

Stochastic Process and Forecasting Assignment

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Question 2

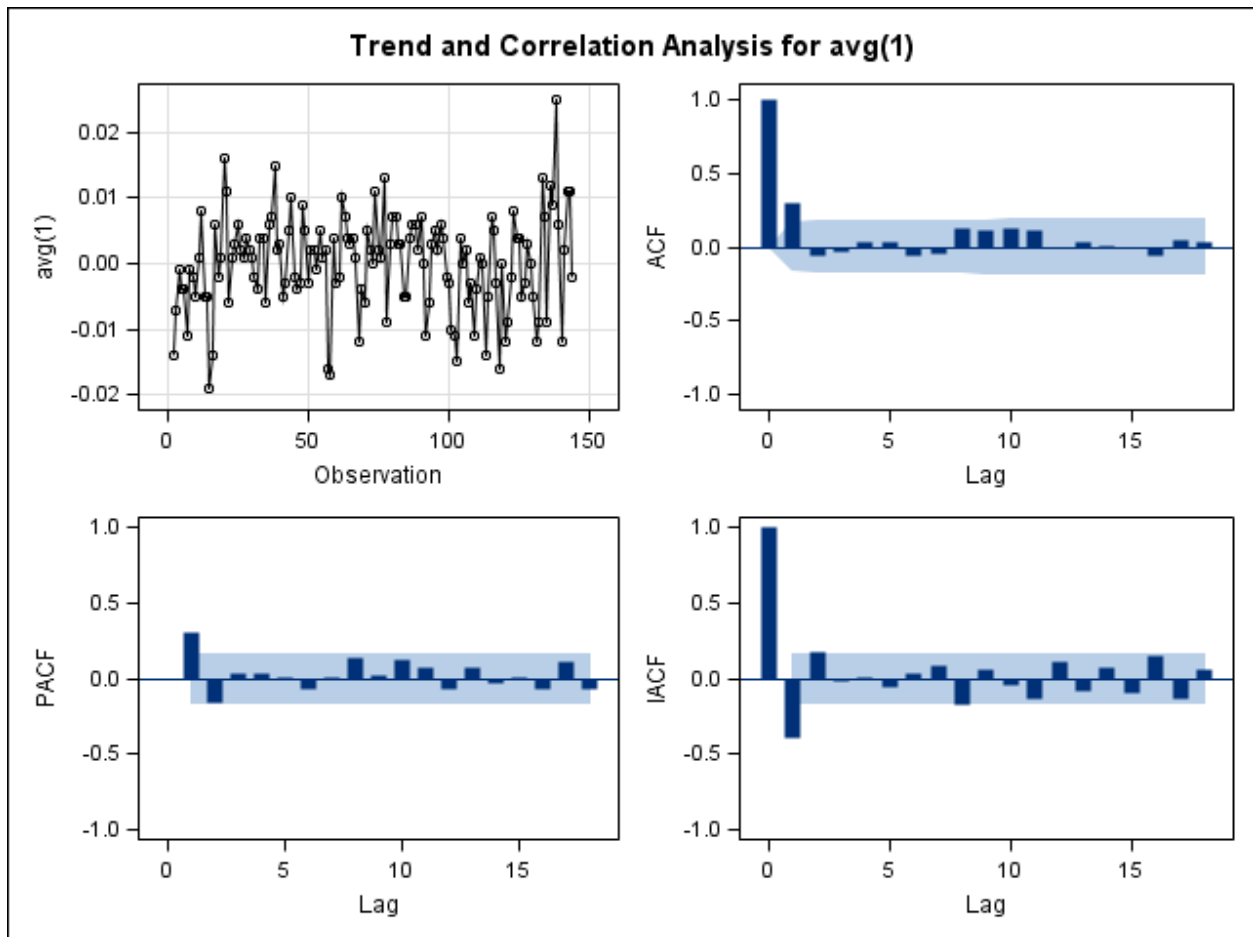
i)

The following SAS code was used to identify and estimate appropriate univariate ARIMA models for each of the `avg` and `end` exchange rate time series:

```
proc arima data=LatDol;  
identify var=avg(1) nlag=18;  
estimate q=1 noint;  
identify var=end nlag=18;  
estimate p=1;  
run;
```

The diagnostics plots indicates that the first difference of `avg` has an ACF cut-off at lag 1, thereby leading us to believe the data follows an Arima(0,1,1) model with the following model equation:

$$\Delta Y_t = -0.36347\epsilon_{t-1} + \epsilon_t$$



In addition the Ljung-Box chi-square statistics do not have any significant p-values, giving further weight to the chosen model:

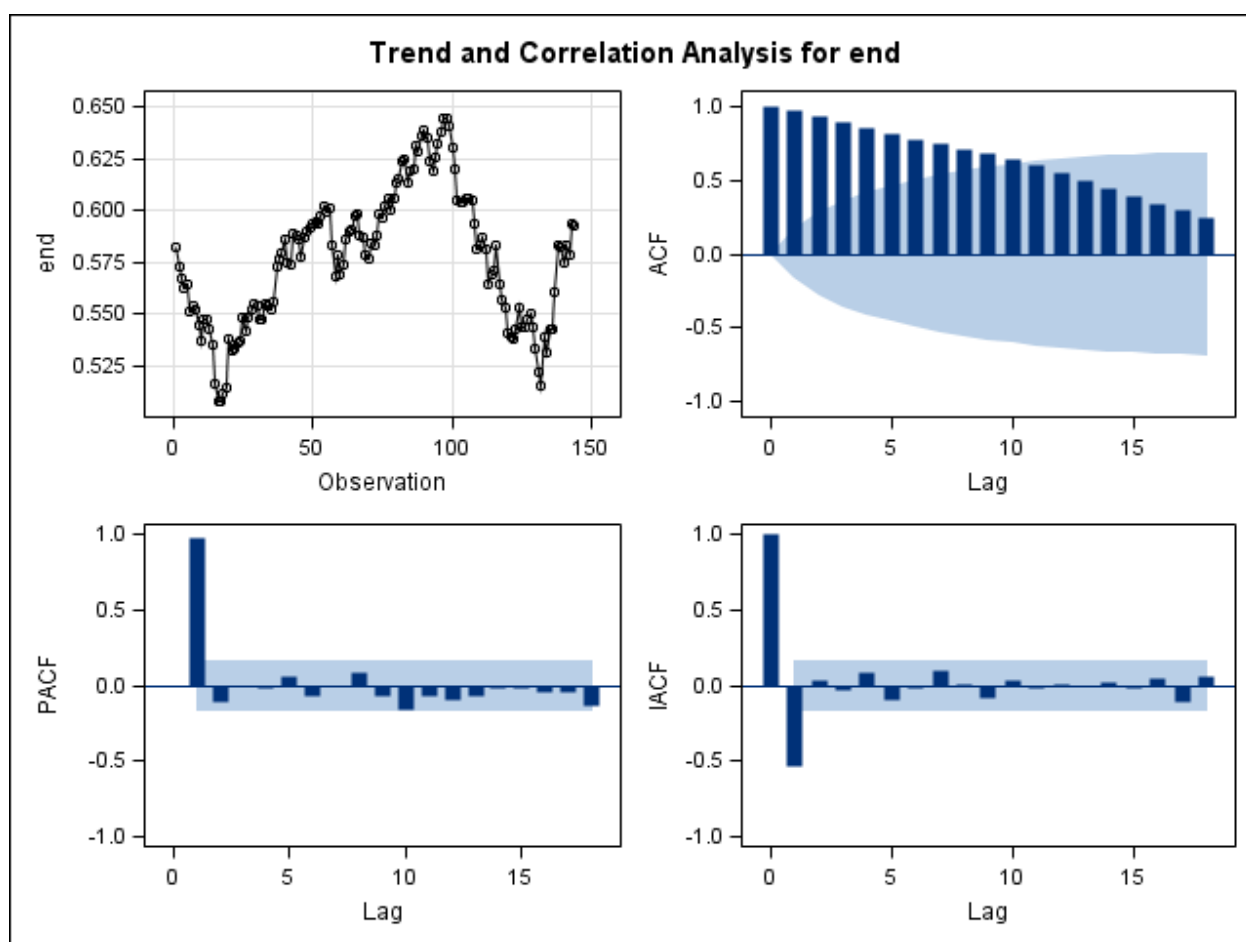
Autocorrelation Check of Residuals

To Lag	Chi- Square	DF	Pr > ChiSq	-----Autocorrelations-----					
6	1.30	5	0.9346	-0.010	-0.041	-0.034	0.032	0.046	-0.051
12	8.50	11	0.6681	-0.071	0.133	0.046	0.079	0.104	-0.066
18	11.49	17	0.8299	0.059	-0.022	0.030	-0.087	0.075	0.015
24	16.13	23	0.8497	-0.014	-0.121	-0.044	-0.074	-0.025	-0.066

end is found to follow an AR(1) model with the following model equation:

$$Y_t = 0.58167 + 0.96945Y_{t-1} + \epsilon_t$$

This model was identified by the lag 1 cut-off in the PACF as shown in the diagnostics plots below:



In addition the Ljung-Box chi-square statistics do not have any significant p-values, giving further weight to the chosen model:

Autocorrelation Check of Residuals

To Lag	Chi- Square	DF	Pr > ChiSq	-----Autocorrelations-----					
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6	2.84	5	0.7239	0.116	0.043	0.007	-0.048	0.040	0.006
12	11.19	11	0.4279	-0.050	0.081	0.153	0.092	0.081	0.076
18	13.25	17	0.7192	-0.035	-0.019	-0.019	-0.022	0.095	-0.033
24	18.91	23	0.7064	-0.024	-0.076	-0.109	-0.044	-0.028	-0.108

ii)

The following SAS code identifies and fits a VAR(p) model to the bivariate data:

```
proc varmax data=LatDol;
model end avg /
minic = (type=slc p=(0:10) q=0) noint dif=(end(1) avg(1)) PRINT=DIAGNOSE;
output lead=3;
run;
```

Which gives the following truncated output:

Model Parameter Estimates						
Equation	Parameter	Estimate	Standard Error	t Value	Pr > t	Variable
end	AR1_1_1	0.03600	0.11185	0.32	0.7480	end(t-1)
	AR1_1_2	0.11050	0.12356	0.89	0.3727	avg(t-1)
avg	AR1_2_1	0.70995	0.07553	9.40	0.0001	end(t-1)
	AR1_2_2	-0.22236	0.08344	-2.66	0.0086	avg(t-1)

Covariances of Innovations			
Variable	end	avg	
end	0.00007	0.00004	
avg	0.00004	0.00003	

Based off which the fitted model is as follows:

$$\begin{pmatrix} x_t \\ y_t \end{pmatrix} = \begin{pmatrix} .03600 & 0.11050 \\ .70995 & 0.22236 \end{pmatrix} \begin{pmatrix} x_{t-1} \\ y_{t-1} \end{pmatrix} + \epsilon_t$$

The following Portmanteau Statistics shows significant p-values at all lags indicating that this VAR(1) model does not fit adequately:

Portmanteau Test for Cross Correlations of Residuals			
Up To Lag	DF	Chi-Square	Pr > ChiSq
2	4	23.29	0.0001
3	8	23.46	0.0028
4	12	26.37	0.0095
5	16	34.09	0.0053
6	20	35.06	0.0198
7	24	43.30	0.0092
8	28	44.79	0.0232
9	32	51.56	0.0157
10	36	58.37	0.0106
11	40	63.56	0.0103
12	44	64.87	0.0219

The following outputs show the forecasts of the average exchange rate for the next three months of 2006 are:
0.59273, 0.59261, 0.59261

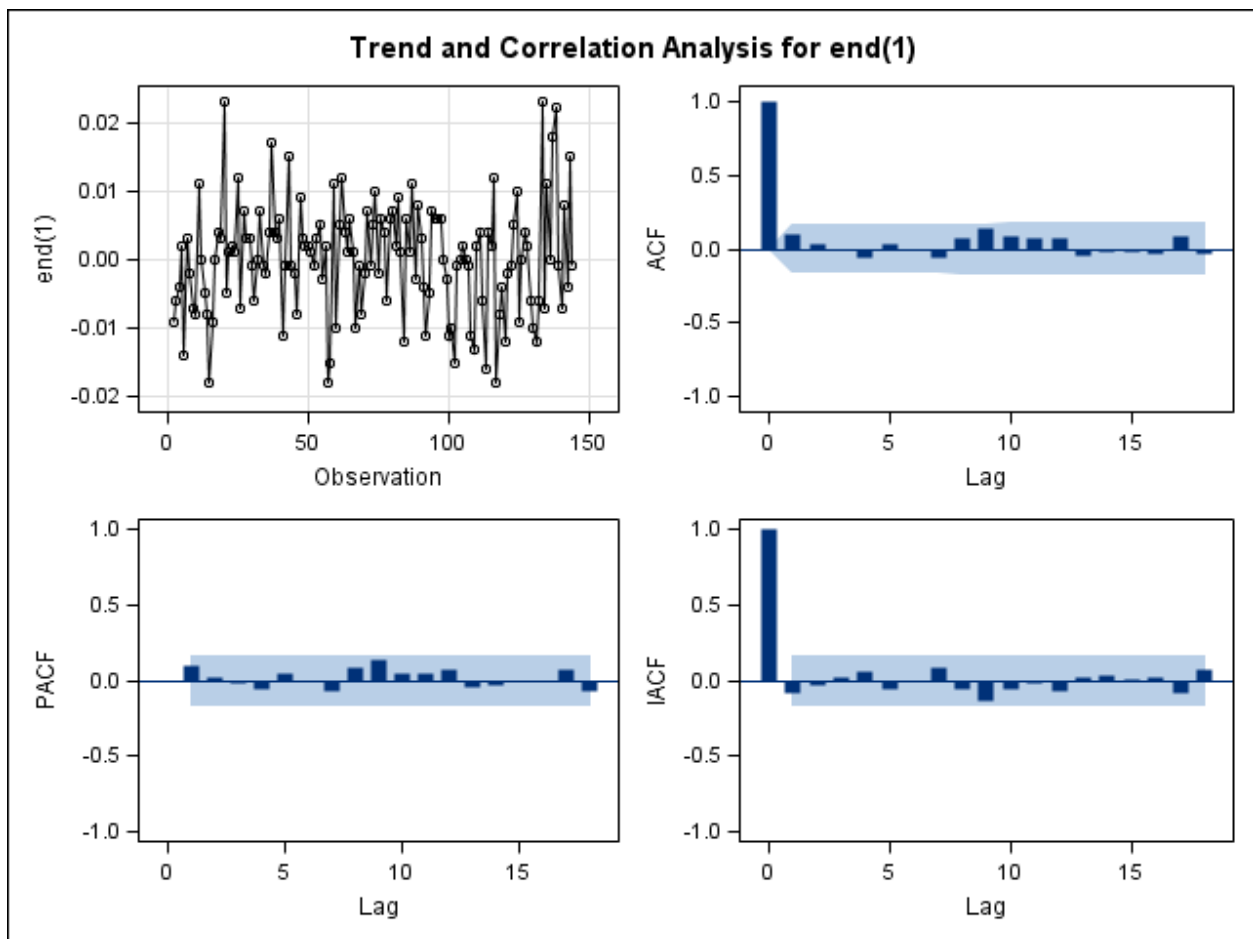
Forecasts					
Variable	Obs	Forecast	Standard Error	95% Confidence Limits	
end	145	0.59274	0.00810	0.57686	0.60863
	146	0.59270	0.01204	0.56911	0.61630
	147	0.59269	0.01530	0.56270	0.62268
avg	145	0.59273	0.00547	0.58201	0.60346
	146	0.59261	0.01102	0.57101	0.61421
	147	0.59261	0.01435	0.56448	0.62074

iii)

The following SAS code was used to identify and estimate an appropriate transfer function model where `avg` was specified as the output variable and `end` the input variable:

```
proc arima data=LatDol;  
identify var=end(1) nlag=18;  
estimate q=1 noint;  
identify var=avg(1) crosscor=end(1) nlag=18;  
estimate q=1 input=(1 $ (1) / end) noint;  
forecast lead=3 out=results;  
run;
```

The following diagnostics plots show from the lag 1 cutoff that an ARIMA(0,1,1) model is appropriate for the first difference of `end`:



Hence the estimation procedure shows the following model for `end`:

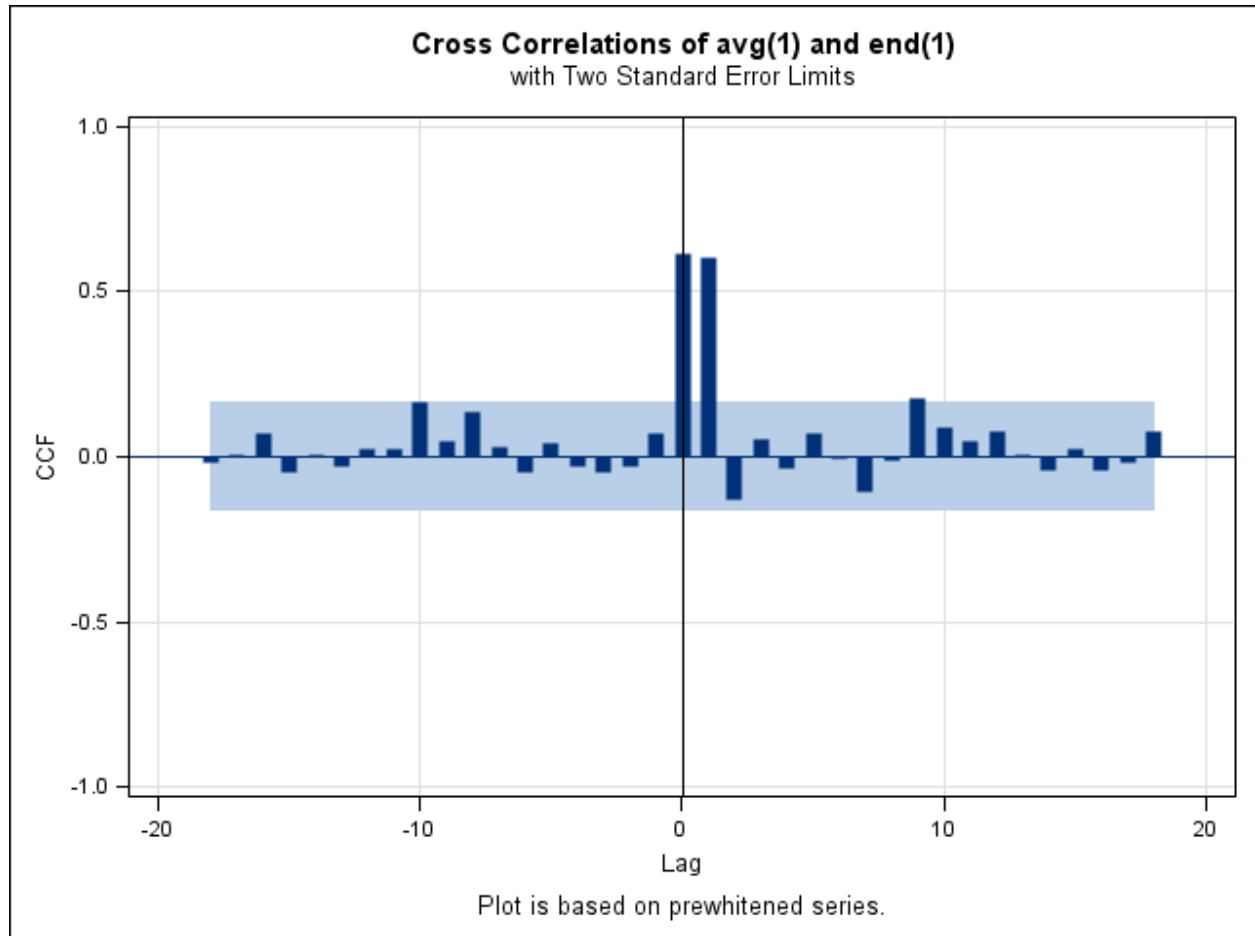
$$\Delta X_t = \eta_t + 0.09801\eta_{t-1}$$

The following output shows the p-values from the portmanteau statistics indicate the model fits well:

Autocorrelation Check of Residuals

To Lag	Chi- Square	DF	Pr > ChiSq	-----Autocorrelations-----					
6	0.95	5	0.9668	0.003	0.029	-0.003	-0.065	0.035	-0.003
12	7.14	11	0.7880	-0.069	0.066	0.134	0.066	0.062	0.069
18	9.75	17	0.9136	-0.045	-0.017	-0.018	-0.034	0.101	-0.044
24	14.42	23	0.9143	-0.015	-0.067	-0.102	-0.033	-0.013	-0.105

The next statement shows the output of the second `identify` statement which shows the following cross-correlation function:



This indicates that the transfer function is in the form of a lag-1 pulse function. There is a sharp (not decayed) response after lag 1 which indicates a transfer function of the form:

$$Y_t = \omega X_t + U_t$$

NB: The lack of intercept is due to the first differencing, and the lack of denominator terms due to the pulse intervention

With the subsequent estimation run, SAS provides us the estimated model of:

$$Y_t = (1.1118 - 0.14899L)X_{t-1} + U_t$$

Where

$$U_t = (1 - 0.95978L)\epsilon_t$$

The ARIMA Procedure

Moving Average Factors

Factor 1: 1 - 0.95978 B**(1)

Input Number 1

Input Variable	end
Shift	1
Period(s) of Differencing	1

Numerator Factors

Factor 1: 1.1118 - 0.14899 B**(1)

The forecast values for avg are given as:

Forecasts for variable avg

Obs	Forecast	Std Error	95% Confidence Limits	
145	0.5924	0.0051	0.5824	0.6024
146	0.5922	0.0104	0.5719	0.6125
147	0.5923	0.0135	0.5658	0.6188