URN etd-0407109-183710-716
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Statistics This thesis had been viewed 49 times. Download 0 times.
Department
Year 2006
Semester 2
Degree Master
Type of Document Master's Thesis
Language zh-TW.Big5 Chinese
Title The Application of the Markov Regime Switching Model in Economic and Financial Time Series
Date of Defense 0000-00-00
Page Count 61
Keyword
Markov regime switching model
Markov chain
mixture distribution model
Phillips curve

Abstract
Many economic and financial time series occasionally exhibit dramatic breaks in their behavior, associated with events such as financial crises or abrupt changes in government policy. Thus, we consider the behavior of economic and financial time series, using the methodology of Hamilton (1989), by allowing several regimes affecting both the mean and variance. Besides it allows of several jumps and the nature of the Markov chain, solving the statistical problems which the mixture distribution model cannot settle posed by regime shifts.
First, this paper will focus on the topic of the Phillips curve. We examine the relationship between the unemployment rate and the inflation rate using the Markov regime switching model. The results show that the relationship between the unemployment rate and the inflation rate is unstable. Second, we examine the dynamic relationship between the price of the Taiwan stock index futures and spots employing the Markov regime switching model. The results show that the long-run equilibrium relationship between the price of the Taiwan stock index futures and spots certainly exists, but not stable. Besides we also discover that the Markov regime switching model outperforms the linear model significantly, because it can capture well the properties of the economic and financial time series.
Advisory Committee Hsueh Fu Liang - advisor

Files No Any Full Text File.
Date of Submission 2007-06-29