

Contents

List of Contributors	ix
Series Preface	xiii
Editors' Preface	xv
Introduction, C. Heij, J.M. Schumacher, B. Hanzon and C. Praagman	xvii
1 The Purposes of this Book	xvii
2 Some of the Background	xviii
3 Outline of the Book	xxii
References	xxv
SECTION 1: NON-LINEAR DYNAMICS IN ECONOMIC AND FINANCIAL MODELS	1
1 Models of Complexity in Economics and Finance, W.A. Brock and C.H. Hommes	3
1.1 Introduction	3
1.2 Adaptive Beliefs in the Simple Mean Variance Framework	7
1.3 Some Adaptive Belief Systems	11
1.4 An Empirical Exercise Suggested by the Evolutionary Theory	25
1.5 Conclusions	31
Comments, F. Takens and H. Nijmeijer	34
Replies, W.A. Brock and C.H. Hommes	38
References	42
2 Non-linear Dynamics and Predictability in the Austrian Stock Market, E.J. Dockner, A. Prskawetz, G. Feichtinger	45
2.1 Introduction	45
2.2 Statistical Techniques for Analysing Non-linearities in Stock Market Data	49
2.3 Univariate Time Series Models for Austrian Stock Market Data	51

2.4 A Nearest-neighbour Approach to Forecast Non-linear Time Series	54
2.5 Non-linear Forecasts for Austrian Stock Market Returns	58
2.6 Conclusions	62
Comments, D.S.G. Pollock, J.C. Engwerda and H. Nijmeijer	63
Replies, E.J. Dockner, A. Prskawetz and G. Feichtinger	70
References	72
3 Predictability and Economic Time Series, P. Ormerod and M. Campbell	73
3.1 Introduction	73
3.2 Singular Spectrum Analysis	75
3.3 Applications of SSA to US and UK Quarterly GDP Data	82
3.4 Conclusion	87
Comments, F.C. Palm, C.H. Hommes, A.H.Q.M. Merkies and P.C. Young	90
Replies, P. Ormerod and M. Campbell	100
References	104
SECTION 2: NON-LINEARITIES IN EMPIRICAL MODELLING	107
4 Smooth Transition Models, T. Teräsvirta	109
4.1 Introduction	109
4.2 Smooth Transition Regression Model	110
4.3 Testing Linearity against Smooth Transition Regression	113
4.4 Inference in Smooth Transition Regression Models	116
4.5 Application of Tests	117
4.6 Examples	118
4.7 Conclusions	123
Comments, M. Basseville, D. van Dijk, P.H.B.F. Franses and M. Campbell	124
Replies, T. Teräsvirta	130
References	134
5 Empirical Behaviour of Interest-rate Models, J.M. Moraleda and A.C.F. Vorst	137
5.1 Introduction	137
5.2 The Models	140
5.3 The Data	146
5.4 The Methodology for the Estimation of the Volatility Functions	148
5.5 Results	151
5.6 Conclusions	159
Comment, M.H.A. Davis	162

Contents	vii
Reply, J.M. Moraleda and A.C.F. Vorst	164
References	166
6 Data-based Mechanistic Modelling, P.C. Young and D.J. Pedregal	169
6.1 Introduction	169
6.2 Data-based Mechanistic Modelling	171
6.3 Exploring the Relationship between Unemployment, Investment and GNP in the USA 1948(2) to 1988(2)	181
6.4 Discussion	193
6.5 Conclusions	195
Comments, T. Kloek and J.C. Engwerda	199
Replies, P.C. Young and D.J. Pedregal	204
References	211
SECTION 3: TRENDS AND NON-STATIONARITY	215
7 Cointegration Analysis, H.J. Bierens	217
7.1 Introduction	217
7.2 Introduction to Cointegration	221
7.3 The Error Correction Form of a Cointegrated System	223
7.4 Johansen's Maximum Likelihood Approach	224
7.5 Non-parametric Cointegration Analysis	228
7.6 An Empirical Example	234
Comments, R. Tschernig, M. Deistler and M. Wagner	239
Reply, H.J. Bierens	244
References	245
8 The Relationship between Money and Prices: An Econometric Appraisal Based on Cointegration and Causality, M. Funke, S.G. Hall and M. Beeby	247
8.1 Introduction	247
8.2 The Derivation of the p^* Model and Cointegration	248
8.3 The Economic and Statistical Framework	249
8.4 An Empirical Investigation for the UK	254
8.5 The Analysis for Germany	255
8.6 An Analysis of a Changing Causal Structure	257
8.7 Conclusion	261
Comment, P.H.B.F. Franses	263
Reply, M. Funke, S.G. Hall and M. Beeby	266
References	267

9 Multivariate Structural Time Series Models, A.C. Harvey and S.J. Koopman	269
9.1 Introduction	269
9.2 Univariate Structural Time Series Models	270
9.3 Multivariate Models	271
9.4 Common Trends and Cointegration	273
9.5 Seasonals, Cycles and Explanatory Variables	278
9.6 A Testbed Example: Minks and Muskrats	279
9.7 Economic Applications	281
9.8 Detrending	285
Comments, J.C. Engwerda, H. Lütkepohl, P.C. Young and D.J. Pedregal	286
Replies, A.C. Harvey and S. J. Koopman	294
References	297
10 Impulse Response Analysis of Vector Autoregressive Processes, H. Lütkepohl and J. Breitung	299
10.1 Introduction	299
10.2 Vector Autoregressive Models	300
10.3 Estimation and Specification of VAR and ECM Forms	305
10.4 An Empirical Application	314
10.5 Conclusions	318
Comment, P.C. Young	321
Reply, H. Lütkepohl and J. Breitung	322
References	324
11 Data Transformations and Detrending in Econometrics, D.S.G. Pollock	327
11.1 Introduction	327
11.2 The Effects of the Differencing Operator	328
11.3 ARIMA Models and the Differencing Operator	332
11.4 Trend Estimation by Signal Extraction	336
11.5 Model-based Methods of Trend Estimation	338
11.6 Trend Estimation by Heuristic Methods	341
11.7 Appendix: Implementing the Filters	347
Comments, I.J. Steyn and M. Ooms	350
Reply, D.S.G. Pollock	357
References	361
Index	363