborn as sns
import matplotlib.pyplot as plt
import statsmodels.api as sm

trainf = pd.read_csv('./Datasets/Car_features_train.csv')
trainp = pd.read_csv('./Datasets/Car_prices_train.csv')
testf = pd.read_csv('./Datasets/Car_features_test.csv')
testp = pd.read_csv('./Datasets/Car_prices_test.csv')
train = pd.merge(trainf, trainp)
train.head()
```

	carID	brand	model	year	transmission	mileage	fuelType	tax	mpg	engineSize	price
0	18473	bmw	6 Series	2020	Semi-Auto	11	Diesel	145	53.3282	3.0	37980
1	15064	bmw	6 Series	2019	Semi-Auto	10813	Diesel	145	53.0430	3.0	33980
2	18268	bmw	6 Series	2020	Semi-Auto	6	Diesel	145	53.4379	3.0	36850
3	18480	bmw	6 Series	2017	Semi-Auto	18895	Diesel	145	51.5140	3.0	25998
4	18492	bmw	6 Series	2015	Automatic	62953	Diesel	160	51.4903	3.0	18990

```
# Model with an interaction term and a variable transformation term
ols_object = smf.ols(formula = 'np.log(price)~(year+engineSize+mileage+mpg)**2+I(mileage**2)')
model_log = ols_object.fit()
model_log.summary()
```

Table 5.2: OLS Regression Results

Dep. Variable:	np.log(price)	R-squared:	0.803
Model:	OLS	Adj. R-squared:	0.803
Method:	Least Squares	F-statistic:	1834.
Date:	Sun, 05 Feb 2023	Prob (F-statistic):	0.00
Time:	19:31:46	Log-Likelihood:	-1173.8
No. Observations:	4960	AIC:	2372.
Df Residuals:	4948	BIC:	2450.
Df Model:	11		
Covariance Type:	nonrobust		

	coef	std err	t	P> t	[0.025	0.975]
Intercept	-238.2125	25.790	-9.237	0.000	-288.773	-187.652
year	0.1227	0.013	9.608	0.000	0.098	0.148
engineSize	13.8349	5.795	2.387	0.017	2.475	25.195
mileage	0.0005	0.000	3.837	0.000	0.000	0.001
mpg	-1.2446	0.345	-3.610	0.000	-1.921	-0.569
year:engineSize	-0.0067	0.003	-2.324	0.020	-0.012	-0.001
year:mileage	-2.67e-07	6.8e-08	-3.923	0.000	-4e-07	-1.34e-07
year:mpg	0.0006	0.000	3.591	0.000	0.000	0.001
engineSize:mileage	-2.668e-07	4.08e-07	-0.654	0.513	-1.07e-06	5.33e-07
engineSize:mpg	0.0028	0.000	6.842	0.000	0.002	0.004
mileage:mpg	7.235e-08	1.79e-08	4.036	0.000	3.72e-08	1.08e-07
I(mileage ** 2)	1.828e-11	5.64e-12	3.240	0.001	7.22e-12	2.93e-11

Omnibus:	711.515	Durbin-Watson:	0.498
Prob(Omnibus):	0.000	Jarque-Bera (JB):	2545.807
Skew:	0.699	Prob(JB):	0.00
Kurtosis:	6.220	Cond. No.	1.73e+13

## 5.1 Outliers

An outlier is a point for which the true response ( $y_i$ ) is far from the value predicted by the model. Residual plots can be used to identify outliers.

If the the response at the  $i^{th}$  observation is  $y_i$ , the prediction is  $\hat{y}_i$ , then the residual  $e_i$  is:

$$e_i = y_i - \hat{y}_i$$

```
#Plotting residuals vs fitted values
sns.set(rc={'figure.figsize':(10,6)})
sns.scatterplot(x = (model_log.fittedvalues), y=(model_log.resid),color = 'orange')
sns.lineplot(x = [model_log.fittedvalues.min(),model_log.fittedvalues.max()],y = [0,0],col
plt.xlabel('Fitted values')
plt.ylabel('Residuals')
```

```
Text(0, 0.5, 'Residuals')
```



Some of the errors may be high. However, it is difficult to decide how large a residual needs to be before we can consider a point to be an outlier. To address this problem, we have standardized residuals, which are defined as:

$$r_i = \frac{e_i}{RSE(\sqrt{1 - h_{ii}})},$$

where  $r_i$  is the standardized residual,  $RSE$  is the residual standard error, and  $h_{ii}$  is the leverage (*introduced in the next section*) of the  $i^{th}$  observation.

Standardized residuals, allow the residuals to be compared on a *standard scale*.

**Issue with standardized residuals:** If the observation corresponding to the standardized residual has a high leverage, then it will drag the regression line / plane / hyperplane towards it, thereby influencing the estimate of the residual itself.

**Studentized residuals:** To address the issue with standardized residuals, studentized residual for the  $i^{th}$  observation is computed as the standardized residual, but with the  $RSE$  (residual standard error) computed after removing the  $i^{th}$  observation from the data. Studentized residual,  $t_i$  for the  $i^{th}$  observation is given as:

$$t_i = \frac{e_i}{RSE_i(\sqrt{1 - h_{ii}})},$$

where  $RSE_i$  is the residual standard error of the model developed on the data without the  $i^{th}$  observation.

Studentized residuals follow a  $t$  distribution with  $(n-p-2)$  degrees of freedom. Thus, in general, observations whose studentized residuals have a magnitude higher than 3 are potential outliers.

Let us find the studentized residuals in our car price prediction model.

```
#Studentized residuals
out = model_log.outlier_test()
out
```

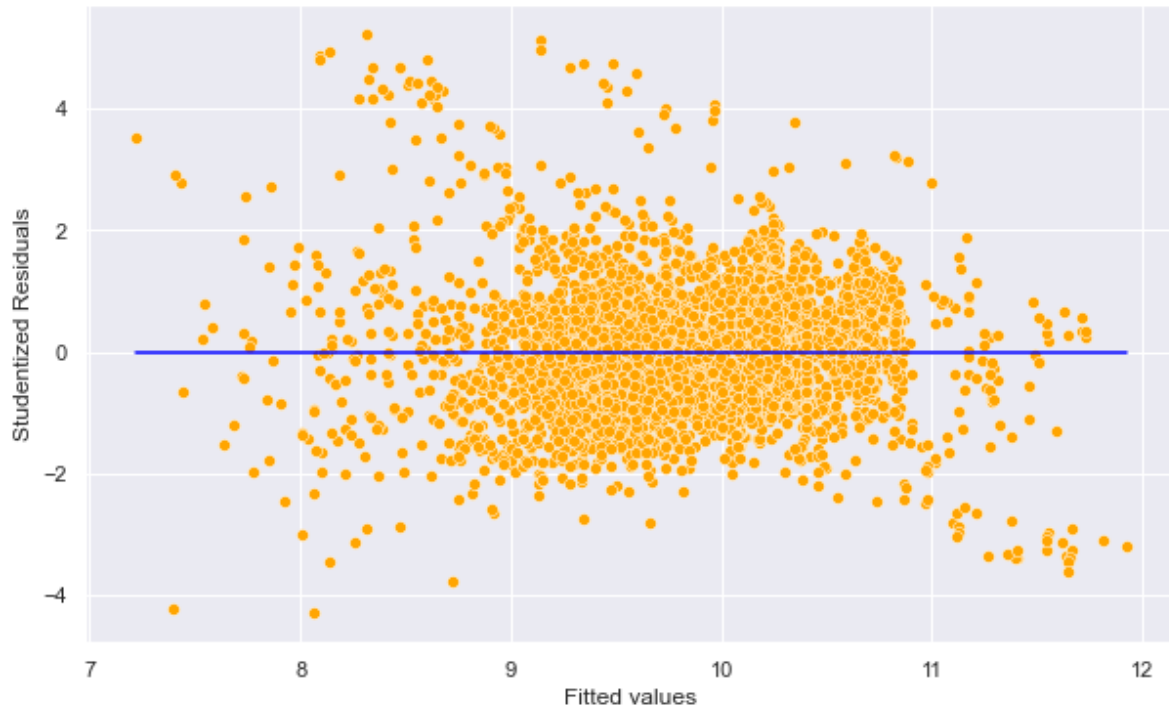
	student_resid	unadj_p	bonf(p)
0	-1.164204	0.244398	1.0
1	-0.801879	0.422661	1.0
2	-1.263820	0.206354	1.0
3	-0.614171	0.539130	1.0
4	0.027930	0.977719	1.0
...	...	...	...
4955	-0.523361	0.600747	1.0
4956	-0.509539	0.610397	1.0
4957	-1.718802	0.085713	1.0
4958	-0.077595	0.938153	1.0
4959	-0.482388	0.629551	1.0

Studentized residuals are in the first column of the above table.

```
#Plotting studentized residuals vs fitted values
sns.scatterplot(x = (model_log.fittedvalues), y=(out.student_resid),color = 'orange')
sns.lineplot(x = [model_log.fittedvalues.min(),model_log.fittedvalues.max()],y = [0,0],col
```

```
plt.xlabel('Fitted values')
plt.ylabel('Studentized Residuals')
```

```
Text(0, 0.5, 'Studentized Residuals')
```



**Potential outliers:** Observations whose studentized residuals have a magnitude greater than 3.

**Impact of outliers:** Outliers do not have a large impact on the OLS line / plane / hyperplane. However, outliers do inflate the residual standard error (RSE). RSE in turn is used to compute the standard errors of regression coefficients. As a result, statistically significant variables may appear to be insignificant, and  $R^2$  may appear to be lower.

```
#Number of points with absolute studentized residuals greater than 3
np.sum((np.abs(out.student_resid)>3))
```

86



**Are there outliers in our example?:** In the above plot, there are 86 points with absolute studentized residuals larger than 3. However, most of the predictors are significant and R-squared has a relatively high value of 80%. Thus, even if there are outliers, there is no need to remove them as it is unlikely to change the significance of individual variables. Furthermore, looking into the data, we find that the price of some of the luxury cars such as Mercedes G-class is actually much higher than average. So, the potential outliers in the data do not seem to be due to incorrect data. The high studentized residuals may be due to some deficiency in the model, such as missing predictor(s) (like car `model`), rather than incorrect data. Thus, we should not remove any data that has an outlying value of  $\log(\text{price})$ .

Since `model` seems to be a variable that can explain the price of overly expensive cars, let us include it in the regression model.

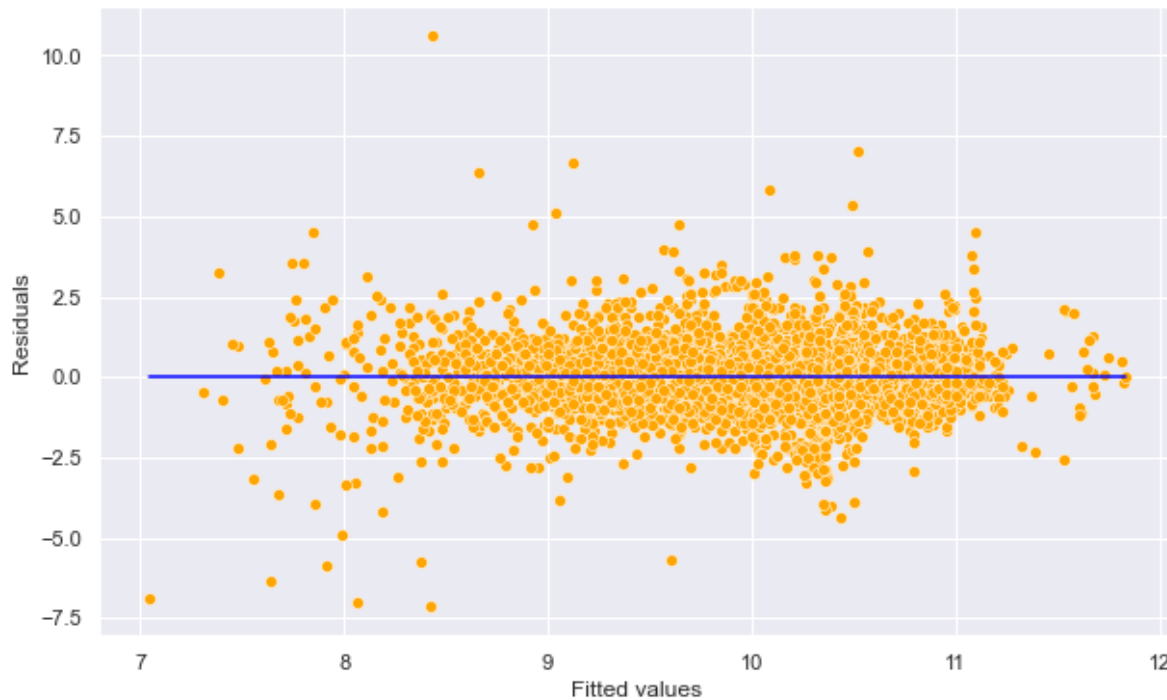
```
#Model with an interaction term and a variable transformation term
ols_object = smf.ols(formula = 'np.log(price)~(year+engineSize+mileage+mpg)**2+I(mileage**2)')
model_log = ols_object.fit()
#Model summary not printed to save space
#model_log.summary()
```

```
#Computing RMSE on test data with car 'model' as one of the predictors
pred_price_log2 = model_log.predict(testf)
np.sqrt(((testf.price - np.exp(pred_price_log2))**2).mean())
```

4252.20045604376

```
#Plotting studentized residuals vs fitted values for the model with car 'model' as one of the predictors
out = model_log.outlier_test()
sns.scatterplot(x = (model_log.fittedvalues), y=(out.student_resid),color = 'orange')
sns.lineplot(x = [model_log.fittedvalues.min(),model_log.fittedvalues.max()],y = [0,0],color = 'red')
plt.xlabel('Fitted values')
plt.ylabel('Residuals')
```

Text(0, 0.5, 'Residuals')



```
#Number of points with absolute studentized residuals greater than 3
np.sum((np.abs(out.student_resid)>3))
```

69

Note the RMSE has reduced to almost half of its value as compared to the regression model without the predictor - `model1`. Car model does help better explain the variation in price of cars! The number of points with absolute studentized residuals greater than 3 has also reduced to 69 from 86.

## 5.2 High leverage points

High leverage points are those with an unusual value of the predictor(s). They have a relatively higher impact on the OLS line / plane / hyperplane, as compared to the outliers.

**Leverage statistic** (page 99 of the book): In order to quantify an observation's leverage, we compute the leverage statistic. A large value of this statistic indicates an observation with

high leverage. For simple linear regression,

$$h_i = \frac{1}{n} + \frac{(x_i - \bar{x})^2}{\sum_{i'=1}^n (x_{i'} - \bar{x})^2}. \quad (5.1)$$

It is clear from this equation that  $h_i$  increases with the distance of  $x_i$  from  $\bar{x}$ . The leverage statistic  $h_i$  is always between  $1/n$  and 1, and the average leverage for all the observations is always equal to  $(p+1)/n$ . So if a given observation has a leverage statistic that greatly exceeds  $(p+1)/n$ , then we may suspect that the corresponding point has high leverage.

**Influential points:** Note that if a high leverage point falls in line with the regression line, then it will not affect the regression line. However, it may inflate R-squared and increase the significance of predictors. If a high leverage point falls away from the regression line, then it is also an outlier, and will affect the regression line. The points whose presence significantly affects the regression line are called influential points. A point that is both a high leverage point and an outlier is likely to be an influential point. However, a high leverage point is not necessarily an influential point.

Source for influential points: <https://online.stat.psu.edu/stat501/book/export/html/973>

Let us see if there are any high leverage points in our regression model without the predictor - model.

```
#Model with an interaction term and a variable transformation term
ols_object = smf.ols(formula = 'np.log(price)~(year+engineSize+mileage+mpg)**2+I(mileage**
model_log = ols_object.fit()
model_log.summary()
```

Table 5.6: OLS Regression Results

Dep. Variable:	np.log(price)	R-squared:	0.803
Model:	OLS	Adj. R-squared:	0.803
Method:	Least Squares	F-statistic:	1834.
Date:	Sun, 05 Feb 2023	Prob (F-statistic):	0.00
Time:	19:31:59	Log-Likelihood:	-1173.8
No. Observations:	4960	AIC:	2372.
Df Residuals:	4948	BIC:	2450.
Df Model:	11		
Covariance Type:	nonrobust		

	coef	std err	t	P> t	[0.025	0.975]
Intercept	-238.2125	25.790	-9.237	0.000	-288.773	-187.652

year	0.1227	0.013	9.608	0.000	0.098	0.148
engineSize	13.8349	5.795	2.387	0.017	2.475	25.195
mileage	0.0005	0.000	3.837	0.000	0.000	0.001
mpg	-1.2446	0.345	-3.610	0.000	-1.921	-0.569
year:engineSize	-0.0067	0.003	-2.324	0.020	-0.012	-0.001
year:mileage	-2.67e-07	6.8e-08	-3.923	0.000	-4e-07	-1.34e-07
year:mpg	0.0006	0.000	3.591	0.000	0.000	0.001
engineSize:mileage	-2.668e-07	4.08e-07	-0.654	0.513	-1.07e-06	5.33e-07
engineSize:mpg	0.0028	0.000	6.842	0.000	0.002	0.004
mileage:mpg	7.235e-08	1.79e-08	4.036	0.000	3.72e-08	1.08e-07
I(mileage ** 2)	1.828e-11	5.64e-12	3.240	0.001	7.22e-12	2.93e-11

Omnibus:	711.515	Durbin-Watson:	0.498
Prob(Omnibus):	0.000	Jarque-Bera (JB):	2545.807
Skew:	0.699	Prob(JB):	0.00
Kurtosis:	6.220	Cond. No.	1.73e+13

```
#Computing the leverage statistic for each observation
influence = model_log.get_influence()
leverage = influence.hat_matrix_diag
```

```
#Visualizng leverage against studentized residuals
sns.set(rc={'figure.figsize':(15,8)})
sm.graphics.influence_plot(model_log);
```



Let us identify the high leverage points in the data, as they may be affecting the regression line if they are outliers as well, i.e., if they are influential points. Note that there is no defined threshold for a point to be classified as a high leverage point. Some statisticians consider points having twice the average leverage as high leverage points, some consider points having thrice the average leverage as high leverage points, and so on.

```
out = model_log.outlier_test()

#Average leverage of points
average_leverage = (model_log.df_model+1)/model_log.nobs
average_leverage
```

0.0024193548387096775

Let us consider points having four times the average leverage as high leverage points.

```
#We will remove all observations that have leverage higher than the threshold value.  
high_leverage_threshold = 4*average_leverage
```

```
#Number of high leverage points in the dataset
np.sum(leverage>high_leverage_threshold)
```

197

## 5.3 Influential points

Observations that are both high leverage points and outliers are influential points that may affect the regression line. Let's remove these influential points from the data and see if it improves the model prediction accuracy on test data.

```
#Dropping influential points from data
train_filtered = train.drop(np.intersect1d(np.where(np.abs(out.student_resid)>3)[0],
                                             (np.where(leverage>high_leverage_threshold)[0]))
```

```
train_filtered.shape
```

(4921, 11)

```
#Number of points removed as they were influential
train.shape[0]-train_filtered.shape[0]
```

39

We removed 39 influential data points from the training data.

```
#Model after removing the influential observations
ols_object = smf.ols(formula = 'np.log(price)~(year+engineSize+mileage+mpg)**2+I(mileage**
model_log = ols_object.fit()
model_log.summary()
```

Table 5.9: OLS Regression Results

Dep. Variable:	np.log(price)	R-squared:	0.830
Model:	OLS	Adj. R-squared:	0.829
Method:	Least Squares	F-statistic:	2173.

Table 5.9: OLS Regression Results

Date:	Sun, 29 Jan 2023	Prob (F-statistic):	0.00
Time:	01:26:25	Log-Likelihood:	-775.51
No. Observations:	4921	AIC:	1575.
Df Residuals:	4909	BIC:	1653.
Df Model:	11		
Covariance Type:	nonrobust		

	coef	std err	t	P> t	[0.025	0.975]
Intercept	-262.7743	24.455	-10.745	0.000	-310.717	-214.832
year	0.1350	0.012	11.148	0.000	0.111	0.159
engineSize	16.6645	5.482	3.040	0.002	5.917	27.412
mileage	0.0008	0.000	5.945	0.000	0.001	0.001
mpg	-1.1217	0.324	-3.458	0.001	-1.758	-0.486
year:engineSize	-0.0081	0.003	-2.997	0.003	-0.013	-0.003
year:mileage	-3.927e-07	6.5e-08	-6.037	0.000	-5.2e-07	-2.65e-07
year:mpg	0.0005	0.000	3.411	0.001	0.000	0.001
engineSize:mileage	-4.566e-07	3.86e-07	-1.183	0.237	-1.21e-06	3e-07
engineSize:mpg	0.0071	0.000	16.202	0.000	0.006	0.008
mileage:mpg	7.29e-08	1.68e-08	4.349	0.000	4e-08	1.06e-07
I(mileage ** 2)	1.418e-11	5.29e-12	2.683	0.007	3.82e-12	2.46e-11

Omnibus:	631.414	Durbin-Watson:	0.553
Prob(Omnibus):	0.000	Jarque-Bera (JB):	1851.015
Skew:	0.682	Prob(JB):	0.00
Kurtosis:	5.677	Cond. No.	1.73e+13

Note that we obtain a higher R-squared value of 83% as compared to 80% with the complete data. Removing the influential points helped obtain a better model fit. However, that may also happen just by reducing observations.

```
#Computing RMSE on test data
pred_price_log = model_log.predict(testf)
np.sqrt(((testp.price - np.exp(pred_price_log))**2).mean())
```

8820.685844070766

The RMSE on test data has also reduced. This shows that some of the influential points were impacting the regression line. With those points removed, the model better captures the general trend in the data.

## 5.4 Collinearity

Collinearity refers to the situation when two or more predictor variables have a high linear association. Linear association between a pair of variables can be measured by the correlation coefficient. Thus the correlation matrix can indicate some potential collinearity problems.

### 5.4.1 Why and how is collinearity a problem

*(Source: page 100-101 of book)*

The presence of collinearity can pose problems in the regression context, since it can be difficult to separate out the individual effects of collinear variables on the response.

Since collinearity reduces the accuracy of the estimates of the regression coefficients, it causes the standard error for  $\hat{\beta}_j$  to grow. Recall that the  $t$ -statistic for each predictor is calculated by dividing  $\hat{\beta}_j$  by its standard error. Consequently, collinearity results in a decline in the  $t$ -statistic. As a result, **in the presence of collinearity, we may fail to reject  $H_0 : \beta_j = 0$ . This means that the power of the hypothesis test—the probability of correctly detecting a non-zero coefficient—is reduced by collinearity.**

### 5.4.2 How to measure collinearity/multicollinearity

*(Source: page 102 of book)*

Unfortunately, not all collinearity problems can be detected by inspection of the correlation matrix: it is possible for collinearity to exist between three or more variables even if no pair of variables has a particularly high correlation. We call this situation multicollinearity. Instead of inspecting the correlation matrix, a better way to assess multicollinearity is to compute the variance inflation factor (VIF). The VIF is variance inflation factor the ratio of the variance of  $\hat{\beta}_j$  when fitting the full model divided by the variance of  $\hat{\beta}_j$  if fit on its own. The smallest possible value for VIF is 1, which indicates the complete absence of collinearity. Typically in practice there is a small amount of collinearity among the predictors. As a rule of thumb, a **VIF value that exceeds 5 or 10 indicates a problematic amount of collinearity.**

The estimated variance of the coefficient  $\beta_j$ , of the  $j^{th}$  predictor  $X_j$ , can be expressed as:



$$\widehat{var}(\hat{\beta}_j) = \frac{(\hat{\sigma})^2}{(n-1)\widehat{var}(X_j)} \cdot \frac{1}{1 - R_{X_j|X_{-j}}^2},$$

where  $R_{X_j|X_{-j}}^2$  is the  $R$ -squared for the regression of  $X_j$  on the other covariates (a regression that does not involve the response variable  $Y$ ).

In case of simple linear regression, the variance expression in the equation above does not contain the term  $\frac{1}{1-R_{X_j|X_{-j}}^2}$ , as there is only one predictor. However, in case of multiple linear regression, the variance of the estimate of the  $j^{th}$  coefficient ( $\hat{\beta}_j$ ) gets inflated by a factor of  $\frac{1}{1-R_{X_j|X_{-j}}^2}$  (Note that in the complete absence of collinearity,  $R_{X_j|X_{-j}}^2 = 0$ , and the value of this factor will be 1).

Thus, the Variance inflation factor, or the VIF for the estimated coefficient of the  $j^{th}$  predictor  $X_j$  is:

$$VIF(\hat{\beta}_j) = \frac{1}{1 - R_{X_j|X_{-j}}^2} \quad (5.2)$$

```
#Correlation matrix
train.corr()
```

	carID	year	mileage	tax	mpg	engineSize	price
carID	1.000000	0.006251	-0.001320	0.023806	-0.010774	0.011365	0.012129
year	0.006251	1.000000	-0.768058	-0.205902	-0.057093	0.014623	0.501296
mileage	-0.001320	-0.768058	1.000000	0.133744	0.125376	-0.006459	-0.478705
tax	0.023806	-0.205902	0.133744	1.000000	-0.488002	0.465282	0.144652
mpg	-0.010774	-0.057093	0.125376	-0.488002	1.000000	-0.419417	-0.369919
engineSize	0.011365	0.014623	-0.006459	0.465282	-0.419417	1.000000	0.624899
price	0.012129	0.501296	-0.478705	0.144652	-0.369919	0.624899	1.000000

Let us compute the Variance Inflation Factor (VIF) for the four predictors.

```
X = train[['mpg','year','mileage','engineSize']]
```

```
X.columns[1:]
```

```
Index(['year', 'mileage', 'engineSize'], dtype='object')
```

```

from statsmodels.stats.outliers_influence import variance_inflation_factor
from statsmodels.tools.tools import add_constant
X = add_constant(X)
vif_data = pd.DataFrame()
vif_data["feature"] = X.columns

for i in range(len(X.columns)):
    vif_data.loc[i, 'VIF'] = variance_inflation_factor(X.values, i)

print(vif_data)

```

	feature	VIF
0	const	1.201579e+06
1	mpg	1.243040e+00
2	year	2.452891e+00
3	mileage	2.490210e+00
4	engineSize	1.219170e+00

As all the values of VIF are close to one, we do not have the problem of multicollinearity in the model. Note that the VIF of `year` and `mileage` is relatively high as they are the most correlated.

**Q1:** Why is the VIF of the constant so high?

**Q2:** Why do we need to include the constant while finding the VIF?

### 5.4.3 Manual computation of VIF

```

#Manually computing the VIF for year
ols_object = smf.ols(formula = 'year~mpg+engineSize+mileage', data = train)
model_log = ols_object.fit()
model_log.summary()

```

Table 5.13: OLS Regression Results

Dep. Variable:	year	R-squared:	0.592
Model:	OLS	Adj. R-squared:	0.592
Method:	Least Squares	F-statistic:	2400.
Date:	Mon, 30 Jan 2023	Prob (F-statistic):	0.00
Time:	02:49:19	Log-Likelihood:	-10066.

Table 5.13: OLS Regression Results

No. Observations:	4960	AIC:	2.014e+04
Df Residuals:	4956	BIC:	2.017e+04
Df Model:	3		
Covariance Type:	nonrobust		

	coef	std err	t	P> t	[0.025	0.975]
Intercept	2018.3135	0.140	1.44e+04	0.000	2018.039	2018.588
mpg	0.0095	0.002	5.301	0.000	0.006	0.013
engineSize	0.1171	0.037	3.203	0.001	0.045	0.189
mileage	-9.139e-05	1.08e-06	-84.615	0.000	-9.35e-05	-8.93e-05

Omnibus:	2949.664	Durbin-Watson:	1.161
Prob(Omnibus):	0.000	Jarque-Bera (JB):	63773.271
Skew:	-2.426	Prob(JB):	0.00
Kurtosis:	19.883	Cond. No.	1.91e+05

```
#VIF for year
1/(1-0.592)
```

```
2.4509803921568625
```

Note that year and mileage have a high linear correlation. Removing one of them should decrease the standard error of the coefficient of the other, without significantly decrease R-squared.

```
ols_object = smf.ols(formula = 'price~mpg+engineSize+mileage+year', data = train)
model_log = ols_object.fit()
model_log.summary()
```

Table 5.16: OLS Regression Results

Dep. Variable:	price	R-squared:	0.660
Model:	OLS	Adj. R-squared:	0.660
Method:	Least Squares	F-statistic:	2410.
Date:	Tue, 07 Feb 2023	Prob (F-statistic):	0.00

Table 5.16: OLS Regression Results

Time:	21:39:45	Log-Likelihood:	-52497.
No. Observations:	4960	AIC:	1.050e+05
Df Residuals:	4955	BIC:	1.050e+05
Df Model:	4		
Covariance Type:	nonrobust		

	coef	std err	t	P> t	[0.025	0.975]
Intercept	-3.661e+06	1.49e+05	-24.593	0.000	-3.95e+06	-3.37e+06
mpg	-79.3126	9.338	-8.493	0.000	-97.620	-61.006
engineSize	1.218e+04	189.969	64.107	0.000	1.18e+04	1.26e+04
mileage	-0.1474	0.009	-16.817	0.000	-0.165	-0.130
year	1817.7366	73.751	24.647	0.000	1673.151	1962.322

Omnibus:	2450.973	Durbin-Watson:	0.541
Prob(Omnibus):	0.000	Jarque-Bera (JB):	31060.548
Skew:	2.045	Prob(JB):	0.00
Kurtosis:	14.557	Cond. No.	3.83e+07

Removing mileage from the above regression.

```
ols_object = smf.ols(formula = 'price-mpg+engineSize+year', data = train)
model_log = ols_object.fit()
model_log.summary()
```

Table 5.19: OLS Regression Results

Dep. Variable:	price	R-squared:	0.641
Model:	OLS	Adj. R-squared:	0.641
Method:	Least Squares	F-statistic:	2951.
Date:	Tue, 07 Feb 2023	Prob (F-statistic):	0.00
Time:	21:40:00	Log-Likelihood:	-52635.
No. Observations:	4960	AIC:	1.053e+05
Df Residuals:	4956	BIC:	1.053e+05
Df Model:	3		
Covariance Type:	nonrobust		

	coef	std err	t	P> t	[0.025	0.975]
Intercept	-5.586e+06	9.78e+04	-57.098	0.000	-5.78e+06	-5.39e+06
mpg	-101.9120	9.500	-10.727	0.000	-120.536	-83.288
engineSize	1.196e+04	194.848	61.392	0.000	1.16e+04	1.23e+04
year	2771.1844	48.492	57.147	0.000	2676.118	2866.251

Omnibus:	2389.075	Durbin-Watson:	0.528
Prob(Omnibus):	0.000	Jarque-Bera (JB):	26920.051
Skew:	2.018	Prob(JB):	0.00
Kurtosis:	13.675	Cond. No.	1.41e+06

Note that the standard error of the coefficient of *year* has reduced from 73 to 48, without any large reduction in R-squared.

#### 5.4.4 When can we overlook multicollinearity?

- The severity of the problems increases with the degree of the multicollinearity. Therefore, if there is only moderate multicollinearity ( $5 < VIF < 10$ ), we may overlook it.
- Multicollinearity affects only the standard errors of the coefficients of collinear predictors. Therefore, if multicollinearity is not present for the predictors that we are particularly interested in, we may not need to resolve it.
- Multicollinearity affects the standard error of the coefficients and thereby their  $p$ -values, but it does not influence the prediction accuracy, and the goodness-of-fit statistics. If our sole aim is prediction, and we don't wish to infer the statistical significance of predictors, then we don't need to address multicollinearity. *"The fact that some or all predictor variables are correlated among themselves does not, in general, inhibit our ability to obtain a good fit nor does it tend to affect inferences about mean responses or predictions of new observations, provided these inferences are made within the region of observations"* - Neter, John, Michael H. Kutner, Christopher J. Nachtsheim, and William Wasserman. *"Applied linear statistical models."* (1996): 318.

## 6 Autocorrelation

Below is an example showing violation of the autocorrelation assumption (*refer to the book to understand autocorrelation*) in linear regression. Subsequently, it is shown that addressing the assumption violation leads to a much better model fit.

**Example:** Using linear regression models to predict electricity demand in Toronto, CA.

We have hourly power demand and temperature (in Celsius) data from 2017 to 2020.

We are going to build a linear model to predict the hourly power demand for the next day (for example, when it is 1/1/2021, we predict hourly demand on 1/2/2021 using historical data and the weather forecasts).

When we are building a model, it is important to keep in mind what data we can use as features. For this model:

- We cannot use previous hourly data as features. (Although in a high frequency setting, it is possible)
- The temperature in our raw data can not be used directly, since it is the actual, not the forecasted temperature. We are going to use the previous day temperature as the forecast.

**Source:** [Keep it simple, keep it linear: A linear regression model for time series](#)

```
%pylab inline
import pandas as pd
import seaborn as sns
import statsmodels.api as sm
plt.rcParams['figure.figsize'] = [9, 5]
```

Populating the interactive namespace from numpy and matplotlib

```
# A few helper functions
import numpy.ma as ma
from scipy.stats.stats import pearsonr, normaltest
from scipy.spatial.distance import correlation
```

```

def build_model(features):
    X=sm.add_constant(df[features])
    y=df['power']
    model = sm.OLS(y,X, missing='drop').fit()
    predictions = model.predict(X)
    display(model.summary())
    res=y-predictions
    return res

def plt_residual(res):
    plt.plot(range(len(res)), res)
    plt.ylabel('Residual')
    plt.xlabel("Hour")

def plt_residual_lag(res, nlag):
    x=res.values
    y=res.shift(nlag).values
    sns.kdeplot(x,y=y,color='blue',shade=True )
    plt.xlabel('res')
    plt.ylabel("res-lag-{}".format(nlag))
    rho,p=corrcoef(x,y)
    plt.title("n_lag={} hours, correlation={:f}".format(nlag, rho))

def plt_acf(res):
    plt.rcParams['figure.figsize'] = [18, 5]
    acorr = sm.tsa.acf(res.dropna(), nlags = len(res.dropna())-1)
    fig, (ax1, ax2) = plt.subplots(1, 2)
    ax1.plot(acorr)
    ax1.set_ylabel('corr')
    ax1.set_xlabel('n_lag')
    ax1.set_title('Auto Correlation')
    ax2.plot(acorr[:4*7*24])
    ax2.set_ylabel('corr')
    ax2.set_xlabel('n_lag')
    ax2.set_title('Auto Correlation (4-week zoomed in) ')
    plt.show()
    pd.set_option('display.max_columns', None)
    adf=pd.DataFrame(np.round(acorr[:30*24],2).reshape([30, 24] ))
    adf.index.name='day'
    display(adf)

```

```
plt.rcParams['figure.figsize'] = [9, 5]

def corrcoef(x,y):
    a,b=ma.masked_invalid(x),ma.masked_invalid(y)
    msk = (~a.mask & ~b.mask)
    return pearsonr(x[msk],y[msk])[0], normaltest(res, nan_policy='omit')[1]
```

## 6.1 The data

```
df=pd.read_csv("./Datasets/Toronto_power_demand.csv", parse_dates=['Date'], index_col=0)
df['temperature']=df['temperature'].shift(24*1)
df.tail()
```

	Date	Hour	power	temperature
key				
20201231:19	2020-12-31	19	5948	4.9
20201231:20	2020-12-31	20	5741	4.5
20201231:21	2020-12-31	21	5527	3.7
20201231:22	2020-12-31	22	5301	2.9
20201231:23	2020-12-31	23	5094	2.1

```
ndays=len(set(df['Date']))
print("There are {} rows, which is {}*24={}, for {} days. And The data is already in sorted order")
```

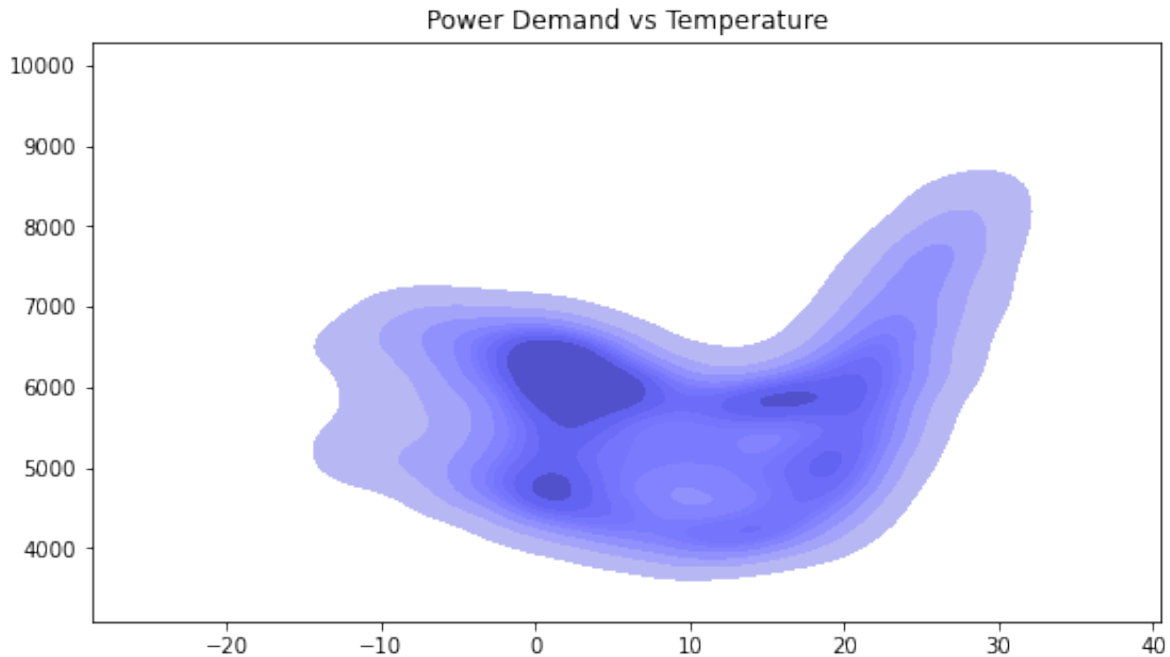
There are 35064 rows, which is 1461\*24=35064, for 1461 days. And The data is already in sorted order

```
print("It is natural to think that there is a relationship between power demand and temperature")
sns.kdeplot(df['temperature'].values, y=df['power'].values,color='blue',shade=True )
plt.title("Power Demand vs Temperature")
```

It is natural to think that there is a relationship between power demand and temperature.

```
Text(0.5, 1.0, 'Power Demand vs Temperature')
```





```
print("""
It is not a linear relationship. We create two features corresponding to hot and cold weather
it possible to develop a linear model.
""")
is_hot=(df['temperature']>15).astype(int)
print("{:f}% of data points are hot".format(is_hot.mean()*100))
df['temp_hot']=df['temperature']*is_hot
df['temp_cold']=df['temperature']*(1-is_hot)
df.tail()
```

It is not a linear relationship. We create two features corresponding to hot and cold weather

34.813484% of data points are hot

	Date	Hour	power	temperature	temp_hot	temp_cold
key						
20201231:19	2020-12-31	19	5948	4.9	0.0	4.9
20201231:20	2020-12-31	20	5741	4.5	0.0	4.5
20201231:21	2020-12-31	21	5527	3.7	0.0	3.7

key	Date	Hour	power	temperature	temp_hot	temp_cold
20201231:22	2020-12-31	22	5301	2.9	0.0	2.9
20201231:23	2020-12-31	23	5094	2.1	0.0	2.1

## 6.2 Predictor: temperature

```
res=build_model(['temp_hot', 'temp_cold'])
```

Table 6.3: OLS Regression Results

Dep. Variable:	power	R-squared:	0.195
Model:	OLS	Adj. R-squared:	0.195
Method:	Least Squares	F-statistic:	4251.
Date:	Sun, 05 Feb 2023	Prob (F-statistic):	0.00
Time:	23:15:53	Log-Likelihood:	-2.8766e+05
No. Observations:	35040	AIC:	5.753e+05
Df Residuals:	35037	BIC:	5.753e+05
Df Model:	2		
Covariance Type:	nonrobust		

	coef	std err	t	P> t	[0.025	0.975]
const	5501.3027	6.222	884.115	0.000	5489.107	5513.499
temp_hot	31.8488	0.462	68.911	0.000	30.943	32.755
temp_cold	-37.5088	0.827	-45.364	0.000	-39.129	-35.888

Omnibus:	945.032	Durbin-Watson:	0.093
Prob(Omnibus):	0.000	Jarque-Bera (JB):	469.200
Skew:	0.034	Prob(JB):	1.30e-102
Kurtosis:	2.437	Cond. No.	17.0

```
plt_residual(res)
```



```
print("acf shows that there is a strong correlation for 24 lags, which is one day.")
plt_acf(res)
```

acf shows that there is a strong correlation for 24 lags, which is one day.

C:\Users\akl0407\Anaconda3\lib\site-packages\statsmodels\tsa\stattools.py:667: FutureWarning  
warnings.warn(



	0	1	2	3	4	5	6	7	8	9	10	11	12	13	14
day															
0	1.00	0.95	0.85	0.72	0.56	0.40	0.24	0.09	-0.02	-0.11	-0.16	-0.20	-0.22	-0.21	-0.19
1	0.81	0.77	0.68	0.55	0.40	0.25	0.09	-0.04	-0.15	-0.23	-0.29	-0.32	-0.34	-0.33	-0.31
2	0.69	0.65	0.57	0.45	0.31	0.16	0.01	-0.12	-0.22	-0.30	-0.35	-0.38	-0.39	-0.38	-0.36
3	0.64	0.61	0.53	0.42	0.28	0.13	-0.01	-0.14	-0.24	-0.32	-0.37	-0.40	-0.41	-0.40	-0.37
4	0.63	0.60	0.52	0.41	0.27	0.12	-0.02	-0.14	-0.24	-0.32	-0.37	-0.40	-0.40	-0.39	-0.36
5	0.65	0.62	0.54	0.43	0.30	0.15	0.01	-0.11	-0.21	-0.28	-0.33	-0.36	-0.36	-0.35	-0.32
6	0.72	0.69	0.61	0.50	0.36	0.21	0.07	-0.05	-0.15	-0.22	-0.27	-0.29	-0.30	-0.29	-0.26
7	0.78	0.75	0.67	0.54	0.40	0.25	0.10	-0.03	-0.13	-0.21	-0.26	-0.29	-0.30	-0.30	-0.27
8	0.71	0.68	0.60	0.48	0.34	0.19	0.04	-0.09	-0.19	-0.27	-0.32	-0.35	-0.36	-0.36	-0.33
9	0.64	0.61	0.53	0.41	0.27	0.13	-0.02	-0.14	-0.24	-0.32	-0.37	-0.40	-0.41	-0.40	-0.37
10	0.61	0.58	0.50	0.39	0.25	0.11	-0.03	-0.16	-0.26	-0.33	-0.38	-0.40	-0.41	-0.40	-0.38
11	0.61	0.58	0.51	0.39	0.26	0.12	-0.02	-0.14	-0.24	-0.32	-0.36	-0.39	-0.40	-0.39	-0.36
12	0.63	0.61	0.53	0.42	0.28	0.14	0.00	-0.12	-0.22	-0.29	-0.33	-0.36	-0.36	-0.35	-0.32
13	0.70	0.67	0.60	0.48	0.35	0.20	0.06	-0.06	-0.16	-0.23	-0.27	-0.30	-0.30	-0.29	-0.26
14	0.76	0.73	0.64	0.52	0.38	0.23	0.09	-0.04	-0.14	-0.22	-0.27	-0.30	-0.31	-0.30	-0.27
15	0.69	0.66	0.58	0.46	0.32	0.17	0.03	-0.10	-0.20	-0.28	-0.33	-0.36	-0.38	-0.37	-0.35
16	0.60	0.57	0.50	0.38	0.25	0.10	-0.04	-0.16	-0.26	-0.34	-0.38	-0.41	-0.42	-0.41	-0.39
17	0.58	0.55	0.47	0.36	0.23	0.09	-0.05	-0.17	-0.27	-0.34	-0.39	-0.42	-0.43	-0.42	-0.39
18	0.57	0.55	0.47	0.36	0.23	0.09	-0.05	-0.17	-0.27	-0.34	-0.39	-0.41	-0.42	-0.41	-0.38
19	0.59	0.57	0.49	0.38	0.25	0.11	-0.03	-0.14	-0.24	-0.31	-0.35	-0.38	-0.38	-0.37	-0.34
20	0.67	0.64	0.56	0.45	0.32	0.18	0.04	-0.08	-0.17	-0.24	-0.29	-0.31	-0.32	-0.31	-0.28
21	0.72	0.69	0.61	0.49	0.36	0.21	0.07	-0.06	-0.16	-0.23	-0.28	-0.31	-0.32	-0.32	-0.29
22	0.66	0.63	0.55	0.43	0.29	0.15	0.01	-0.12	-0.22	-0.29	-0.34	-0.37	-0.38	-0.38	-0.35
23	0.58	0.55	0.47	0.36	0.23	0.09	-0.05	-0.17	-0.27	-0.34	-0.39	-0.42	-0.43	-0.42	-0.39
24	0.55	0.52	0.45	0.34	0.21	0.07	-0.07	-0.19	-0.29	-0.36	-0.40	-0.43	-0.44	-0.43	-0.40
25	0.55	0.52	0.45	0.34	0.21	0.07	-0.07	-0.19	-0.28	-0.35	-0.40	-0.42	-0.43	-0.42	-0.39
26	0.57	0.54	0.47	0.36	0.23	0.09	-0.04	-0.16	-0.25	-0.32	-0.36	-0.39	-0.39	-0.38	-0.35
27	0.64	0.61	0.54	0.43	0.30	0.16	0.03	-0.09	-0.19	-0.25	-0.30	-0.32	-0.33	-0.32	-0.29
28	0.70	0.67	0.59	0.47	0.34	0.19	0.05	-0.07	-0.17	-0.24	-0.29	-0.32	-0.33	-0.33	-0.30
29	0.63	0.60	0.53	0.41	0.28	0.13	-0.01	-0.13	-0.23	-0.30	-0.35	-0.38	-0.39	-0.39	-0.37

```

print("Although 1 hour lag correlation is more strong, but we cannot use it, as we intend
the power consumption for the next day.")
plt_residual_lag(res,1)
plt.show()
plt_residual_lag(res,24)

```

Although 1 hour lag correlation is more strong, but we cannot use it, as we intend to predict



### 6.3 Predictors: Temperature + one day lag of power.

```
df['power_lag_1_day']=df['power'].shift(24)
df.tail()
```

	key	Date	Hour	power	temperature	temp_hot	temp_cold	power_lag_1_day
35059	20201231:19	2020-12-31	19	5948	4.9	0.0	4.9	6163.0
35060	20201231:20	2020-12-31	20	5741	4.5	0.0	4.5	5983.0
35061	20201231:21	2020-12-31	21	5527	3.7	0.0	3.7	5727.0
35062	20201231:22	2020-12-31	22	5301	2.9	0.0	2.9	5428.0
35063	20201231:23	2020-12-31	23	5094	2.1	0.0	2.1	5104.0

```
res=build_model(['temp_hot', 'temp_cold', 'power_lag_1_day' ])
```

```
/usr/local/lib/python3.8/dist-packages/statsmodels/tsa/tsatools.py:142: FutureWarning: In a
x = pd.concat(x[:, :order], 1)
```

Table 6.8: OLS Regression Results

Dep. Variable:	power	R-squared:	0.794
Model:	OLS	Adj. R-squared:	0.794
Method:	Least Squares	F-statistic:	4.513e+04
Date:	Sun, 22 Jan 2023	Prob (F-statistic):	0.00
Time:	19:21:14	Log-Likelihood:	-2.6375e+05
No. Observations:	35040	AIC:	5.275e+05
Df Residuals:	35036	BIC:	5.275e+05
Df Model:	3		
Covariance Type:	nonrobust		

	coef	std err	t	P> t	[0.025	0.975]
const	689.2701	15.384	44.806	0.000	659.118	719.422
temp_hot	3.2158	0.250	12.853	0.000	2.725	3.706
temp_cold	-1.3464	0.433	-3.110	0.002	-2.195	-0.498
power_lag_1_day	0.8747	0.003	319.552	0.000	0.869	0.880

Omnibus:	2035.537	Durbin-Watson:	0.041
Prob(Omnibus):	0.000	Jarque-Bera (JB):	5794.290
Skew:	0.301	Prob(JB):	0.00
Kurtosis:	4.899	Cond. No.	3.69e+04

```
plt_residual(res)
```



```
plt_acf(res)
```

```
/usr/local/lib/python3.8/dist-packages/statsmodels/tsa/stattools.py:667: FutureWarning: fft=
warnings.warn(
```

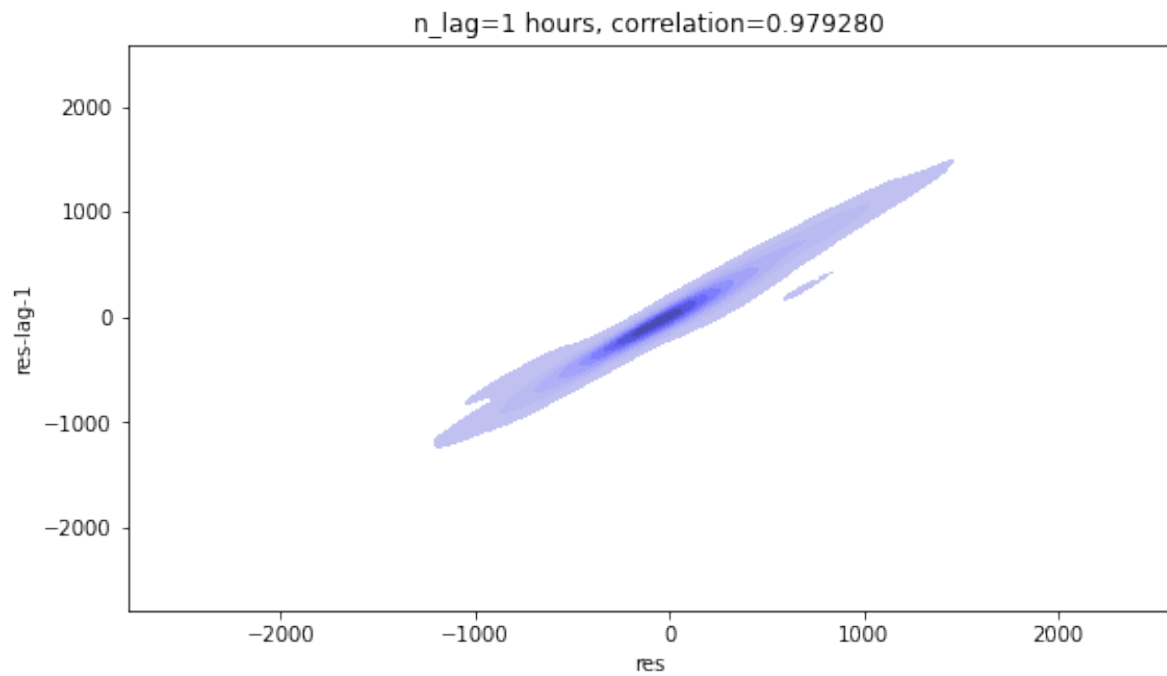


	0	1	2	3	4	5	6	7	8	9	10	11	12	13	14
day															
0	1.00	0.98	0.93	0.87	0.81	0.75	0.70	0.64	0.59	0.54	0.50	0.46	0.42	0.39	0.35
1	0.07	0.05	0.03	0.00	-0.02	-0.04	-0.06	-0.08	-0.10	-0.12	-0.14	-0.15	-0.16	-0.17	-0.18
2	-0.23	-0.23	-0.22	-0.22	-0.21	-0.21	-0.21	-0.21	-0.21	-0.20	-0.20	-0.19	-0.18	-0.18	-0.17
3	-0.07	-0.07	-0.07	-0.07	-0.08	-0.09	-0.09	-0.10	-0.11	-0.11	-0.11	-0.12	-0.12	-0.12	-0.11
4	-0.07	-0.07	-0.07	-0.08	-0.09	-0.10	-0.11	-0.12	-0.13	-0.14	-0.14	-0.15	-0.16	-0.16	-0.15
5	-0.18	-0.18	-0.17	-0.17	-0.17	-0.16	-0.16	-0.16	-0.16	-0.15	-0.14	-0.14	-0.13	-0.12	-0.11
6	0.07	0.08	0.09	0.09	0.10	0.10	0.11	0.12	0.13	0.14	0.16	0.18	0.19	0.21	0.22
7	0.50	0.49	0.46	0.43	0.40	0.37	0.34	0.31	0.28	0.26	0.24	0.22	0.21	0.19	0.17
8	0.10	0.09	0.07	0.06	0.04	0.02	-0.00	-0.02	-0.04	-0.05	-0.07	-0.08	-0.09	-0.10	-0.10
9	-0.16	-0.16	-0.16	-0.15	-0.16	-0.16	-0.16	-0.16	-0.16	-0.16	-0.15	-0.15	-0.14	-0.14	-0.13
10	-0.03	-0.03	-0.03	-0.03	-0.04	-0.04	-0.05	-0.06	-0.06	-0.07	-0.07	-0.07	-0.07	-0.07	-0.06
11	-0.01	-0.01	-0.02	-0.03	-0.03	-0.04	-0.05	-0.06	-0.07	-0.08	-0.09	-0.10	-0.11	-0.11	-0.10
12	-0.14	-0.14	-0.13	-0.13	-0.13	-0.13	-0.14	-0.14	-0.13	-0.13	-0.13	-0.12	-0.11	-0.10	-0.09
13	0.08	0.09	0.10	0.10	0.11	0.11	0.12	0.13	0.14	0.15	0.17	0.18	0.20	0.22	0.23
14	0.49	0.48	0.46	0.43	0.40	0.37	0.34	0.31	0.28	0.26	0.24	0.23	0.21	0.20	0.18
15	0.10	0.09	0.07	0.05	0.03	0.01	-0.01	-0.03	-0.05	-0.07	-0.08	-0.10	-0.11	-0.12	-0.11
16	-0.17	-0.17	-0.17	-0.17	-0.16	-0.16	-0.17	-0.17	-0.16	-0.16	-0.16	-0.16	-0.15	-0.14	-0.13
17	-0.03	-0.02	-0.02	-0.03	-0.03	-0.04	-0.04	-0.05	-0.05	-0.06	-0.06	-0.06	-0.06	-0.06	-0.05
18	-0.03	-0.04	-0.04	-0.05	-0.06	-0.08	-0.09	-0.10	-0.11	-0.12	-0.13	-0.14	-0.15	-0.15	-0.14
19	-0.17	-0.17	-0.16	-0.16	-0.15	-0.15	-0.15	-0.15	-0.14	-0.13	-0.13	-0.12	-0.11	-0.10	-0.09
20	0.10	0.10	0.11	0.11	0.12	0.12	0.12	0.13	0.14	0.15	0.17	0.18	0.20	0.21	0.21
21	0.47	0.46	0.44	0.41	0.38	0.35	0.32	0.29	0.26	0.24	0.22	0.21	0.19	0.18	0.16
22	0.10	0.09	0.07	0.05	0.03	0.01	-0.00	-0.02	-0.04	-0.05	-0.07	-0.08	-0.09	-0.10	-0.09
23	-0.14	-0.14	-0.14	-0.14	-0.14	-0.14	-0.14	-0.14	-0.14	-0.14	-0.13	-0.13	-0.13	-0.12	-0.11
24	-0.03	-0.03	-0.03	-0.04	-0.05	-0.05	-0.06	-0.07	-0.08	-0.08	-0.09	-0.09	-0.09	-0.09	-0.08
25	-0.03	-0.04	-0.04	-0.05	-0.06	-0.07	-0.08	-0.09	-0.10	-0.11	-0.12	-0.13	-0.14	-0.14	-0.13
26	-0.17	-0.17	-0.16	-0.16	-0.16	-0.15	-0.15	-0.15	-0.15	-0.14	-0.13	-0.13	-0.12	-0.11	-0.10
27	0.08	0.09	0.10	0.11	0.11	0.12	0.12	0.13	0.14	0.16	0.18	0.19	0.21	0.22	0.22



	0	1	2	3	4	5	6	7	8	9	10	11	12	13	14
day															
28	0.49	0.48	0.45	0.42	0.39	0.36	0.33	0.30	0.27	0.25	0.23	0.22	0.20	0.19	0.
29	0.09	0.08	0.06	0.04	0.02	-0.00	-0.02	-0.04	-0.06	-0.08	-0.09	-0.10	-0.12	-0.13	-0.

```
plt_residual_lag(res, 1)
```



```
plt_residual_lag(res, 24)
```



```
plt_residual_lag(res, 24*7)
```



## 6.4 Predictors: Temperature + 1 day lag of power + 1 week lag of power

```
df['power_lag_1_week']=df['power'].shift(24*7)
df.tail()
```

	key	Date	Hour	power	temperature	temp_hot	temp_cold	power_lag_1_day
35059	20201231:19	2020-12-31	19	5948	4.9	0.0	4.9	6163.0
35060	20201231:20	2020-12-31	20	5741	4.5	0.0	4.5	5983.0
35061	20201231:21	2020-12-31	21	5527	3.7	0.0	3.7	5727.0
35062	20201231:22	2020-12-31	22	5301	2.9	0.0	2.9	5428.0
35063	20201231:23	2020-12-31	23	5094	2.1	0.0	2.1	5104.0

```
res=build_model(['temp_hot', 'temp_cold', 'power_lag_1_day', 'power_lag_1_week' ])
```

```
/usr/local/lib/python3.8/dist-packages/statsmodels/tsa/tsatools.py:142: FutureWarning: In a future version of pandas the
x = pd.concat(x[:,::order], 1)
```

Table 6.13: OLS Regression Results

Dep. Variable:	power	R-squared:	0.840
Model:	OLS	Adj. R-squared:	0.840
Method:	Least Squares	F-statistic:	4.585e+04
Date:	Sun, 22 Jan 2023	Prob (F-statistic):	0.00
Time:	19:22:49	Log-Likelihood:	-2.5830e+05
No. Observations:	34896	AIC:	5.166e+05
Df Residuals:	34891	BIC:	5.167e+05
Df Model:	4		
Covariance Type:	nonrobust		

	coef	std err	t	P> t	[0.025	0.975]
const	290.4344	14.166	20.502	0.000	262.668	318.201
temp_hot	3.2967	0.221	14.896	0.000	2.863	3.730
temp_cold	-4.5938	0.385	-11.943	0.000	-5.348	-3.840
power_lag_1_day	0.6114	0.004	170.709	0.000	0.604	0.618
power_lag_1_week	0.3342	0.003	99.595	0.000	0.328	0.341

Omnibus:	2729.372	Durbin-Watson:	0.037
Prob(Omnibus):	0.000	Jarque-Bera (JB):	11234.560
Skew:	0.299	Prob(JB):	0.00
Kurtosis:	5.715	Cond. No.	5.43e+04

```
plt_residual(res)
```



```
plt_acf(res)
```

```
/usr/local/lib/python3.8/dist-packages/statsmodels/tsa/stattools.py:667: FutureWarning: fft=
warnings.warn(
```



	0	1	2	3	4	5	6	7	8	9	10	11	12	13	14
day															
0	1.00	0.98	0.94	0.89	0.84	0.79	0.74	0.70	0.65	0.61	0.58	0.54	0.51	0.48	0.44
1	0.20	0.18	0.16	0.14	0.12	0.10	0.09	0.07	0.06	0.04	0.03	0.02	0.01	0.00	-0.01
2	-0.05	-0.06	-0.06	-0.05	-0.05	-0.05	-0.05	-0.05	-0.05	-0.05	-0.05	-0.04	-0.04	-0.04	-0.04
3	0.00	0.00	0.00	-0.00	-0.00	-0.01	-0.01	-0.01	-0.02	-0.02	-0.02	-0.03	-0.03	-0.03	-0.03
4	-0.03	-0.03	-0.03	-0.03	-0.03	-0.04	-0.04	-0.04	-0.05	-0.05	-0.05	-0.06	-0.06	-0.06	-0.06
5	-0.10	-0.09	-0.09	-0.08	-0.08	-0.07	-0.07	-0.07	-0.06	-0.06	-0.05	-0.05	-0.04	-0.04	-0.04
6	0.03	0.03	0.03	0.03	0.03	0.03	0.03	0.03	0.03	0.04	0.04	0.05	0.05	0.05	0.05
7	0.10	0.10	0.09	0.08	0.06	0.05	0.05	0.04	0.03	0.02	0.01	0.01	0.00	-0.01	-0.01
8	-0.08	-0.08	-0.08	-0.09	-0.09	-0.09	-0.09	-0.10	-0.10	-0.10	-0.10	-0.11	-0.11	-0.11	-0.11
9	-0.17	-0.16	-0.16	-0.15	-0.15	-0.14	-0.14	-0.13	-0.13	-0.12	-0.12	-0.11	-0.11	-0.10	-0.10
10	-0.06	-0.05	-0.05	-0.05	-0.05	-0.05	-0.04	-0.04	-0.04	-0.04	-0.04	-0.04	-0.04	-0.04	-0.04
11	-0.01	-0.01	-0.01	-0.01	-0.01	-0.01	-0.01	-0.01	-0.01	-0.02	-0.02	-0.02	-0.03	-0.03	-0.03
12	-0.07	-0.07	-0.06	-0.06	-0.06	-0.06	-0.06	-0.05	-0.05	-0.05	-0.05	-0.04	-0.04	-0.03	-0.03
13	0.05	0.06	0.06	0.07	0.08	0.08	0.09	0.10	0.11	0.12	0.13	0.14	0.15	0.16	0.16
14	0.29	0.29	0.27	0.26	0.24	0.23	0.21	0.20	0.19	0.18	0.17	0.16	0.15	0.14	0.13
15	0.05	0.04	0.03	0.02	0.01	-0.00	-0.01	-0.02	-0.03	-0.04	-0.05	-0.06	-0.06	-0.07	-0.07
16	-0.13	-0.13	-0.12	-0.12	-0.11	-0.11	-0.11	-0.10	-0.10	-0.10	-0.10	-0.09	-0.09	-0.08	-0.08
17	-0.03	-0.03	-0.03	-0.03	-0.03	-0.03	-0.03	-0.03	-0.03	-0.03	-0.03	-0.03	-0.03	-0.03	-0.03
18	-0.05	-0.05	-0.06	-0.06	-0.06	-0.07	-0.07	-0.08	-0.08	-0.09	-0.09	-0.10	-0.10	-0.10	-0.10
19	-0.14	-0.14	-0.13	-0.13	-0.12	-0.11	-0.11	-0.10	-0.10	-0.09	-0.08	-0.08	-0.07	-0.06	-0.06
20	0.03	0.03	0.04	0.04	0.05	0.05	0.06	0.07	0.07	0.08	0.09	0.10	0.11	0.12	0.12
21	0.25	0.24	0.23	0.22	0.20	0.19	0.17	0.16	0.14	0.13	0.12	0.11	0.11	0.10	0.09
22	0.04	0.03	0.02	0.02	0.01	0.00	-0.01	-0.01	-0.02	-0.03	-0.03	-0.04	-0.04	-0.05	-0.05
23	-0.10	-0.10	-0.09	-0.09	-0.09	-0.08	-0.08	-0.08	-0.07	-0.07	-0.07	-0.07	-0.07	-0.06	-0.06
24	-0.05	-0.05	-0.05	-0.05	-0.05	-0.05	-0.06	-0.06	-0.06	-0.06	-0.06	-0.06	-0.06	-0.06	-0.06
25	-0.05	-0.05	-0.05	-0.05	-0.05	-0.06	-0.06	-0.06	-0.07	-0.07	-0.08	-0.08	-0.09	-0.09	-0.09
26	-0.13	-0.13	-0.12	-0.12	-0.11	-0.11	-0.10	-0.10	-0.09	-0.09	-0.08	-0.08	-0.07	-0.07	-0.07
27	0.02	0.03	0.03	0.04	0.05	0.06	0.06	0.07	0.08	0.10	0.11	0.12	0.13	0.14	0.14

	0	1	2	3	4	5	6	7	8	9	10	11	12	13	14
day															
28	0.27	0.27	0.25	0.24	0.22	0.21	0.19	0.18	0.17	0.15	0.14	0.14	0.13	0.12	0.11
29	0.04	0.03	0.02	0.02	0.01	-0.00	-0.01	-0.02	-0.03	-0.04	-0.04	-0.05	-0.06	-0.07	-0.08

```
plt_residual_lag(res, 1)
```



```
plt_residual_lag(res, 24)
```



```
plt_residual_lag(res, 24*7)
```



```
plt_residual_lag(res, 24*7*2)
```



## 6.5 Predictors: Temperature + 1 day lag of power + 1 week lag of power + 2 weeks lag of power

Although the data shows there is a significant (but not strong) correlation, we need to be cautious to use this feature because there are no simple reasons for this relationship.

For 1-day-lag feature, the correlation is easily understood.

For 1-week-lag feature, we could argue that the behaviour is different between weekday and weekend.

But for 2-week-lag feature, it is hard to understand especially when we have included 1-day-lag and 1-week-lag features. The relation is spurious.

```
df['power_lag_2_week']=df['power'].shift(24*7*2)
df.tail()
```



	key	Date	Hour	power	temperature	temp_hot	temp_cold	power_lag_1_day
35059	20201231:19	2020-12-31	19	5948	4.9	0.0	4.9	6163.0
35060	20201231:20	2020-12-31	20	5741	4.5	0.0	4.5	5983.0
35061	20201231:21	2020-12-31	21	5527	3.7	0.0	3.7	5727.0
35062	20201231:22	2020-12-31	22	5301	2.9	0.0	2.9	5428.0
35063	20201231:23	2020-12-31	23	5094	2.1	0.0	2.1	5104.0

```
res=build_model(['temp_hot', 'temp_cold', 'power_lag_1_day', 'power_lag_1_week', 'power_lag_2_week'])
```

```
/usr/local/lib/python3.8/dist-packages/statsmodels/tsa/tsatools.py:142: FutureWarning: In a future version of pandas,
x = pd.concat(x[:, :order], 1)
```

Table 6.18: OLS Regression Results

Dep. Variable:	power	R-squared:	0.848
Model:	OLS	Adj. R-squared:	0.847
Method:	Least Squares	F-statistic:	3.860e+04
Date:	Sun, 22 Jan 2023	Prob (F-statistic):	0.00
Time:	19:25:04	Log-Likelihood:	-2.5626e+05
No. Observations:	34728	AIC:	5.125e+05
Df Residuals:	34722	BIC:	5.126e+05
Df Model:	5		
Covariance Type:	nonrobust		

	coef	std err	t	P> t	[0.025	0.975]
const	200.8402	14.046	14.298	0.000	173.309	228.371
temp_hot	3.2508	0.217	14.983	0.000	2.826	3.676
temp_cold	-5.6865	0.379	-15.005	0.000	-6.429	-4.944
power_lag_1_day	0.5637	0.004	152.597	0.000	0.556	0.571
power_lag_1_week	0.2415	0.004	60.139	0.000	0.234	0.249
power_lag_2_week	0.1565	0.004	40.465	0.000	0.149	0.164

Omnibus:	2229.659	Durbin-Watson:	0.036
Prob(Omnibus):	0.000	Jarque-Bera (JB):	7850.238
Skew:	0.262	Prob(JB):	0.00
Kurtosis:	5.270	Cond. No.	6.72e+04

```
plt_acf(res)
```

```
/usr/local/lib/python3.8/dist-packages/statsmodels/tsa/stattools.py:667: FutureWarning: fft=
warnings.warn(
```



	0	1	2	3	4	5	6	7	8	9	10	11	12	13	14
day															
0	1.00	0.98	0.94	0.90	0.85	0.80	0.75	0.71	0.67	0.63	0.59	0.56	0.53	0.50	0.47
1	0.23	0.21	0.20	0.18	0.16	0.14	0.13	0.11	0.10	0.08	0.07	0.06	0.05	0.05	0.04
2	-0.01	-0.01	-0.01	-0.01	-0.01	-0.01	-0.01	-0.01	-0.01	-0.01	-0.01	-0.01	-0.00	-0.00	0.00
3	0.03	0.03	0.03	0.03	0.02	0.02	0.02	0.01	0.01	0.01	0.00	0.00	0.00	-0.00	-0.01
4	0.01	0.01	0.00	0.00	0.00	-0.00	-0.00	-0.01	-0.01	-0.01	-0.02	-0.02	-0.02	-0.02	-0.02
5	-0.05	-0.05	-0.04	-0.04	-0.04	-0.03	-0.03	-0.03	-0.02	-0.02	-0.02	-0.01	-0.01	-0.00	0.00
6	0.07	0.07	0.07	0.07	0.07	0.07	0.07	0.07	0.08	0.08	0.09	0.09	0.10	0.10	0.10
7	0.17	0.16	0.15	0.14	0.13	0.12	0.11	0.10	0.09	0.09	0.08	0.07	0.07	0.06	0.06
8	-0.00	-0.01	-0.01	-0.02	-0.02	-0.02	-0.03	-0.03	-0.03	-0.04	-0.04	-0.04	-0.05	-0.05	-0.05
9	-0.10	-0.10	-0.09	-0.09	-0.09	-0.08	-0.08	-0.08	-0.07	-0.07	-0.06	-0.06	-0.06	-0.05	-0.05
10	-0.01	-0.01	-0.01	-0.01	-0.00	-0.00	-0.00	-0.00	-0.00	-0.00	0.00	0.00	0.00	0.00	0.00
11	0.02	0.02	0.02	0.02	0.02	0.02	0.02	0.02	0.02	0.02	0.02	0.01	0.01	0.01	0.01
12	-0.03	-0.03	-0.03	-0.03	-0.03	-0.03	-0.03	-0.03	-0.02	-0.02	-0.02	-0.02	-0.01	-0.01	-0.01
13	0.05	0.05	0.05	0.05	0.06	0.06	0.06	0.07	0.07	0.08	0.08	0.09	0.09	0.10	0.10
14	0.16	0.16	0.15	0.14	0.13	0.12	0.11	0.10	0.09	0.08	0.08	0.07	0.06	0.06	0.06
15	-0.02	-0.03	-0.03	-0.04	-0.05	-0.05	-0.06	-0.06	-0.07	-0.08	-0.08	-0.09	-0.09	-0.10	-0.10
16	-0.15	-0.15	-0.14	-0.14	-0.13	-0.13	-0.12	-0.12	-0.11	-0.11	-0.11	-0.10	-0.10	-0.10	-0.10
17	-0.05	-0.05	-0.05	-0.04	-0.04	-0.04	-0.04	-0.04	-0.03	-0.03	-0.03	-0.03	-0.03	-0.03	-0.03
18	-0.05	-0.05	-0.06	-0.06	-0.06	-0.07	-0.07	-0.07	-0.07	-0.08	-0.08	-0.09	-0.09	-0.09	-0.09
19	-0.13	-0.13	-0.12	-0.11	-0.11	-0.10	-0.09	-0.09	-0.08	-0.08	-0.07	-0.07	-0.06	-0.05	-0.05
20	0.02	0.03	0.03	0.04	0.04	0.05	0.05	0.06	0.07	0.07	0.08	0.09	0.10	0.10	0.10

	0	1	2	3	4	5	6	7	8	9	10	11	12	13	14
day															
21	0.21	0.20	0.19	0.18	0.17	0.16	0.15	0.13	0.12	0.11	0.11	0.10	0.09	0.09	0.0
22	0.03	0.03	0.02	0.02	0.01	0.00	-0.00	-0.01	-0.01	-0.02	-0.02	-0.03	-0.03	-0.04	-0
23	-0.08	-0.08	-0.08	-0.08	-0.07	-0.07	-0.07	-0.06	-0.06	-0.06	-0.06	-0.05	-0.05	-0.05	-0
24	-0.04	-0.04	-0.04	-0.04	-0.04	-0.04	-0.05	-0.05	-0.05	-0.05	-0.05	-0.05	-0.05	-0.05	-0
25	-0.04	-0.04	-0.05	-0.05	-0.05	-0.05	-0.05	-0.06	-0.06	-0.06	-0.07	-0.07	-0.07	-0.08	-0
26	-0.11	-0.11	-0.11	-0.10	-0.10	-0.09	-0.09	-0.08	-0.08	-0.08	-0.07	-0.07	-0.06	-0.06	-0
27	0.02	0.02	0.03	0.04	0.04	0.05	0.06	0.07	0.07	0.09	0.10	0.11	0.11	0.12	0.3
28	0.23	0.23	0.22	0.20	0.19	0.18	0.17	0.16	0.15	0.14	0.13	0.12	0.11	0.11	0.3
29	0.03	0.03	0.02	0.01	0.01	-0.00	-0.01	-0.01	-0.02	-0.03	-0.03	-0.04	-0.05	-0.05	-0

```
plt_residual_lag(res, 1)
```



```
plt_residual_lag(res, 24)
```



```
plt_residual_lag(res, 24*7)
```



```
plt_residual_lag(res, 24*7*2)
```



## 7 Remark

We saw that with 2-week-lag feature, the  $R^2$  only increased a little. The model summary seems still good so we could keep it. However, from the viewpoint of interpretation I may remove it.

One may also notice that the 1-day-lag correlation becomes bigger although 1-day-lag feature is already in the model. It is probably because of the multicollinearity between the lag features.

The following table shows the correlation between lag features.

```
df[['power_lag_1_day', 'power_lag_1_week', 'power_lag_2_week']].corr()
```

	power_lag_1_day	power_lag_1_week	power_lag_2_week
power_lag_1_day	1.000000	0.768394	0.745817
power_lag_1_week	0.768394	1.000000	0.819955
power_lag_2_week	0.745817	0.819955	1.000000

## **Part II**

# **Logistic regression**

## 8 Logistic regression

*Note that in this course, lecture notes are not sufficient, you must read the book for better understanding. Lecture notes are just implementing the concepts of the book on a dataset, but not explaining the concepts elaborately.*

Logistic regression is the go-to linear classification algorithm for two-class problems. It is easy to implement, easy to understand and gets great results on a wide variety of problems, even when the expectations the method has for your data are violated.

### 8.0.1 Description

Logistic regression is named for the function used at the core of the method, the [logistic function](#).

The logistic function, also called the **Sigmoid function** was developed by statisticians to describe properties of population growth in ecology, rising quickly and maxing out at the carrying capacity of the environment. It's an S-shaped curve that can take any real-valued number and map it into a value between 0 and 1, but never exactly at those limits.

$$\frac{1}{1 + e^{-x}}$$

$e$  is the base of the natural logarithms and  $x$  is value that you want to transform via the logistic function.

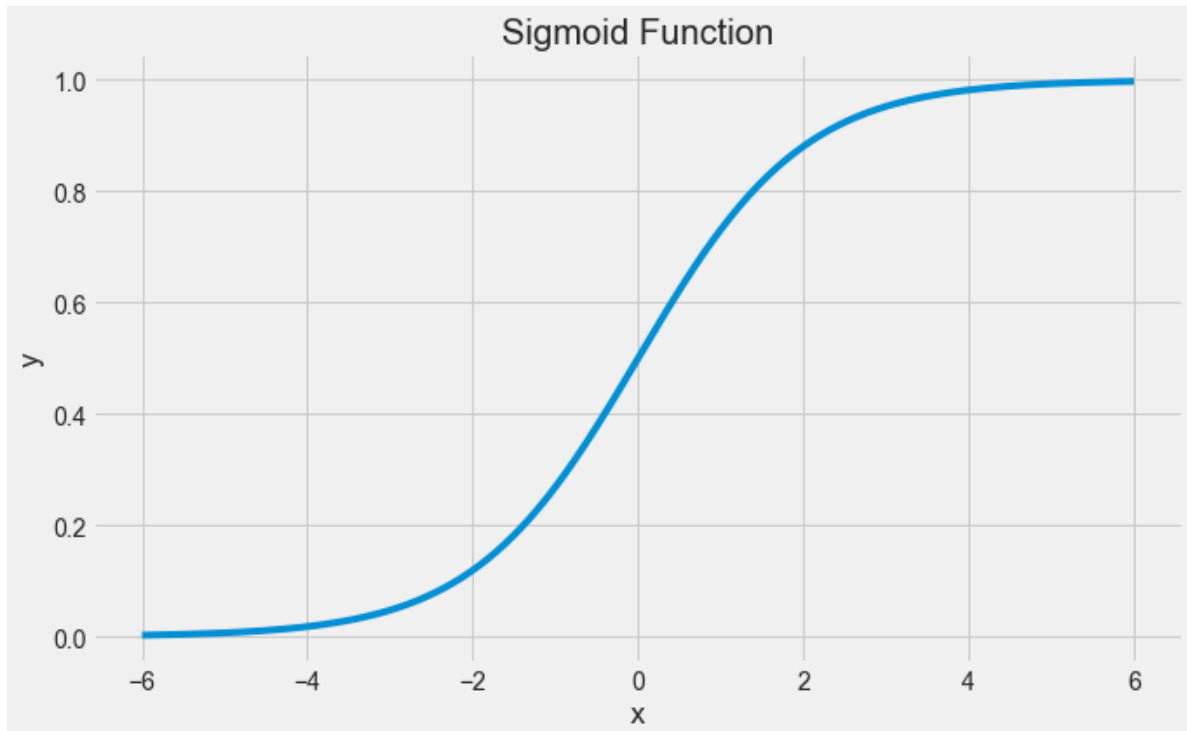
```
import pandas as pd
import numpy as np
import seaborn as sns
import matplotlib.pyplot as plt
import statsmodels.formula.api as sm
```

```
%matplotlib inline
sns.set_style('whitegrid')
plt.style.use("fivethirtyeight")
x = np.linspace(-6, 6, num=1000)
```



```
plt.figure(figsize=(10, 6))
plt.plot(x, (1 / (1 + np.exp(-x))))
plt.xlabel("x")
plt.ylabel("y")
plt.title("Sigmoid Function")
```

```
Text(0.5, 1.0, 'Sigmoid Function')
```



The logistic regression equation has a very similar representation like linear regression. The difference is that the output value being modelled is binary in nature.

$$\hat{y} = \frac{e^{\beta_0 + \beta_1 x_1}}{1 + e^{\beta_0 + \beta_1 x_1}}$$

or

$$\hat{y} = \frac{1.0}{1.0 + e^{-\beta_0 - \beta_1 x_1}}$$

$\beta_0$  is the intercept term

$\beta_1$  is the coefficient for  $x_1$

$\hat{y}$  is the predicted output with real value between 0 and 1. To convert this to binary output of 0 or 1, this would either need to be rounded to an integer value or a cutoff point be provided to specify the class segregation point.

## 8.0.2 Learning the Logistic Regression Model

The coefficients (Beta values  $\beta$ ) of the logistic regression algorithm must be estimated from your training data. This is done using [maximum-likelihood estimation](#).

Maximum-likelihood estimation is a common learning algorithm used by a variety of machine learning algorithms, although it does make assumptions about the distribution of your data (more on this when we talk about preparing your data).

The best coefficients should result in a model that would predict a value very close to 1 (e.g. male) for the default class and a value very close to 0 (e.g. female) for the other class. The intuition for maximum-likelihood for logistic regression is that a search procedure seeks values for the coefficients (Beta values) that maximize the likelihood of the observed data. In other words, in MLE, we estimate the parameter values (Beta values) which are the most likely to produce that data at hand.

Here is an analogy to understand the idea behind Maximum Likelihood Estimation (MLE). Let us say, you are listening to a song (data). You are not aware of the singer (parameter) of the song. With just the musical piece at hand, you try to guess the singer (parameter) who you feel is the most likely (MLE) to have sung that song. You are making a maximum likelihood estimate! Out of all the singers (parameter space) you have chosen them as the one who is the most likely to have sung that song (data).

We are not going to go into the math of maximum likelihood. It is enough to say that a minimization algorithm is used to optimize the best values for the coefficients for your training data. This is often implemented in practice using efficient numerical optimization algorithm (like the Quasi-newton method).

When you are learning logistic, you can implement it yourself from scratch using the much simpler gradient descent algorithm.

## 8.0.3 Preparing Data for Logistic Regression

The assumptions made by logistic regression about the distribution and relationships in your data are much the same as the assumptions made in linear regression.

Much study has gone into defining these assumptions and precise probabilistic and statistical language is used. My advice is to use these as guidelines or rules of thumb and experiment with different data preparation schemes.

Ultimately in predictive modeling machine learning projects you are laser focused on making accurate predictions rather than interpreting the results. As such, you can break some assumptions as long as the model is robust and performs well.

- **Binary Output Variable:** This might be obvious as we have already mentioned it, but logistic regression is intended for binary (two-class) classification problems. It will predict the probability of an instance belonging to the default class, which can be snapped into a 0 or 1 classification.
- **Remove Noise:** Logistic regression assumes no error in the output variable ( $y$ ), consider removing outliers and possibly misclassified instances from your training data.
- **Gaussian Distribution:** Logistic regression is a linear algorithm (with a non-linear transform on output). It does assume a linear relationship between the input variables with the output. Data transforms of your input variables that better expose this linear relationship can result in a more accurate model. For example, you can use log, root, Box-Cox and other univariate transforms to better expose this relationship.
- **Remove Correlated Inputs:** Like linear regression, the model can overfit if you have multiple highly-correlated inputs. Consider calculating the pairwise correlations between all inputs and removing highly correlated inputs.
- **Fail to Converge:** It is possible for the expected likelihood estimation process that learns the coefficients to fail to converge. This can happen if there are many highly correlated inputs in your data or the data is very sparse (e.g. lots of zeros in your input data).

## 8.1 Logistic Regression: Scikit-learn vs Statsmodels

Python gives us two ways to do logistic regression. Statsmodels offers modeling from the perspective of statistics. Scikit-learn offers some of the same models from the perspective of machine learning.

So we need to understand the difference between statistics and machine learning! Statistics makes mathematically valid inferences about a population based on sample data. Statistics answers the question, “What is the evidence that  $X$  is related to  $Y$ ?” Machine learning has the goal of optimizing predictive accuracy rather than inference. Machine learning answers the question, “Given  $X$ , what prediction should we make for  $Y$ ?”

Let us see the use of `statsmodels` for logistic regression. We’ll see `scikit-learn` later in the course, when we learn methods that focus on prediction.

## 8.2 Training a logistic regression model

Read the data on social network ads. The data shows if the person purchased a product when targeted with an ad on social media. Fit a logistic regression model to predict if a user will purchase the product based on their characteristics such as age, gender and estimated salary.

```
train = pd.read_csv('./Datasets/Social_Network_Ads_train.csv') #Develop the model on train
test = pd.read_csv('./Datasets/Social_Network_Ads_test.csv') #Test the model on test data

train.head()
```

	User ID	Gender	Age	EstimatedSalary	Purchased
0	15755018	Male	36	33000	0
1	15697020	Female	39	61000	0
2	15796351	Male	36	118000	1
3	15665760	Male	39	122000	1
4	15794661	Female	26	118000	0

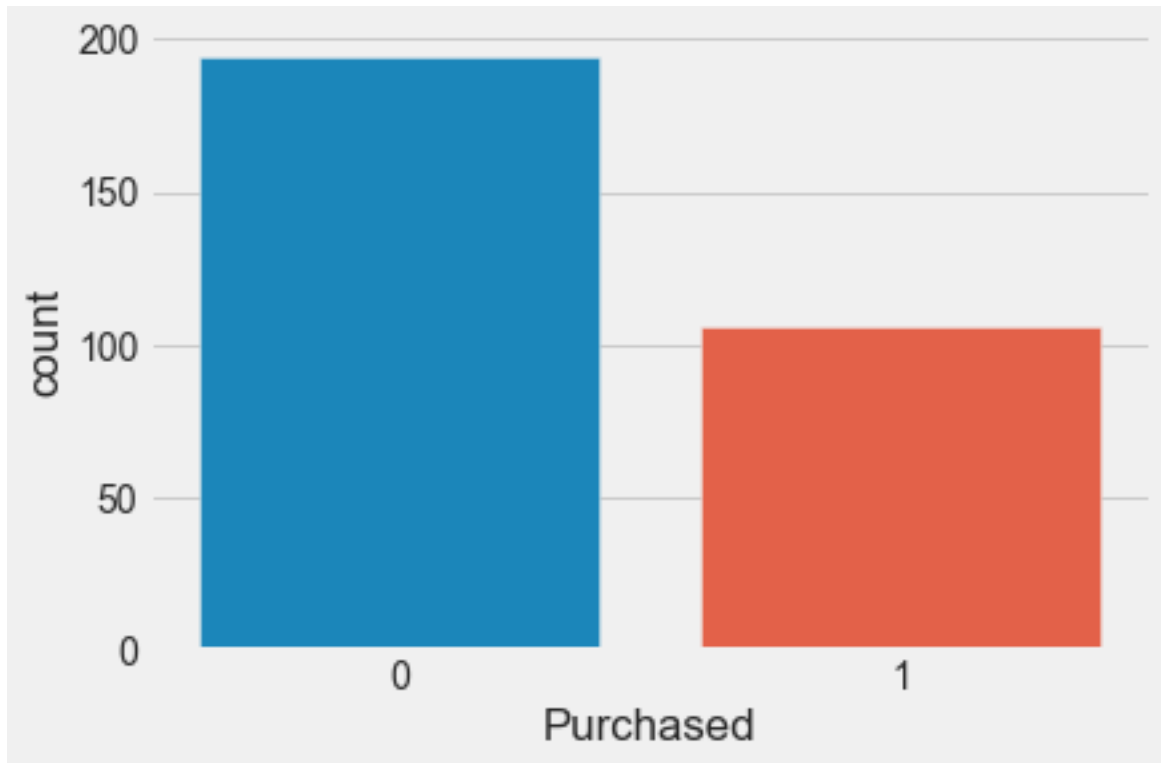
### 8.2.1 Examining the Distribution of the Target Column

Make sure our target is not serverly imbalanced

```
train.Purchased.value_counts()
```

```
0    194
1    106
Name: Purchased, dtype: int64
```

```
sns.countplot(x = 'Purchased',data = train);
```



Let us try to fit a linear regression model, instead of logistic regression. We fit a linear regression model to predict probability of purchase based on age.

```
sns.scatterplot(x = 'Age', y = 'Purchased', data = train, color = 'orange') #Visualizing d
lm = sm.ols(formula = 'Purchased~Age', data = train).fit() #Developing linear regression m
sns.lineplot(x = 'Age', y= lm.predict(train), data = train, color = 'blue') #Visualizing m
```

```
<AxesSubplot:xlabel='Age', ylabel='Purchased'>
```



Note the issues with the linear regression model:

1. The regression line goes below 0 and over 1. However, probability of purchase must be in  $[0,1]$ .
2. The linear regression model does not seem to fit the data well.

## 8.2.2 Fitting the logistic regression model

Now, let us fit a logistic regression model to predict probability of purchase based on Age.

```
sns.scatterplot(x = 'Age', y = 'Purchased', data = train, color = 'orange') #Visualizing d
logit_model = sm.logit(formula = 'Purchased~Age', data = train).fit() #Developing logistic
sns.lineplot(x = 'Age', y=logit_model.predict(train), data = train, color = 'blue') #Visu
```

Optimization terminated successfully.

Current function value: 0.430107

Iterations 7

<AxesSubplot:xlabel='Age', ylabel='Purchased'>



As logistic regression uses the sigmoid function, the probability stays in  $[0,1]$ . Also, it seems to better fit the points as compared to linear regression.

```
logit_model.summary()
```

Table 8.2: Logit Regression Results

Dep. Variable:	Purchased	No. Observations:	300
Model:	Logit	Df Residuals:	298
Method:	MLE	Df Model:	1
Date:	Tue, 19 Apr 2022	Pseudo R-squ.:	0.3378
Time:	16:46:02	Log-Likelihood:	-129.03
converged:	True	LL-Null:	-194.85
Covariance Type:	nonrobust	LLR p-value:	1.805e-30

	coef	std err	z	P> z	[0.025	0.975]
Intercept	-7.8102	0.885	-8.825	0.000	-9.545	-6.076
Age	0.1842	0.022	8.449	0.000	0.141	0.227

### Interpret the coefficient of age

For a unit increase in age, the log odds of purchase increase by 0.18, or the odds of purchase get multiplied by  $\exp(0.18) = 1.2$

### Is the increase in probability of purchase constant with a unit increase in age?

No, it depends on age.

### Is gender associated with probability of purchase?

```
logit_model_gender = sm.logit(formula = 'Purchased~Gender', data = train).fit()
logit_model_gender.summary()
```

Optimization terminated successfully.

Current function value: 0.648804

Iterations 4

Table 8.4: Logit Regression Results

Dep. Variable:	Purchased	No. Observations:	300
Model:	Logit	Df Residuals:	298
Method:	MLE	Df Model:	1
Date:	Tue, 19 Apr 2022	Pseudo R-squ.:	0.001049
Time:	16:46:04	Log-Likelihood:	-194.64
converged:	True	LL-Null:	-194.85
Covariance Type:	nonrobust	LLR p-value:	0.5225

	coef	std err	z	P> z	[0.025	0.975]
Intercept	-0.5285	0.168	-3.137	0.002	-0.859	-0.198
Gender[T.Male]	-0.1546	0.242	-0.639	0.523	-0.629	0.319

No, assuming a significance level of  $\alpha = 5\%$ , **Gender** is not associated with probability of default, as the  $p$ -value for **Male** is greater than 0.05.

## 8.3 Confusion matrix and classification accuracy

A confusion matrix is a summary of prediction results on a classification problem. The number of correct and incorrect predictions are summarized with count values and broken down by each class.



```

#Function to compute confusion matrix and prediction accuracy on training data
def confusion_matrix_train(model,cutoff=0.5):
    # Confusion matrix
    cm_df = pd.DataFrame(model.pred_table(threshold = cutoff))
    #Formatting the confusion matrix
    cm_df.columns = ['Predicted 0', 'Predicted 1']
    cm_df = cm_df.rename(index={0: 'Actual 0',1: 'Actual 1'})
    cm = np.array(cm_df)
    # Calculate the accuracy
    accuracy = (cm[0,0]+cm[1,1])/cm.sum()
    sns.heatmap(cm_df, annot=True, cmap='Blues', fmt='g')
    plt.ylabel("Actual Values")
    plt.xlabel("Predicted Values")
    print("Classification accuracy = {:.1%}".format(accuracy))

```

Find the confusion matrix and classification accuracy of the model with **Age** as the predictor on training data.

```

cm = confusion_matrix_train(logit_model)

```

Classification accuracy = 83.3%



#### Confusion matrix:

- Each row: actual class
- Each column: predicted class

First row: Non-purchasers, the negative class:

- 181 were correctly classified as Non-purchasers. **True negatives.**
- Remaining 13 were wrongly classified as Non-purchasers. **False positive**

Second row: Purchasers, the positive class:

- 37 were incorrectly classified as Non-purchasers. **False negatives**
- 69 were correctly classified Purchasers. **True positives**

```
#Function to compute confusion matrix and prediction accuracy on test data
def confusion_matrix_test(data,actual_values,model,cutoff=0.5):
#Predict the values using the Logit model
    pred_values = model.predict(data)
# Specify the bins
    bins=np.array([0,cutoff,1])
```

```
#Confusion matrix
cm = np.histogram2d(actual_values, pred_values, bins=bins)[0]
cm_df = pd.DataFrame(cm)
cm_df.columns = ['Predicted 0', 'Predicted 1']
cm_df = cm_df.rename(index={0: 'Actual 0', 1: 'Actual 1'})
accuracy = (cm[0,0]+cm[1,1])/cm.sum()
sns.heatmap(cm_df, annot=True, cmap='Blues', fmt='g')
plt.ylabel("Actual Values")
plt.xlabel("Predicted Values")
print("Classification accuracy = {:.1%}".format(accuracy))
```

Find the confusion matrix and classification accuracy of the model with **Age** as the predictor on test data.

```
confusion_matrix_test(test,test.Purchased,logit_model)
```

Classification accuracy = 86.0%



The model classifies a bit more accurately on test data as compared to the training data, which

is a bit unusual. However, it shows that the model did not overfit on training data.

**Include EstimatedSalary as a predictor in the above model**

```
logit_model2 = sm.logit(formula = 'Purchased~Age+EstimatedSalary', data = train).fit()  
logit_model2.summary()
```

Optimization terminated successfully.

Current function value: 0.358910

Iterations 7

Table 8.6: Logit Regression Results

Dep. Variable:	Purchased	No. Observations:	300
Model:	Logit	Df Residuals:	297
Method:	MLE	Df Model:	2
Date:	Tue, 14 Feb 2023	Pseudo R-squ.:	0.4474
Time:	12:03:29	Log-Likelihood:	-107.67
converged:	True	LL-Null:	-194.85
Covariance Type:	nonrobust	LLR p-value:	1.385e-38

	coef	std err	z	P> z	[0.025	0.975]
Intercept	-11.9432	1.424	-8.386	0.000	-14.735	-9.152
Age	0.2242	0.028	7.890	0.000	0.168	0.280
EstimatedSalary	3.48e-05	6.15e-06	5.660	0.000	2.27e-05	4.68e-05

```
confusion_matrix_train(logit_model2)
```

Classification accuracy = 83.3%



```
confusion_matrix_test(test,test.Purchased,logit_model2)
```

Classification accuracy = 89.0%



The log likelihood of the model has increased, while also increasing the prediction accuracy on test data, which shows that the additional predictor is helping explain the response better, without overfitting the data.

**Include Gender as a predictor in the above model**

```
logit_model = sm.logit(formula = 'Purchased~Age+EstimatedSalary+Gender', data = train).fit()
logit_model.summary()
```

Optimization terminated successfully.

Current function value: 0.357327

Iterations 7

Table 8.8: Logit Regression Results

Dep. Variable:	Purchased	No. Observations:	300
Model:	Logit	Df Residuals:	296
Method:	MLE	Df Model:	3
Date:	Tue, 14 Feb 2023	Pseudo R-squ.:	0.4498

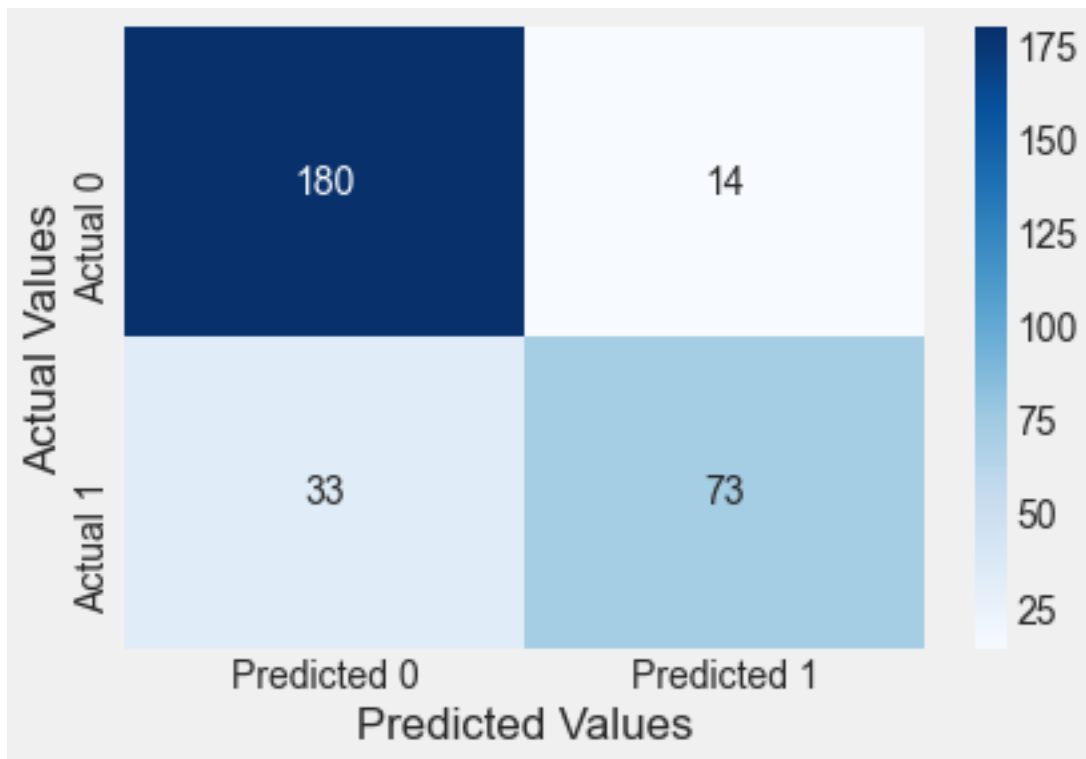
Table 8.8: Logit Regression Results

Time:	12:17:28	Log-Likelihood:	-107.20
converged:	True	LL-Null:	-194.85
Covariance Type:	nonrobust	LLR p-value:	9.150e-38

	coef	std err	z	P> z	[0.025	0.975]
Intercept	-12.2531	1.478	-8.293	0.000	-15.149	-9.357
Gender[T.Male]	0.3356	0.346	0.970	0.332	-0.342	1.013
Age	0.2275	0.029	7.888	0.000	0.171	0.284
EstimatedSalary	3.494e-05	6.17e-06	5.666	0.000	2.29e-05	4.7e-05

```
confusion_matrix_train(logit_model)
```

Classification accuracy = 84.3%



```
confusion_matrix_test(test,test.Purchased,logit_model)
```

Classification accuracy = 88.0%



**Gender** is a statistically insignificant predictor, and including it slightly lowers the classification accuracy on test data. Note that the classification accuracy on training data will continue to increase on adding more predictors, irrespective of their relevance (*similar to the idea of RSS on training data in linear regression*).

**Is there a residual in logistic regression?**

No, since the response is assumed to have a Bernoulli distribution, instead of a normal distribution.

**Is the odds ratio for a unit increase in a predictor  $X_j$ , a constant (assuming that the rest of the predictors are held constant)?**

Yes, the odds ratio in this case will  $e^{\beta_j}$



## 8.4 Variable transformations in logistic regression

Read the dataset *diabetes.csv* that contains if a person has diabetes (*Outcome* = 1) based on health parameters such as BMI, blood pressure, age etc. Develop a model to predict the probability of a person having diabetes based on their age.

```
data = pd.read_csv('./Datasets/diabetes.csv')
```

```
data.head()
```

	Pregnancies	Glucose	BloodPressure	SkinThickness	Insulin	BMI	DiabetesPedigreeFunction	Age
0	6	148	72	35	0	33.6	0.627	50
1	1	85	66	29	0	26.6	0.351	31
2	8	183	64	0	0	23.3	0.672	32
3	1	89	66	23	94	28.1	0.167	21
4	0	137	40	35	168	43.1	2.288	33

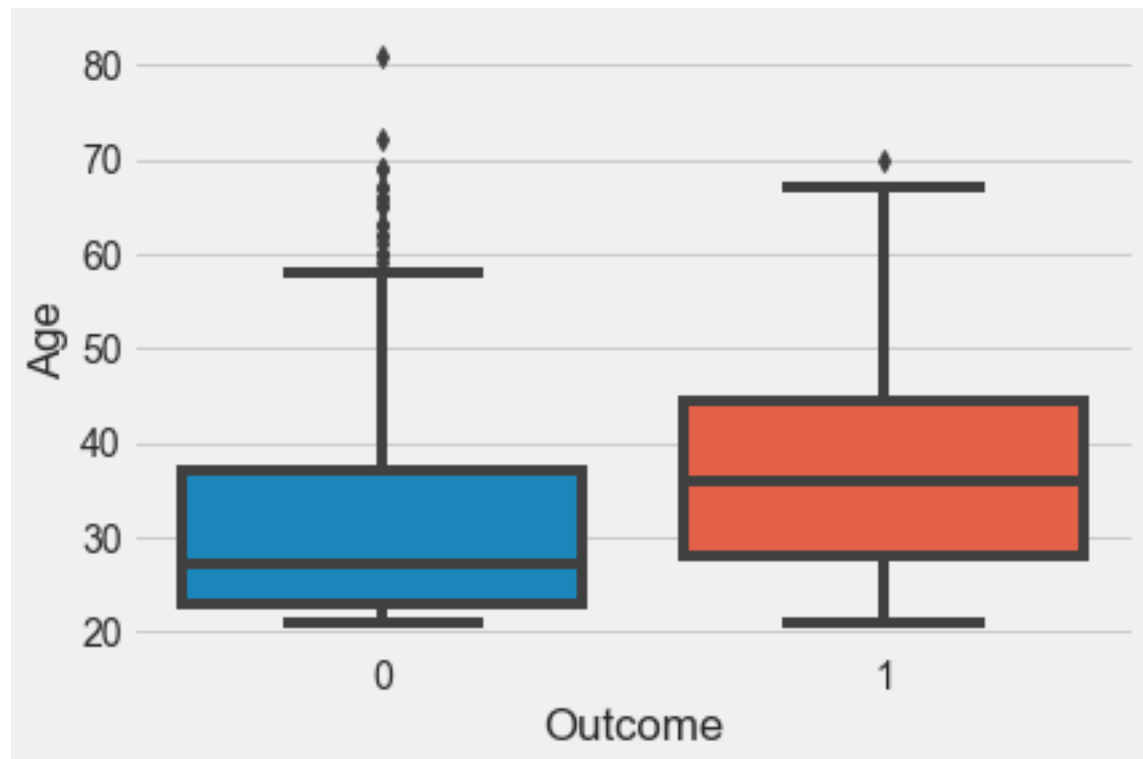
Randomly select 80% of the observations to create a training dataset. Create a test dataset with the remaining 20% observations.

```
#Creating training and test datasets
np.random.seed(2)
train = data.sample(round(data.shape[0]*0.8))
test = data.drop(train.index)
```

Does *Age* seem to distinguish *Outcome* levels?

```
sns.boxplot(x = 'Outcome', y = 'Age', data = train)
```

```
<AxesSubplot:xlabel='Outcome', ylabel='Age'>
```



Yes it does!

Develop and visualize a logistic regression model to predict Outcome using Age.

```
#Jittering points to better see the density of points in any given region of the plot
def jitter(values,j):
    return values + np.random.normal(j,0.02,values.shape)
sns.scatterplot(x = jitter(train.Age,0), y = jitter(train.Outcome,0), data = train, color = 'blue')
logit_model = sm.logit(formula = 'Outcome~Age', data = train).fit()
sns.lineplot(x = 'Age', y= logit_model.predict(train), data = train, color = 'blue')
print(logit_model.llf) #Printing the log likelihood to compare it with the next model we build
```

Optimization terminated successfully.

Current function value: 0.612356

Iterations 5

-375.9863802089716



```
confusion_matrix_train(logit_model)
```

Classification accuracy = 65.6%



Classification accuracy on train data = 66%

```
confusion_matrix_test(test,test.Outcome,logit_model)
```

Classification accuracy = 59.7%



Classification accuracy on test data = 60%

Can a transformation of **Age** provide a more accurate model?

Let us visualize how the probability of people having diabetes varies with **Age**. We will bin **Age** to get the percentage of people having diabetes within different **Age** bins.

```
#Binning Age
binned_age = pd.qcut(train['Age'],11,retbins=True)
train['age_binned'] = binned_age[0]
```

```
#Finding percentage of people having diabetes in each Age bin
age_data = train.groupby('age_binned')['Outcome'].agg([('diabetes_percent','mean'),('nobs',
age_data
```

	age_binned	diabetes_percent	nobs
0	(20.999, 22.0]	0.110092	109
1	(22.0, 23.0]	0.206897	29
2	(23.0, 25.0]	0.243243	74
3	(25.0, 26.0]	0.259259	27

	age_binned	diabetes_percent	nobs
4	(26.0, 28.0]	0.271186	59
5	(28.0, 31.0]	0.415094	53
6	(31.0, 35.0]	0.434783	46
7	(35.0, 39.0]	0.450980	51
8	(39.0, 43.545]	0.500000	54
9	(43.545, 52.0]	0.576271	59
10	(52.0, 81.0]	0.415094	53

```
#Visualizing percentage of people having diabets with increasing Age (or Age bins)
sns.lineplot(x = age_data.index, y= age_data['diabetes_percent'])
plt.xlabel('Age_bin')
```

```
Text(0.5, 0, 'Age_bin')
```



We observe that the probability of people having diabetes does **not** keep increasing monotonically with age. People with ages 52 and more have a lower probability of having diabetes than people in the immediately younger Age bin.

A quadratic transformation of Age may better fit the above trend

```
#Model with the quadratic transformation of Age
def jitter(values,j):
    return values + np.random.normal(j,0.02,values.shape)
sns.scatterplot(x = jitter(train.Age,0), y = jitter(train.Outcome,0), data = train, color
logit_model = sm.logit(formula = 'Outcome~Age+I(Age**2)', data = train).fit()
sns.lineplot(x = 'Age', y= logit_model.predict(train), data = train, color = 'blue')
logit_model.llf
```

Optimization terminated successfully.

Current function value: 0.586025

Iterations 6

-359.81925590230185



```
logit_model.summary()
```

Table 8.12: Logit Regression Results

Dep. Variable:	Outcome	No. Observations:	614
Model:	Logit	Df Residuals:	611
Method:	MLE	Df Model:	2
Date:	Tue, 14 Feb 2023	Pseudo R-squ.:	0.08307
Time:	12:25:54	Log-Likelihood:	-359.82
converged:	True	LL-Null:	-392.42
Covariance Type:	nonrobust	LLR p-value:	6.965e-15

	coef	std err	z	P> z	[0.025	0.975]
Intercept	-6.6485	0.908	-7.320	0.000	-8.429	-4.868
Age	0.2936	0.048	6.101	0.000	0.199	0.388
I(Age ** 2)	-0.0031	0.001	-5.280	0.000	-0.004	-0.002

The log likelihood of the model is higher and both the predictors are statistically significant indicating a better model fit. However, the model may also be overfitting. Let us check the model accuracy on test data.

```
confusion_matrix_train(logit_model)
```

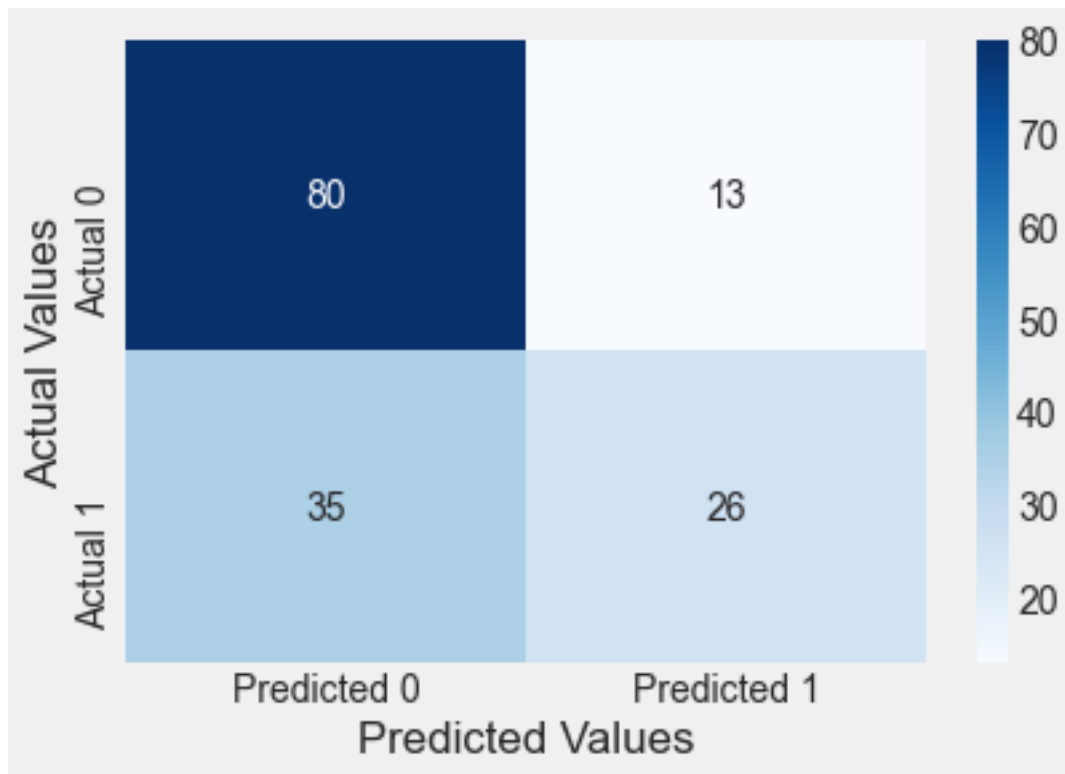
Classification accuracy = 68.1%





```
confusion_matrix_test(test,test.Outcome,logit_model)
```

Classification accuracy = 68.8%



The classification accuracy on test data has increased to 69%. However, the number of *false positives* have increased. But in case of diabetes, *false negatives* are more concerning than *false positives*. This is because if a person has diabetes, and is told that they do not have diabetes, their condition may deteriorate. If a person does not have diabetes, and is told that they have diabetes, they may take unnecessary precautions or tests, but it will not be as harmful to the person as in the previous case. So, in this problem, we will be more focused on reducing the number of *false negatives*, instead of reducing the *false positives* or increasing the overall classification accuracy.

We can decrease the cutoff for classifying a person as having diabetes to reduce the number of false negatives.

```
#Reducing the cutoff for classifying a person as diabetic to 0.3 (instead of 0.5)
confusion_matrix_test(test,test.Outcome,logit_model,0.3)
```

Classification accuracy = 69.5%



Note that the changed cut-off reduced the number of *false negatives*, but at the cost of increasing the *false positives*. However, the stakeholders may prefer the reduced cut-off to be safer.

### Is there another way to transform Age?

Yes, binning age into bins that have similar proportion of people with diabetes may provide a better model fit.

```
#Creating a function to bin age so that it can be applied to both the test and train datasets
def var_transform(data):
    binned_age = pd.qcut(train['Age'],10,retbins=True)
    bins = binned_age[1]
    data['age_binned'] = pd.cut(data['Age'],bins = bins)
    dum = pd.get_dummies(data.age_binned,drop_first = True)
    dum.columns = ['age'+str(x) for x in range(1,len(bins)-1)]
    data = pd.concat([data,dum], axis = 1)
    return data
```

```
#Binning age using the function var_transform()
train = var_transform(train)
test = var_transform(test)

#Re-creating the plot of diabetes_percent vs age created earlier, just to check if the fun
age_data = train.groupby('age_binned')['Outcome'].agg([('diabetes_percent', 'mean'), ('nobs'
sns.lineplot(x = age_data.index, y = age_data['diabetes_percent'])
plt.xlabel('Age_bin')
```

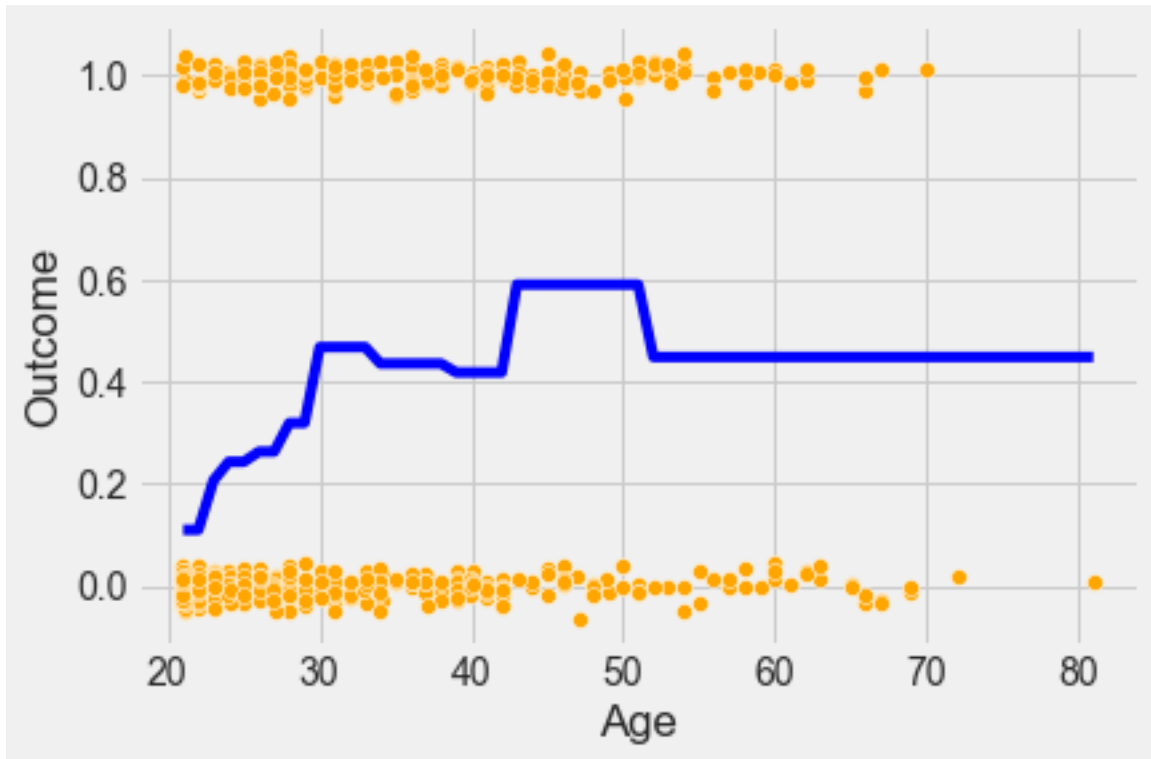
Text(0.5, 0, 'Age\_bin')



```
#Model with binned Age
def jitter(values,j):
    return values + np.random.normal(j,0.02,values.shape)
sns.scatterplot(x = jitter(train.Age,0), y = jitter(train.Outcome,0), data = train, color
logit_model = sm.logit(formula = 'Outcome~' + '+' .join(['age'+str(x) for x in range(1,10)]
sns.lineplot(x = 'Age', y = logit_model.predict(train), data = train, color = 'blue')
```

Optimization terminated successfully.  
Current function value: 0.585956  
Iterations 6

<AxesSubplot:xlabel='Age', ylabel='Outcome'>



```
logit_model.summary()
```

Table 8.14: Logit Regression Results

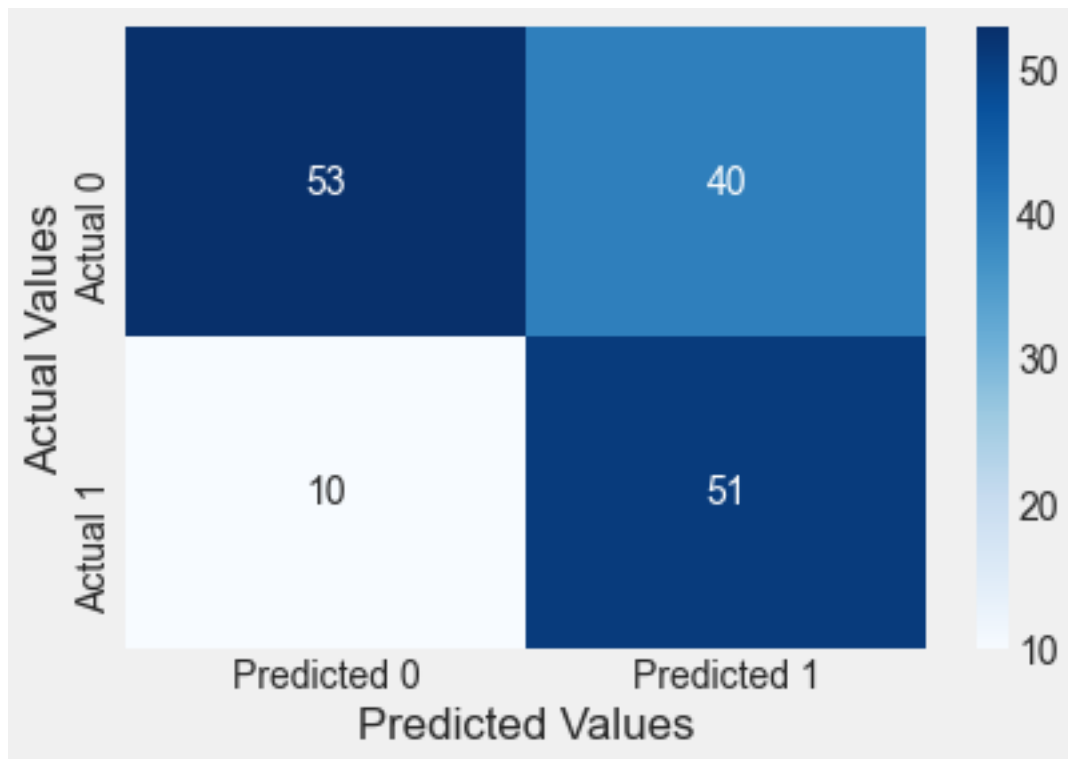
Dep. Variable:	Outcome	No. Observations:	614
Model:	Logit	Df Residuals:	604
Method:	MLE	Df Model:	9
Date:	Wed, 15 Feb 2023	Pseudo R-squ.:	0.08318
Time:	02:35:57	Log-Likelihood:	-359.78
converged:	True	LL-Null:	-392.42
Covariance Type:	nonrobust	LLR p-value:	1.273e-10

	coef	std err	z	P> z	[0.025	0.975]
Intercept	-2.0898	0.306	-6.829	0.000	-2.690	-1.490
age1	0.7461	0.551	1.354	0.176	-0.334	1.826
age2	0.9548	0.409	2.336	0.019	0.154	1.756
age3	1.0602	0.429	2.471	0.013	0.219	1.901
age4	1.3321	0.438	3.044	0.002	0.474	2.190
age5	1.9606	0.398	4.926	0.000	1.180	2.741
age6	1.8303	0.399	4.586	0.000	1.048	2.612
age7	1.7596	0.410	4.288	0.000	0.955	2.564
age8	2.4544	0.402	6.109	0.000	1.667	3.242
age9	1.8822	0.404	4.657	0.000	1.090	2.674

Note that the probability of having diabetes for each age bin is a constant, as per the above plot.

```
confusion_matrix_test(test,test.Outcome,logit_model,0.3)
```

Classification accuracy = 67.5%



Binning `Age` provides a similar results as compared to the model with the quadratic transformation of `Age`.

```
train.head()
```

	Pregnancies	Glucose	BloodPressure	SkinThickness	Insulin	BMI	DiabetesPedigreeFunction	A
158	2	88	74	19	53	29.0	0.229	22
251	2	129	84	0	0	28.0	0.284	27
631	0	102	78	40	90	34.5	0.238	24
757	0	123	72	0	0	36.3	0.258	52
689	1	144	82	46	180	46.1	0.335	46

```
#Model with the quadratic transformation of Age and more predictors
logit_model_diabetes = sm.logit(formula = 'Outcome~Age+I(Age**2)+Glucose+BloodPressure+BMI
logit_model_diabetes.summary()
```

Optimization terminated successfully.

Current function value: 0.470478

Iterations 6

Table 8.17: Logit Regression Results

Dep. Variable:	Outcome	No. Observations:	614
Model:	Logit	Df Residuals:	607
Method:	MLE	Df Model:	6
Date:	Tue, 14 Feb 2023	Pseudo R-squ.:	0.2639
Time:	15:14:37	Log-Likelihood:	-288.87
converged:	True	LL-Null:	-392.42
Covariance Type:	nonrobust	LLR p-value:	5.878e-42

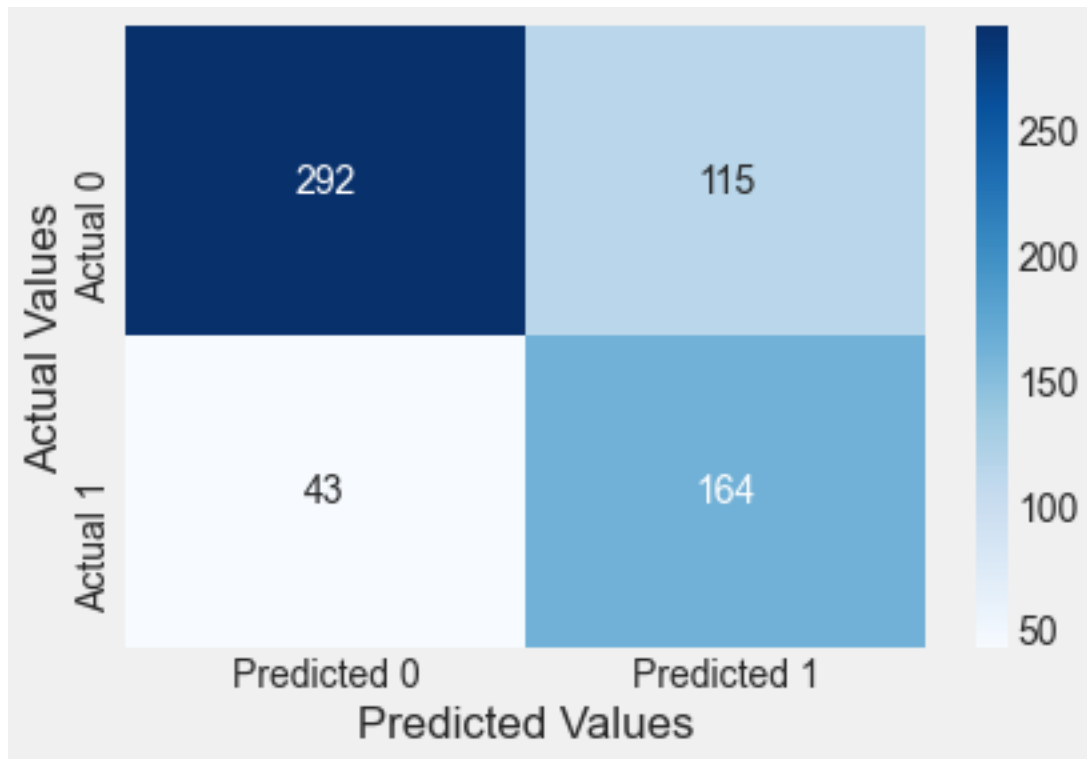
	coef	std err	z	P> z	[0.025	0.975]
Intercept	-12.3347	1.282	-9.621	0.000	-14.847	-9.822
Age	0.2852	0.056	5.121	0.000	0.176	0.394
I(Age ** 2)	-0.0030	0.001	-4.453	0.000	-0.004	-0.002
Glucose	0.0309	0.004	8.199	0.000	0.024	0.038
BloodPressure	-0.0141	0.006	-2.426	0.015	-0.025	-0.003
BMI	0.0800	0.016	4.978	0.000	0.049	0.112

DiabetesPedigreeFunction	0.7138	0.322	2.213	0.027	0.082	1.346
--------------------------	--------	-------	-------	-------	-------	-------

Adding more predictors has increased the log likelihood of the model as expected.

```
confusion_matrix_train(logit_model_diabetes,cutoff=0.3)
```

Classification accuracy = 74.3%



```
confusion_matrix_test(test,test.Outcome,logit_model_diabetes,0.3)
```

Classification accuracy = 80.5%





The model with more predictors also has lesser number of *false negatives*, and higher overall classification accuracy.

**How many bins must you make for Age to get the most accurate model?**

If the number of bins are too less, the trend may not be captured accurately. If the number of bins are too many, it may lead to overfitting of the model. There is an optimal value of the number of bins that captures the trend, but does not overfit. A couple of ways of estimating the optimal number of bins can be:

1. The number of bins for which the trend continues to be “almost” the same for several samples of the data.
2. Testing the model on multiple test datasets.

Optimizing the number of bins for each predictor may be a time-consuming exercises. You may do it for your course project. However, we will not do it here in the class notes.

## 8.5 Performance Measurement

We have already seen the confusion matrix, and classification accuracy. Now, let us see some other useful performance metrics that can be computed from the confusion matrix. The metrics below are computed for the confusion matrix immediately above this section (*or the confusion matrix on test data corresponding to the model `logit_model_diabetes`*).

### 8.5.1 1. Precision-recall

**Precision** measures the accuracy of positive predictions. Also called the **precision** of the classifier

$$\text{precision} = \frac{\text{True Positives}}{\text{True Positives} + \text{False Positives}}$$

==> 70.13%

**Precision** is typically used with **recall** (**Sensitivity** or **True Positive Rate**). The ratio of positive instances that are correctly detected by the classifier.

$$\text{recall} = \frac{\text{True Positives}}{\text{True Positives} + \text{False Negatives}}$$

==> 88.52%

**Precision / Recall Tradeoff:** Increasing precision reduces recall and vice versa.

**Visualize the precision-recall curve for the model `logit_model_diabetes`.**

```
from sklearn.metrics import precision_recall_curve
y=train.Outcome
ypred = logit_model_diabetes.predict(train)
p, r, thresholds = precision_recall_curve(y, ypred)
def plot_precision_recall_vs_threshold(precisions, recalls, thresholds):
    plt.figure(figsize=(8, 8))
    plt.title("Precision and Recall Scores as a function of the decision threshold")
    plt.plot(thresholds, precisions[:-1], "b--", label="Precision")
    plt.plot(thresholds, recalls[:-1], "g-", label="Recall")
    plt.ylabel("Score")
    plt.xlabel("Decision Threshold")
    plt.legend(loc='best')
    plt.legend()
plot_precision_recall_vs_threshold(p, r, thresholds)
```



As the decision threshold probability increases, the precision increases, while the recall decreases.

### 8.5.2 2. The Receiver Operating Characteristics (ROC) Curve

A **ROC(Receiver Operator Characteristic Curve)** is a plot of sensitivity (True Positive Rate) on the y axis against (1-specificity) (False Positive Rate) on the x axis for varying values of the threshold  $t$ . The 45° diagonal line connecting (0,0) to (1,1) is the ROC curve corresponding to random chance. The ROC curve for the gold standard is the line connecting (0,0) to (0,1) and (0,1) to (1,1).

<IPython.core.display.Image object>

<IPython.core.display.Image object>

An animation to demonstrate how an ROC curve relates to sensitivity and specificity for all possible cutoffs ([Source](#))

### High Threshold:

- High specificity
- Low sensitivity

### Low Threshold

- Low specificity
- High sensitivity

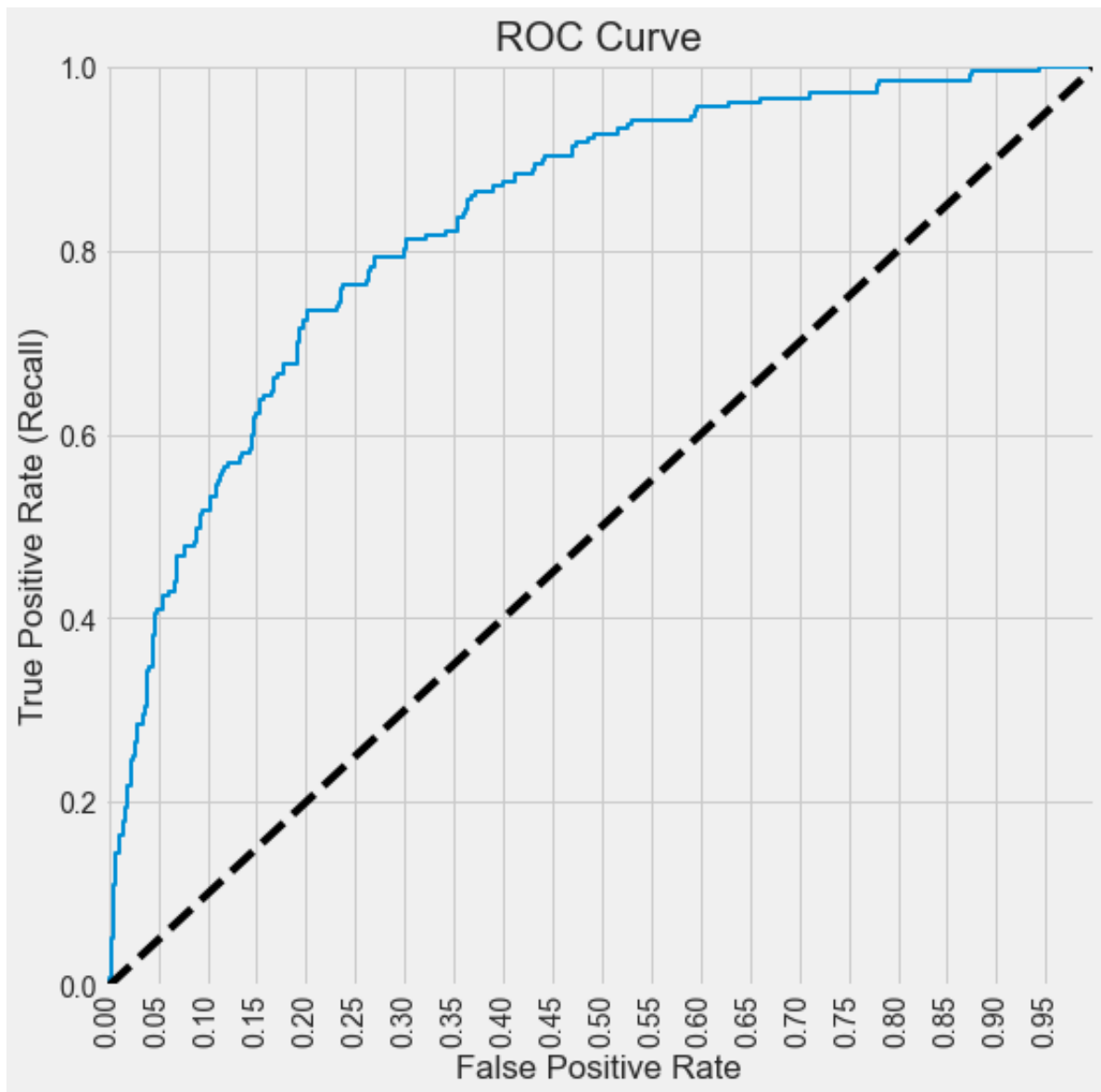
The area under ROC is called *Area Under the Curve (AUC)*. AUC gives the rate of successful classification by the logistic model. To get a more in-depth idea of what a ROC-AUC curve is and how is it calculated, here is a good blog [link](#)

**Visualize the ROC curve and compute the ROC-AUC for the model `logit_model_diabetes`.**

```
from sklearn.metrics import roc_curve, auc
y=train.Outcome
ypred = logit_model.predict(train)
fpr, tpr, auc_thresholds = roc_curve(y, ypred)
print(auc(fpr, tpr))# AUC of ROC
def plot_roc_curve(fpr, tpr, label=None):
    plt.figure(figsize=(8,8))
    plt.title('ROC Curve')
    plt.plot(fpr, tpr, linewidth=2, label=label)
    plt.plot([0, 1], [0, 1], 'k--')
    plt.axis([-0.005, 1, 0, 1.005])
    plt.xticks(np.arange(0,1, 0.05), rotation=90)
    plt.xlabel("False Positive Rate")
    plt.ylabel("True Positive Rate (Recall)")

fpr, tpr, auc_thresholds = roc_curve(y, ypred)
plot_roc_curve(fpr, tpr)
```

0.8325914847653979



Below is a function that prints the confusion matrix along with all the performance metrics we discussed above for a given threshold probability, on train / test data. Note that ROC-AUC does not depend on a decision threshold probability.

```
#Function to compute confusion matrix and prediction accuracy on test/train data
def confusion_matrix_data(data,actual_values,model,cutoff=0.5):
    #Predict the values using the Logit model
    pred_values = model.predict(data)
```

```

# Specify the bins
bins=np.array([0,cutoff,1])
#Confusion matrix
cm = np.histogram2d(actual_values, pred_values, bins=bins)[0]
cm_df = pd.DataFrame(cm)
cm_df.columns = ['Predicted 0','Predicted 1']
cm_df = cm_df.rename(index={0: 'Actual 0',1:'Actual 1'})
# Calculate the accuracy
accuracy = (cm[0,0]+cm[1,1])/cm.sum()
fnr = (cm[1,0])/(cm[1,0]+cm[1,1])
precision = (cm[1,1])/(cm[0,1]+cm[1,1])
fpr = (cm[0,1])/(cm[0,0]+cm[0,1])
tpr = (cm[1,1])/(cm[1,0]+cm[1,1])
fpr_roc, tpr_roc, auc_thresholds = roc_curve(actual_values, pred_values)
auc_value = (auc(fpr_roc, tpr_roc))# AUC of ROC
sns.heatmap(cm_df, annot=True, cmap='Blues', fmt='g')
plt.ylabel("Actual Values")
plt.xlabel("Predicted Values")
print("Classification accuracy = {:.1%}".format(accuracy))
print("Precision = {:.1%}".format(precision))
print("TPR or Recall = {:.1%}".format(tpr))
print("FNR = {:.1%}".format(fnr))
print("FPR = {:.1%}".format(fpr))
print("ROC-AUC = {:.1%}".format(auc_value))

```

```

confusion_matrix_data(test,test.Outcome,logit_model_diabetes,0.3)

```

```

Classification accuracy = 80.5%
Precision = 70.1%
TPR or Recall = 88.5%
FNR = 11.5%
FPR = 24.7%
ROC-AUC = 90.1%

```



# A Assignment A

1. You may talk to a friend, discuss the questions and potential directions for solving them. However, you need to write your own solutions and code separately, and not as a group activity.
2. Do not write your name on the assignment.
3. Write your code in the *Code* cells and your answer in the *Markdown* cells of the Jupyter notebook. Ensure that the solution is written neatly enough to understand and grade.
4. Use [Quarto](#) to print the *.ipynb* file as HTML. You will need to open the command prompt, navigate to the directory containing the file, and use the command: `quarto render filename.ipynb --to html`. Submit the HTML file.
5. The assignment is worth 100 points, and is due on **Tuesday, 17th January 2023 at 11:59 pm**.
6. There is a **bonus** question worth 5 points.
7. **Five points are for properly formatting the assignment.** The breakdown is as follows:
  - Must be an HTML file rendered using Quarto (1 pt); *If you have a Quarto issue, you must mention the issue & quote the error you get when rendering using Quarto in the comments section of Canvas, and submit the ipynb file.*
  - No name can be written on the assignment, nor can there be any indicator of the student's identity—e.g., printouts of the working directory should not be included in the final submission (1 pt).
  - There aren't excessively long outputs of extraneous information (e.g. no printouts of entire data frames without good reason, there aren't long printouts of which iteration a loop is on, there aren't long sections of commented-out code, etc.) (1 pt).
  - Final answers of each question are written in Markdown cells (1 pt).
  - There is no piece of unnecessary / redundant code, and no unnecessary / redundant text (1 pt).
8. The maximum possible score in the assignment is  $95 + 5$  (formatting)  $+ 5$  (bonus question) = 105 out of 100. There is no partial credit for the bonus question.



## A.1 Regression vs Classification; Prediction vs Inference

Explain (1) whether each scenario is a classification or regression problem, and (2) whether we are most interested in inference or prediction. Answers to both parts must be supported by a justification.

### A.1.1

Consider a company that is interested in conducting a marketing campaign. The goal is to identify individuals who are likely to respond positively to a marketing campaign, based on observations of demographic variables (*such as age, gender, income, etc.*) measured on each individual.

*(2+2 points)*

### A.1.2

Consider that the company mentioned in the previous question is interested in understanding the impact of advertising promotions in different media types on the company sales. For example, the company is interested in the question, *'how large of an increase in sales is associated with a given increase in radio vis-a-vis TV advertising?'*

*(2+2 points)*

### A.1.3

Consider a company selling furniture is interested in the finding the association between demographic characteristics of customers (such as age, gender, income, etc.) and their probability of purchase of a particular company product.

*(2+2 points)*

### A.1.4

We are interested in predicting the % change in the USD/Euro exchange rate in relation to the weekly changes in the world stock markets. Hence we collect weekly data for all of 2022. For each week we record the % change in the USD/Euro, the % change in the US market, the % change in the British market, and the % change in the German market.

*(2+2 points)*

## A.2 RMSE vs MAE

### A.2.1

Describe a regression problem, where it will be more appropriate to assess the model accuracy using the root mean squared error (RMSE) metric as compared to the mean absolute error (MAE) metric.

**Note:** Don't use the examples presented in class

*(4 points)*

### A.2.2

Describe a regression problem, where it will be more appropriate to assess the model accuracy using the mean absolute error (MAE) metric as compared to the root mean squared error (RMSE) metric.

**Note:** Don't use the examples presented in class

*(4 points)*

## A.3 FNR vs FPR

### A.3.1

A classification model is developed to predict those customers who will respond positively to a company's tele-marketing campaign. All those customers that are predicted to respond positively to the campaign will be called by phone to buy the product being marketed. If the customer being called purchases the product ( $y = 1$ ), the company will get a profit of \$100. On the other hand, if they are called and they don't purchase ( $y = 0$ ), the company will have a loss of \$1. Among FPR (False positive rate) and FNR (False negative rate), which metric is more important to be minimized to reduce the loss associated with misclassification? Justify your answer.

In your justification, you must clearly interpret False Negatives (FN) and False Positives (FP) first.

**Assumption:** Assume that based on the past marketing campaigns, around 50% of the customers will actually respond positively to the campaign.

*(4 points)*

### A.3.2

Can the answer to the previous question change if the assumption stated in the question is false? Justify your answer.

*(6 points)*

## A.4 Petrol consumption

Read the dataset `petrol_consumption_train.csv`. It contains the following five columns:

`Petrol_tax`: Petrol tax (cents per gallon)

`Per_capita_income`: Average income (dollars)

`Paved_highways`: Paved Highways (miles)

`Prop_license`: Proportion of population with driver's licenses

`Petrol_consumption`: Consumption of petrol (millions of gallons)

### A.4.1

Make a pairwise plot of all the variables in the dataset. Which variable seems to have the highest linear correlation with `Petrol_consumption`? Let this variable be predictor  $P$ . *Note: If you cannot figure out  $P$  by looking at the visualization, you may find the pairwise linear correlation coefficient to identify  $P$ .*

*(4 points)*

### A.4.2

Fit a simple linear regression model to predict `Petrol_consumption` based on predictor  $P$  (identified in the previous part). Print the model summary.

*(4 points)*

### A.4.3

Interpret the coefficient of  $P$ . What is the increase in petrol consumption for an increase of 0.05 in  $P$ ?

*(2+2 points)*

#### **A.4.4**

Does petrol consumption have a statistically significant relationship with the predictor  $P$ ? Justify your answer.

*(4 points)*

#### **A.4.5**

What is the R-squared? Interpret its value.

*(4 points)*

#### **A.4.6**

Use the model developed above to estimate the petrol consumption for a state in which 50% of the population has a driver's license. What are the confidence and prediction intervals for your estimate? Which interval includes the irreducible error?

*(4+3+3+2 = 12 points)*

#### **A.4.7**

Use the model developed above to estimate the petrol consumption for a state in which 10% of the population has a driver's license. Are you getting a reasonable estimate? Why or why not?

*(5 points)*

#### **A.4.8**

What is the residual standard error of the model?

*(4 points)*

#### **A.4.9**

Using the model developed above, predict the petrol consumption for the observations in *petrol\_consumption\_test.csv*. Find the RMSE (Root mean squared error). Include the units of RMSE in your answer.

*(5 points)*

#### A.4.10

Based on the answers to the previous two questions, do you think the model is overfitting? Justify your answer.

*(4 points)*

Make a scatterplot of `Petrol_consumption` vs `Prop_license` using `petrol_consumption_test.csv`. Over the scatterplot, plot the regression line, the prediction interval, and the confidence interval. Distinguish the regression line, prediction interval lines, and confidence interval lines with the following colors. Include the legend as well.

- Regression line: red
- Confidence interval lines: blue
- Prediction interval lines: green

*(4 points)*

Among the confidence and prediction intervals, which interval is wider, and why?

*(1+2 points)*

#### A.4.11

Find the correlation between `Petrol_consumption` and the rest of the variables in `petrol_consumption_train.csv`. Based on the correlations, a simple linear regression model with which predictor will have the least R-squared value for predicting `Petrol_consumption`. Don't develop any linear regression models.

*(4 points)*

#### Bonus point question

*(5 points - no partial credit)*

#### A.4.12

Fit a simple linear regression model to predict `Petrol_consumption` based on predictor  $P$ , but without an intercept term.

*(you must answer this correctly to qualify for earning bonus points)*

#### **A.4.13**

Estimate the petrol consumption for the observations in *petrol\_consumption\_test.csv* using the model in developed in the previous question. Find the RMSE.

*(you must answer this correctly to qualify for earning bonus points)*

#### **A.4.14**

The RMSE for the models with and without the intercept are similar, which indicates that both models are almost equally good. However, the R-squared for the model without intercept is much higher than the R-squared for the model with the intercept. Why? Justify your answer.

*(5 points)*

## B Assignment B

1. You may talk to a friend, discuss the questions and potential directions for solving them. However, you need to write your own solutions and code separately, and not as a group activity.
2. Do not write your name on the assignment.
3. Write your code in the *Code* cells and your answer in the *Markdown* cells of the Jupyter notebook. Ensure that the solution is written neatly enough to understand and grade.
4. Use [Quarto](#) to print the *.ipynb* file as HTML. You will need to open the command prompt, navigate to the directory containing the file, and use the command: `quarto render filename.ipynb --to html`. Submit the HTML file.
5. The assignment is worth 100 points, and is due on **Thursday, 26th January 2023 at 11:59 pm**.
6. **Five points are properly formatting the assignment.** The breakdown is as follows:
  - Must be an HTML file rendered using Quarto (1 pt). *If you have a Quarto issue, you must mention the issue & quote the error you get when rendering using Quarto in the comments section of Canvas, and submit the ipynb file.*
  - No name can be written on the assignment, nor can there be any indicator of the student's identity—e.g. printouts of the working directory should not be included in the final submission (1 pt)
  - There aren't excessively long outputs of extraneous information (e.g. no printouts of entire data frames without good reason, there aren't long printouts of which iteration a loop is on, there aren't long sections of commented-out code, etc.) (1 pt)
  - Final answers of each question are written in Markdown cells (1 pt).
  - There is no piece of unnecessary / redundant code, and no unnecessary / redundant text (1 pt)

### B.1 Multiple linear regression

A study was conducted on 97 men with prostate cancer who were due to receive a radical prostatectomy. The dataset *prostate.csv* contains data on 9 measurements made on these 97 men. The description of variables can be found [here](#):

### B.1.1 Training MLR

Fit a linear regression model with `lpsa` as the response and all the other variables as predictors. Write down the equation to predict `lpsa` based on the other eight variables.

*(2+2 points)*

### B.1.2 Model significance

Is the overall regression significant at 5% level? Justify your answer.

*(2 points)*

### B.1.3 Coefficient interpretation

Interpret the coefficient of `svi`.

*(2 points)*

### B.1.4 Variable significance

Report the  $p$ -values for `gleason` and `age`. What do you conclude about the significance of these variables?

*(2+2 points)*

### B.1.5 Variable significance from confidence interval

What is the 95% confidence interval for the coefficient of `age`? Can you conclude anything about its significance based on the confidence interval?

*(2+2 points)*

### B.1.6 $p$ -value

Fit a simple linear regression on `lpsa` against `gleason`. What is the  $p$ -value for `gleason`?

*(1+1 points)*



### B.1.7 Predictor significance in presence / absence of other predictors

Is the predictor `gleason` statistically significant in the model developed in the previous question (B.1.6)?

Was `gleason` statistically significant in the model developed in the first question (B.1.1) with multiple predictors?

Did the statistical significance of `gleason` change in the absence of other predictors? Why or why not?

(1+1+4 points)

### B.1.8 Prediction

Predict `lpsa` of a 65-year old man with `lcavol` = 1.35, `lweight` = 3.65, `lbph` = 0.1, `svi` = 0.22, `lcp` = -0.18, `gleason` = 6.75, and `pgg45` = 25 and find 95% prediction intervals.

(2 points)

### B.1.9 Variable selection

Find the largest subset of predictors in the model developed in the first question (B.1.1), such that their coefficients are zero, i.e., none of the predictors in the subset are statistically significant.

Does the model *R*-squared change a lot if you remove the set of predictors identified above from the model in the first question (B.1.1)?

**Hint:** You may use the `f_test()` method to test hypotheses.

(4+1 points)

## B.2 Using MLR coefficients and variable transformation

The dataset *infmort.csv* gives the infant mortality of different countries in the world. The column `mortality` contains the infant mortality in deaths per 1000 births.

### B.2.1 Data visualisation

Make the following plots:

1. a boxplot of `log(mortality)` against `region` (*note that a plot of `log(mortality)` against `region` better distinguishes the mortality among regions as compared to a plot of `mortality` against `region`,*
2. a boxplot of `income` against `region`, and
3. a scatter plot of `mortality` against `income`.

What trends do you see in these plots? *Mention the trend separately for each plot.*

*(3+2 points)*

### B.2.2 Removing effect of predictor from response

Europe seems to have the lowest infant mortality, but it also has the highest per capita annual income. We want to see if Europe still has the lowest mortality if we remove the effect of income from the mortality. We will answer this question with the following steps.

#### B.2.2.1 Variable transformation

Plot:

1. `mortality` against `income`,
2. `log(mortality)` against `income`,
3. `mortality` against `log(income)`, and
4. `log(mortality)` against `log(income)`.

Based on the plots, postulate an appropriate model to predict mortality as a function of income. *Print the model summary.*

*(2+4 points)*

### B.2.2.2 Model update

Update the model developed in the previous question by adding `region` as a predictor. Print the model summary.

*(2 points)*

Use the model developed in the previous question to compute `adjusted_mortality` for each observation in the data, where adjusted mortality is the mortality after removing the estimated effect of income. Make a boxplot of `log(adjusted_mortality)` against `region`.

*(4+2 points)*

### B.2.3 Data visualisation after removing effect of predictor from response

From the plot in the previous question:

1. Does Europe still seem to have the lowest mortality as compared to other regions after removing the effect of income from mortality?
2. After adjusting for income, is there any change in the mortality comparison among different regions. Compare the plot developed in the previous question to the plot of `log(mortality)` against `region` developed earlier (B.2.1) to answer this question.

**Hint:** Do any African / Asian / American countries seem to do better than all the European countries with regard to mortality after adjusting for income?

*(1+3 points)*

## B.3 Variable transformations and interactions

The dataset `soc_ind.csv` contains the GDP per capita of some countries along with several social indicators.

### B.3.1 Training SLR

For a simple linear regression model predicting `gdpPerCapita`. Which predictor will provide the best model fit (*ignore categorical predictors*)? Let that predictor be  $P$ .

*(2 points)*

### B.3.2 Linearity in relationship

Make a scatterplot of `gdpPerCapita` vs  $P$ . Does the relationship between `gdpPerCapita` and  $P$  seem linear or non-linear?

*(1 + 2 points)*

### B.3.3 Variable transformation

If the relationship identified in the previous question is non-linear, identify and include transformation(s) of the predictor  $P$  in the model to improve the model fit.

Mention the predictors of the transformed model, and report the change in the  $R$ -squared value of the transformed model as compared to the simple linear regression model with only  $P$ .

*(4+4 points)*

### B.3.4 Model visualisation with transformed predictor

Plot the regression curve of the transformed model (*developed in the previous question*) over the scatterplot in (b) to visualize model fit. Also make the regression line of the simple linear regression model with only  $P$  on the same plot.

*(3 + 1 points)*

### B.3.5 Training MLR with qualitative predictor

Develop a model to predict `gdpPerCapita` with  $P$  and `continent` as predictors.

1. Interpret the intercept term.
2. For a given value of  $P$ , are there any continents that **do not** have a significant difference between their mean `gdpPerCapita` and that of Africa? If yes, then which ones, and why? If no, then why not? Consider a significance level of 5%.

*(4 + 4 points)*

### B.3.6 Variable interaction

The model developed in the previous question has a limitation. It assumes that the increase in mean `gdpPerCapita` with a unit increase in  $P$  does not depend on the `continent`.

1. Eliminate this limitation by including interaction of `continent` with  $P$  in the model developed in the previous question. Print the model summary of the model with interactions.
2. Interpret the coefficient of any one of the interaction terms.

*(4 + 4 points)*

### B.3.7 Model visualisation with qualitative predictor

Use the model developed in the previous question to plot the regression lines for Africa, Asia, and Europe. Put `gdpPerCapita` on the vertical axis and  $P$  on the horizontal axis. Use a legend to distinguish among the regression lines of the three continents.

*(4 points)*

### B.3.8 Model interpretation

Based on the plot develop in the previous question, which continent has the highest increase in mean `gdpPerCapita` for a unit increase in  $P$ , and which one has the least? Justify your answer.

*(2+2 points)*

## C Assignment C

1. You may talk to a friend, discuss the questions and potential directions for solving them. However, you need to write your own solutions and code separately, and not as a group activity.
2. Do not write your name on the assignment.
3. Write your code in the *Code* cells and your answer in the *Markdown* cells of the Jupyter notebook. Ensure that the solution is written neatly enough to understand and grade.
4. Use [Quarto](#) to print the *.ipynb* file as HTML. You will need to open the command prompt, navigate to the directory containing the file, and use the command: `quarto render filename.ipynb --to html`. Submit the HTML file.
5. The assignment is worth 100 points, and is due on **Thursday, 9th February 2023 at 11:59 pm**.
6. **Five points are properly formatting the assignment.** The breakdown is as follows:
  - Must be an HTML file rendered using Quarto (1 pt). *If you have a Quarto issue, you must mention the issue & quote the error you get when rendering using Quarto in the comments section of Canvas, and submit the ipynb file.*
  - No name can be written on the assignment, nor can there be any indicator of the student's identity—e.g. printouts of the working directory should not be included in the final submission (1 pt)
  - There aren't excessively long outputs of extraneous information (e.g. no printouts of entire data frames without good reason, there aren't long printouts of which iteration a loop is on, there aren't long sections of commented-out code, etc.) (1 pt)
  - Final answers of each question are written in Markdown cells (1 pt).
  - There is no piece of unnecessary / redundant code, and no unnecessary / redundant text (1 pt)

## C.1 Model assumptions

### C.1.1

Using *house\_feature\_train.csv* and *house\_price\_train.csv*, fit a multiple linear regression model without transformation to predict `house_price` based on `distance_MRT`, `latitude`, and `longitude`, `house_age`, and `number_convenience_stores`. Print the model summary. What is the model  $R^2$ ?

*(1 + 1 points)*

### C.1.2

Obtain the residuals and plot them separately against fitted values and each of the five feature variables. Make one plot including the 6 subplots.

*(4 points)*

### C.1.3

Comment on the plot of residuals against fitted values. Does the model violate the assumption of linearity? Does the model violate the constant variance assumption?

*(2 + 2 points)*

### C.1.4

Comment on the plot of residuals against the predictor variables. On the basis of these plots, should any further modifications of the regression model be attempted?

*(5 points)*

### C.1.5

Calculate the RMSE using the test datasets for the model constructed in the first question. The test datasets are *house\_feature\_test.csv* and *house\_price\_test.csv*.

*(2 points)*

### C.1.6

Using appropriate transformation(s) and/or variable interaction(s), update the model to obtain a model that has a  $R^2$  of at least 80%, and a RMSE (Root mean squared error) of at max \$350k on test data.

Print the model summary and report the  $R^2$ , and RMSE on test data. Note:

1. House prices are provided in thousands of dollars. A value of 556 in the `house_price` column indicates a house price of \$556k.
2. The test datasets are `house_feature_test.csv` and `house_price_test.csv`.
3.  $R^2$  is computed on training data, and RMSE is computed on test data.
4. You must proceed logically, i.e., **justify every transformation** that you introduce into the model to improve it. If you are introducing **interactions**, there should be some rationale behind including only certain interactions in the model, unless you are including all possible interactions.

*(12 points for achieving the objectives + 8 points for justifications)*

### C.1.7

Are the assumptions of linearity and constant variance of errors satisfied in the model developed in the previous question? Make a scatterplot between the residuals and fitted values and use it to answer the question.

*(4 points)*

## C.2 Multicollinearity and Outliers

The datasets `Austin_Affordable_Housing_Train.csv` and `Austin_Affordable_Housing_Test.csv` provide data on housing development projects that have received funding from the Affordable Housing Development Fund in Austin, Texas. The city provides property developers with tax credits and other forms of funding in exchange for agreements to set housing prices (e.g. rent) below market rate.

Each row represents a housing development in Austin. Variables include the amount (USD) provided by the city, the status of the housing project, the number of housing units, the period of affordability, and more.

Let's say that you're hired by the city as a consultant to work with subject matter experts in their Housing and Planning Department.



*General Hint:* For written sections, writing “it depends” (along with an explanation) often characterizes a good answer.

**Note for Grading Team:** Written answers should be given full credit as long as they’re thoughtful answers that address the question fully, base findings on relevant data/results, and align with the relevant regression theory/thinking. Many questions don’t have a single right answer and/or depend on context that isn’t provided here.

### C.2.1

Suppose you run the code `status_vars = pd.get_dummies(housing_dataframe["Status"])`, append the columns of `status_vars` to your original data frame, and use the columns as predictors in a linear regression model. What potential problem would you likely be introducing into the model? How could it affect your results?

*(4 points)*

### C.2.2

Suppose that a subject matter expert recommends using the variables `Total_Units`, `Total_Affordable_Units`, `Total_Accessible_Units`, and `Market_Rate_Units` as predictors in your model. From a regression modeling standpoint, does this sound advisable? Produce metrics to quantify the potential impact of including the four predictors in a model. Interpret at least one of the metrics you provide, both statistically and in the context of the problem.

*(4 points)*

### C.2.3

Say that the subject matter expert agrees to use `Total_Affordable_Units`, `Affordability_Expiration_Year`, and `Units_Under_50_Percent_MFI` as predictors for `City_Amount`. Fit the appropriate model (without transformations). Then interpret the results associated with `Total_Affordable_Units`, and comment on the overall model fit.

*(4 points)*

### C.2.4

Using visualizations, investigate whether the model you fit in the previous question yields outlying observations. What count and proportion of observations would you classify as outliers?

Note: Show separate plots for both - residuals and studentized residuals. However, consider studentized residuals when identifying outliers.

*(4 points)*

### C.2.5

Based on your results in the previous question, would you choose to remove outlying observations? Why or why not?

*(4 points)*

### C.2.6

Consider a scenario in which the model will be used by property owners seeking to predict the amount of money they may receive from the city of Austin. How would this change, support, or complicate your answer in the previous question, if at all?

*(3 points)*

### C.2.7

Say that the model will be used by a team of sociologists seeking statistical evidence at the  $\alpha = 0.01$  significance level that a property's affordability expiration year has an effect on the amount of money issued by the city of Austin? How would this change, support, or complicate your answer in C.2.5, if at all?

*(3 points)*

### C.2.8

Determine whether the model you fit in C.2.3 contains any high-leverage points. Produce a visualization, then report the count and proportions of observations that are high-leverage (*define an observation as "high-leverage" if its leverage is greater than four times the average leverage of all observations*).

*(4 points)*

### C.2.9

Based on your results in the previous question, would you choose to remove high-leverage observations? Why or why not?

*(3 points)*

### C.2.10

Identify and remove any influential points from the training data and refit the model. How does removing the influential points affect the model, if at all?

Think about using the model summary, and use the test data provided.

*(6 points)*

## C.3 Autocorrelation

Refer to the autocorrelation example in the [class notes](#). Predict the power consumption for each hour of each day of the year 2020. For predicting a power consumption on a particular hour of a day, use all the data you have until the previous day. However, don't use any data of the day on which you are making the predictions. For example, for making 24 predictions for each hour of 4th April, 2020, use all the data upto 3rd April 2020. Make the predictions using four different models:

1. Model with only `temp_hot` and `temp_cold` as the predictors
2. Model including one day lag of power as a predictor in addition to the predictors in model (1)
3. Model including one week lag of power as a predictor in addition to the predictors in model (2)
4. Model including two weeks lag of power as a predictor in addition to the predictors in model (3)

For each model:

1. Report the RMSE for the predicted power in 2020. You should have  $366 \times 24 = 8784$  predicted values of power for each model.
2. Make a scatterplot of predicted power vs actual power (*use color = 'orange'*). Plot the line  $x = y$  over the scatterplot (*use color = 'blue'*).

Which model makes the most accurate predictions?

*(4 points for developing the models + 4 points for computing the predictions + 4 points for computing the RMSEs + 2 points for the visualizations + 1 point for identifying the most accurate model)*

## D Assignment D

1. You may talk to a friend, discuss the questions and potential directions for solving them. However, you need to write your own solutions and code separately, and not as a group activity.
2. Do not write your name on the assignment.
3. Write your code in the *Code* cells and your answer in the *Markdown* cells of the Jupyter notebook. Ensure that the solution is written neatly enough to understand and grade.
4. Use [Quarto](#) to print the *.ipynb* file as HTML. You will need to open the command prompt, navigate to the directory containing the file, and use the command: `quarto render filename.ipynb --to html`. Submit the HTML file.
5. The assignment is worth 100 points, and is due on **Tuesday, 21st February 2023 at 11:59 pm**.
6. **Five points are properly formatting the assignment.** The breakdown is as follows:
  - Must be an HTML file rendered using Quarto (1 pt). *If you have a Quarto issue, you must mention the issue & quote the error you get when rendering using Quarto in the comments section of Canvas, and submit the ipynb file.*
  - No name can be written on the assignment, nor can there be any indicator of the student's identity—e.g. printouts of the working directory should not be included in the final submission (1 pt)
  - There aren't excessively long outputs of extraneous information (e.g. no printouts of entire data frames without good reason, there aren't long printouts of which iteration a loop is on, there aren't long sections of commented-out code, etc.) (1 pt)
  - Final answers of each question are written in Markdown cells (1 pt).
  - There is no piece of unnecessary / redundant code, and no unnecessary / redundant text (1 pt)

### Data description

The data is related with direct marketing campaigns of a Portuguese banking institution. The marketing campaigns were based on phone calls, where bank clients were called to subscribe for a term deposit.

There is one train data - *train.csv*, which you will use to develop a model. There are two test datasets - *test1.csv* and *test2.csv*, which you will use to test your model. Each dataset has the following attributes about the clients called in the marketing campaign:

1. **age:** Age of the client
2. **education:** Education level of the client
3. **day:** Day of the month the call is made
4. **month:** Month of the call
5. **y:** did the client subscribe to a term deposit?
6. **duration:** Call duration, in seconds. This attribute highly affects the output target (e.g., if duration=0 then y='no'). Yet, the **duration** is not known before a call is performed. Also, after the end of the call **y** is obviously known. Thus, this input should only be included for inference purposes and should be discarded if the intention is to have a realistic predictive model.

(Raw data source: [Source](#). Do not use the raw data source for this assignment. It is just for reference.)

## Instructions / suggestions for answering questions

- (1) **Instruction:** Use *train.csv* for all questions, unless otherwise stated.
- (2) **Suggestion 1:** You may use the functions in the class notes for printing the confusion matrix and the overall classification accuracy based on test / train data.
- (3) **Suggestion 2::** If you make variable transformations, you will need to do it for all the three datasets. Your code will be a bit concise if you make a function containing all the transformations, and then call it for the training and the two test datasets. You can put this function in the beginning of the code and keep adding transformations to it as you proceed with the assignment. You may need transformations in questions (1) and (13).

### D.1 Probability of response vs call duration

Read the datasets. Make an appropriate visualization to visualize how the proportion of clients subscribing to a term deposit change with increasing call duration.

(4 points)

**Hints:**

1. Bin `duration` to create `duration_binned`. Group the data to find the fraction of clients responding positively to the marketing campaign for each bin in `duration_binned`. Make a lineplot of percentage of clients subscribing to a term deposit vs `duration_binned`, where the bins in `duration_binned` are arranged in increasing order of duration.
2. You may choose an appropriate number of bins & type of binning that helps you visualize well.
3. You may also think of other ways of visualization. You don't need to stick with this one.

## D.2 Predictor duration

Based on the plot in D.1, comment whether `duration` seems to be a useful variable to predict if the client will subscribe to a term deposit.

*(1 point)*

## D.3 Model based on duration

Develop a logistic regression model to predict if the client subscribed to a term deposit based on call `duration`. Use the model to make a lineplot showing the probability of the client subscribing to a term deposit based on call `duration`.

*(3 points)*

## Note

Answer questions D.4 to D.11 based on the regression model developed in D.3.

## D.4 Model significance

Is the regression model statistically significant? Justify your answer.

*(1 point for code, 1 point for answer)*

## D.5 Subscription probability in 5 minutes

What is the probability that the client subscribes to a term deposit with a 5-minute marketing call? Note that the call `duration` in data is given in *seconds*.

*(2 points)*

## D.6 Call duration for subscription

What is the minimum call duration (in minutes) for which a client has a 95% or higher chance of subscribing to a term deposit?

*(4 points)*

## D.7 Maximum call duration

What is the maximum call duration (in minutes) in which a client refused to subscribe to a term deposit? What was the probability of the client subscribing to the term deposit in that call?

*(4 points)*

## D.8 Percent increase in odds

What is the percentage increase in the odds of a client subscribing to a term deposit when the call `duration` increases by a minute?

*(4 points)*

## D.9 Doubling the subscription odds

How much must the call `duration` increase (in minutes) so that it doubles the odds of the client subscribing to a term deposit.

*(3 points)*



## D.10 Classification accuracy

What is minimum overall classification accuracy of the model among the classification accuracies on *train.csv*, *test1.csv* and *test2.csv*? Consider a threshold of 30% when classifying observations.

(2 + 1 + 1 points)

## D.11 Recall

What is the minimum *Recall* of the model among the *Recall* performance on *train.csv*, *test1.csv* and *test2.csv*? Consider a decision threshold probability of 30% when classifying observations.

Here, *Recall* is the proportion of clients predicted to subscribe to a term deposit among those who actually subscribed.

(3 points)

## D.12 Subscription probability based on age and education

Develop a logistic regression model to predict the probability of a client subscribing to a term deposit based on **age**, **education** and the two-factor interaction between **age** and **education**. Based on the model, answer:

- People with which type of **education** (*primary* / *secondary* / *tertiary* / *unknown*) have the highest percentage increase in odds of subscribing to a term deposit with a unit increase in **age**? Justify your answer.
- What is the percentage increase in odds of a person subscribing to a term deposit for a unit increase in **age**, if the person has *tertiary* **education**.
- What is the percentage increase in odds of a person subscribing to a term deposit for a unit increase in **age**, if the person has *primary* **education**.

(1 point for developing the model, 3 points for (a), 3 points for (b), 3 points for (c))

## D.13 Model development

Develop a logistic regression model (*using train.csv*) to predict the probability of a client subscribing to a term deposit based on **age**, **education**, **day** and **month**. The model must have:

- a. Minimum overall classification accuracy of 75% among the classification accuracies on *train.csv*, *test1.csv* and *test2.csv*.
- b. Minimum recall of 50% among the recall performance on *train.csv*, *test1.csv* and *test2.csv*.

For all the three datasets - *train.csv*, *test1.csv* and *test2.csv*, print the:

1. Model summary (only for *train.csv*),
2. Confusion matrices,
3. Overall classification accuracies, and
4. Recall

Note that:

1. You cannot use **duration** as a predictor because its value is determined after the marketing call ends. However, after the call ends, we already know whether the client responded positively or negatively. That is why we have used **duration** only for inference in the previous questions. It helped us understand the effect of the length of the call on marketing success.
2. It is possible to develop the model satisfying constraints (a) and (b) with just appropriate transformation(s) of the predictor(s). However, you may consider interactions if you wish. Justify the transformations, if any, with visualizations.
3. You are free to choose any value of the decision threshold probability for classifying observations. However, you must use the same threshold on all the three datasets.

(15 points)

## D.14 ROC-AUC

Report the probability that the model will predict a higher probability of response for a customer who signs up for the term deposit as compared to the customer who does not sign up, i.e., the ROC-AUC of the developed model in D.13.

*Hint:* Use the functions `roc_curve`, and `auc` from the `sklearn.metrics` module

(3 points)

## D.15 Net-profit

Suppose that the model developed in D.13 is used to predict the clients in *test1.csv* and *test2.csv* who will respond positively to the campaign. Only those clients who are predicted to respond positively are called during the marketing campaign. Assume that:

1. A profit of \\$100 is associated with a client who responds positively to the campaign,
2. A loss of \\$10 is associated with a client who responds negatively to the campaign

What is the net profit from the campaign? Use the confusion matrices printed in D.13.

(4 points)

## D.16 Decision threshold probability

Based on the profit and loss associated with client responses specified in D.15, and the model developed in D.13, find the decision threshold probability of classification, such that the net profit is maximized. Use *train.csv*

Proceed as follows:

1. You would have obtained FPR and TPR for all potential decision threshold probabilities in D.14.
2. Formulate an expression quantifying the net profit per client (*among all the clients called in the marketing campaign*), in terms of FPR, TPR, and the overall response rate, i.e., proportion of people actually subscribing to the term deposit.
3. Find the decision threshold probability that maximizes the expression in (2).

(5 points)

## D.17 Net profit based on new decision threshold probability

Using the new decision threshold probability obtained in D.16, answer D.15, i.e., what is the net-profit associated with the clients in *test1.csv* and *test2.csv* if a marketing campaign is performed. Again, only those clients who are predicted to respond positively, based on the new decision threshold probability, are called during the marketing campaign

Also, print the confusion matrices for predictions on *test1.csv* and *test2.csv* with the new threshold probability.

(4 points)

## D.18 Model preference

Was the classification accuracy of the model in D.13 higher than that of the model in D.17? If yes, then should you prefer the model in D.13 for the marketing campaign? Why or why not?

*Note: The model in D.17 is the same as in D.13, except with a different decision threshold probability*

*(3 points)*

## D.19 ROC curve

Plot the ROC curve for the model developed in D.13. Mark the point on the curve corresponding to the decision threshold probability identified in D.16.

*Note that the ROC curve is independent of the decision threshold probability used by the model for prediction*

*(3 points)*

## D.20 Profit with TPR / FPR

Make a scatterplot of TPR vs FPR, and color the points based on net profit per client.

You can use the following code to make the plot if you have the relevant metrics in `tpr`, `fpr`, and `net_profit`

*(1 point)*

```
import matplotlib.pyplot as plt
import seaborn as sns
sns.set(font_scale=1.5)
plt.rcParams["figure.figsize"] = (9,6)
plt.rcParams["figure.autolayout"] = True
f, ax = plt.subplots()
points = ax.scatter(fpr, tpr, c = net_profit, s=50, cmap="Blues")
f.colorbar(points, label = "Net profit ($) \n(per client)")
plt.xlabel("False positive rate")
plt.ylabel("True positive rate")
plt.show()
```

## D.21 Precision-recall

Compare the precision and recall of the models in D.13 and D.17 on *train.csv*.

*Note: The model in D.17 is the same as in D.13, except with a different decision threshold probability*

*(4 points)*

## D.22 Precision-recall: important metric

Based on the above comparison, which metric among precision and recall turns out to be more important for maximizing the net profit in the marketing campaign?

*(1 point)*

## D.23 Precision-recall curve

Plot the precision-recall curve vs decision threshold probability for the model developed in D.13. Mark the points on the curve corresponding to the decision threshold probability identified in D.16.

*(3 points)*

## D.24 Precision-recall vs FPR-TPR

Instead of using the FPR and TPR metrics to find the optimum decision threshold probability in D.16, used the precision-recall metrics to find the same.

*(5 points)*

## E Datasets, assignment and project files

Datasets used in the book, assignment files, project files, and prediction problems report template can be found [here](#)

## References