Aggregate consumption, as structurally	Chow test, 21, 22
interpretable, 124	Citibank Economic Database, 6
Algorithms	Classical theory, 73. See also Monetarist
basic, 128–129	theory
Berndt, Hall, Hall, and Hausman, 10	and inflation, 64
centered, 129–130	priors in, 82, 87
Cochrane-Orcutt, 20, 43	and unemployment, 73
computer, 162	Cochrane-Orcutt algorithm, 20, 43
Schweppe, 175	Collinearity (ill conditioning)
Analysis of residuals, 18	and centering, 117-119, 120-121, 132,
Autocorrelation, correction for, 20, 21, 28	136–137
Autoregressive conditional heteroscedastic	and constant, 134
(ARCH) model, 1, 9, 16	ills of, 119
bivariate, 5, 9	and sensitivity, 119, 120, 121, 128
improvement of, 8–9	and variance decomposition, 163
and maximum likelihood models, 12, 14	Computational error, centering as
Autoregressive model, 207, 209, 211	avoidance of, 140-141
Backward recursive estimates, 23–25, 28,	Computer algorithms, round-off error in, 162
31, 36, 43, 51	Conditional means, 16
Bayesian sensitivity analysis, 74–76	Conditional variance, 1, 9
Bayesian subjective probability model, 62,	Conditioning, 117
74	and basic regression model, 126–127,
Bivariate ARCH process, 5, 9	128–130
Bivariate information set, 8, 16	and centering, 117-124, 126-132, 141,
BLUE (best linear unbiased estimator),	146–149
OLS estimator as, 119, 169	and constant term, 132-137
Bounded-influence (BIF) estimators, 156,	and first-differencing, 142–146, 149–151
171, 172–176	and general centering, 137–141
and empirical results, 177–189	and structurally interpretable data, 124-
ρ function as, 173–174	126, 138, 142–143
Box plot, 187	Condition number
box plot, 167	
Causality	of basic vs. centered data, 126
	and lower bound, 146
in mean, 3–5, 5–6, 12, 14	and numerical instability, 162 scaled, 121–122, 130–131, 146–147
in variance, 2, 5–6, 12	
Causation, Granger, I	spectral, 146
Centered algorithm, 129-130 Centering	Constant term and BIF energy estimates, 178, 179
in approximation of nonlinearities, 138–	
140	and centering, 134-137, 139-140 and collinearity, 134
and basic regression model, 126-127,	and conditioning, 132-137
128-130	perturbation of, 133
and collinearity, 117-119, 120-121, 132,	in regression model, 126
136-137	and variate, 132–133
for computational advantage, 140–141	Contour plots, 180
and conditioning, 117–124, 126–132, 141, 146–149	Cusum test, 19, 25–26 Cusum of squares test, 25, 27–28, 36, 43,
and constant term, 134-137, 139-140	51, 54
data-dependent, 137-138	
example of, 117-124	Data. See also Outside information in
geometry of, 127-128, 132	forecasting
model-dependent, 137, 138	"bad," 173
and small relative changes, 121, 122-124	contamination of, 154-155

Data (cont.) Equations vs. prior opinion, 62, 68, 87 method of comparing, 191-192 in MQEM, 213-214 and robust estimators, 176-177 standardized, 118 in MQEM vs. Fair model, 195-198 structurally interpretable, 124-126, 138, Estimators 142-143 BIF, 156, 171, 172–176, 177–189 Data construction, for RDFOR model, 161 BLUE, 119, 169 Data-dependent centering, 137-138 criteria for judgment of, 169 Deficit, federal, and inflation, 68, 72, 79-80 customary determination of, xiii Demand, excess. See Excess demand Huber, 173, 174, 188-189 Demand, final, MQEM as model of, 234 Krasker-Welsch, 155, 175, 184 Demand for money. See Money demand Mallows, 174-175, 182 Dependent variable, contamination of, 154 maximum likelihood, 9-16, 169, 172 DFBETAS (scaled difference in the OLS, 154, 162–169, 172 (see also OLS coefficient estimates), 163-164, 168, 180 estimators) robust, 155-156, 171, 176-177 DFFITS (scaled difference in predicted value), 163-164, 179-180, 182 Excess demand Diagnostic analysis, and OLS estimators, in Friedmaniac analysis, 64 in Keynesian analysis, 63, 64, 68, 72 Diagnostic checking, 18 Exogenous components of variance, 3 Diagnostics Exogenous data and BIF estimators, 184-185 BIF scaling of, 182 conditioning, 117 (see also Conditioning) and multicollinearity, 162 Exogenous factors, in forecast of 1974-75 DFBETAS, 163–164, 168, 180 DFFITS, 163-164, 179-180, 182 recovery and recession, 113-114 Expected inflation and foreign exchange with OLS, 162-163 premium, 19-22. See also Hyperinflation and recursive stability analysis, 18 robust estimators as, 156 Exploratory method, 18, 22 Differencing. See First-differencing Fair model Diffuse priors, 64, 80 Equations in, 195-198 Discontinuity points, in German MQEM compared with, 193-194, 209, hyperinflation, 31, 36, 43, 51, 54 Dummy variables 210 results for, 207-208, 210 and influential observations, 155 Fair-Parke program, in comparison of in MQEM and Fair model, 194, 209, 211 MQEM and Fair Model, 208 problems with, 194-195 Final demand, MQEM as model of, 234 Dynamic forecasts, and outside information, 109-114 First-differencing, 142–146, 149–151 Forecast error variance, 103, 105 Forecasting Econometric forecasting. See Forecasting; Outside information in forecasting and central tendencies, 157 RDFOR model for, 156-162 (see also Econometric models. See Models Regional Demand Forecasting Model) Econometrics, sources of prior information sources of uncertainty in, 191 in, xiii Forecasting, outside information in. See Economics, data-contamination problems Outside information in forecasting in, 154 Foreign exchange, and expected-inflation EISPACK code, 213 Elasticity, sensitivity to data compared measure, 19 Forward recursive estimates, 23-25, 28, 31, with, 122 43, 51, 73 Energy demand, RDFOR model for, Friedmaniac theory, 73 156-161. See also Regional Demand and inflation, 64 Forecasting Model priors in, 82, 87 Energy prices, and inflation, 69, 79, 80. See and unemployment, 70, 73-74 also Oil, price of

Fuels. See Energy demand

Gauss-Markov theorem, 169 German hyperinflation, 19, 22, 31, 54 Granger causation, 1

Hat matrix, 163 HAT values, 175, 179 Heteroscedasticity, 1 in money-demand model, 54 test for, 25, 28, 36, 51, 54 Heteroscedasticity model, 9 Huber estimator, 173, 174, 188–189 Hyperinflation, 19 German, 19, 22, 31, 54

Inflation. See also Hyperinflation; Prices and deficit, 68, 72, 79-80 momentum in, 65, 76, 79 and money growth, 76 MQEM analysis of, 213-214, 218-219, 223, 226, 231, 234 priors in analysis of, 62, 64, 65 and unemployment, 65 varied analyses of, 62 Inflation model assumptions in, 63 Bayesian sensitivity analysis for, 74–76 data in, 62, 68, 87 general, 64-70 inflation equation in, 65-69 inflation-equation estimates for, 76-82 inflation-equation priors in, 70-72 Keynesian, 63, 64, 68 monetarist, 63-64, 68 unemployment equation in, 69-70 unemployment-equation estimates for, 82 - 87unemployment-equation priors in, 73-74 Influence function, 154-155 and boundedness criterion, 176 of Huber estimator, 174 of OLS estimators, 155, 169, 171, 172-173 Information. See Data; Outside information in forecasting; Prior

and model adequacy, 54 IS-LM model, 63, 69, 73 Keynesian theory on inflation, 63, 64, 65, 68

Instability. See also Stability

and condition number, 162

and Chow test, 21, 22

information

priors in, 62, 64, 68, 70, 72, 73, 74, 76, 79-80, 81, 82, 87 on unemployment, 72 Krasker-Welsch estimator, 155, 175, 184. See also Bounded-influence estimators

Leading indicators, and outside information, 115 Likelihood function, maximization of, 10-11. See also Maximum likelihood estimation LIMO, 213, 218 Linear analysis, of MQEM, 214-220, 235, Linear dynamic equation models, 213 Linear model and boundedness criterion, 176 and nonlinearity, 96-97, 133, 138-139, 214-215, 218 and OLS estimators, 154 omission and constraint problems in, 158 - 159stability of, 157 Linear regression model, and BIF estimator, 171 Location tests, 36, 43, 51, 54 Longest run tests, 26-27, 43, 51, 54 LS estimation problem, 121, 122, 124. See also OLS estimators

Macroeconomic forecasting model, 98-104 Macroeconomic policy, and demand for money, 19 Macroeconomic shocks, 3 Mallows estimator, 174-175, 182. See also Bounded-influence estimators Matrix of basic data, 126, 131, 132 Matrix of centered data, 130, 131, 132 Maximum likelihood estimation, 9-16 OLS as, 169, 172 Measurement, origins of, and structural interpretation of data, 125-126 Michigan Quarterly Econometric Model (MQEM) and autoregressive model, 207, 209 and conditioning, 117, 142, 143-146 equations in, 195-198, 213-214 explanatory variables in, 195 Fair model compared with, 193-194, 209, as final demand model, 234 linear analysis of, 214-220, 235, 237 in outside-information test, 98 parameter perturbations for, 218-231

Michigan Quarterly Econometric Model	in monetarist analysis, 68
(cont.) reduced version of (MINI 1), 231–235,	and unemployment, 82 MQEM. See Michigan Quarterly
237	Econometric Model
results for, 198–207, 208–210	Multicollinearity, 162. See also Collinearity
Midterm Energy Forecasting System	N
(MEFS), 156	Neyman-Pearson hypothesis testing, need
MINI I (compressed version of MQEM),	to extend beyond, xi
231–234, 237 MOEM compared with 234, 235	Nixon price controls, in inflation model,
MQEM compared with, 234–235	69, 79, 80
Misspecification	Oil maios of
and explanatory method, 18	Oil, price of
and MQEM, 199–207, 208, 209, 211	as aberrant, 155
Models See also Mississon Operatorly	and inflation, 69
Models. See also Michigan Quarterly	in Keynesian analysis, 72
Econometric Model	OLS (ordinary least squares) estimators,
ARCH, 9, 16	154, 162–169, 172
autoregressive, 207, 209, 211	algorithms for, 126, 128–130
Bayesian probability, 62	and BIF estimators, 173–174, 177 (see
criticism of and skepticism about, xi	also Bounded-influence estimators)
of demand for money, 19–22, 51	and collinearity, 119, 121
Fair, 193-194, 207, 210 (see also Fair	and data quality, 160
model)	and empirical results, 177–188
final demand, 234	influence function of, 155, 169, 171,
heteroscedasticity, 9	172–173
and instability, 54	justification of, 172
IS-LM, 63, 69, 73	with outliers, 155
linear, 154, 157, 158, 171, 176	and outside-information model, 98
linear approximation of nonlinear, 96–97,	OLS model, 11, 12, 14, 16
133, 138–139, 214–215, 218	OPEC, 3, 69 Origins of measurement, and structural
linear dynamic equation, 213	Origins of measurement, and structural interpretation of data, 125–126
macroeconomic forecasting, 98–104	Outliers, 154–156
maximum likelihood, 11–16 OLS, 11, 12, 14, 16	and DFFITS, 179, 180
quarterly forecasting, 90, 91–92	and Mallows estimator, 174, 175
reduced-form vs. structural, 176	and Schweppe algorithm, 175
Regional Demand Forecasting (RDFOR),	Outside information in forecasting, 90–97,
156–162, 171–172, 177–189	114–115
regression, 126-127, 128-130, 171	experimental model of, 98-104
Monetarist theory	and forecast horizon, 110, 113, 114
classical theory in, 73 (see also Classical	for 1974-75 recession and recovery, 113-
theory)	114
Friedmaniac theory in, 73 (see also	potential value of in dynamic forecasts,
Friedmaniac theory)	109–113
on inflation, 63–64, 65, 68	potential value of in static forecasts, 99,
priors in, 64, 70–72, 73–74, 76, 79–80, 81,	101, 103
87	realized value of in static forecasts,
Money demand, 19	105–109
models of, 19-22, 51	and standard errors, 113
recursive stability analysis of, 28-51	
Money growth	Parameter perturbations, in linear MQEM
in classical analysis, 87	analysis, 218–231
and inflation, 76	Partial characteristic root decompositions,
in inflation model, 65, 68	226–227

Perturbation analysis, and conditioning, RSTUDENT (scaled residual), 179-180 133. See also Small relative changes Phillips curve, 63, 65, 79, 81, 82 Scaled condition number, 121-122, 130-Price deflator for consumption of autos 131, 146-147 and parts, as first-differencing example, Scaled residual (RSTUDENT), 179-180 142, 143-146 Schweppe BIF estimator, 175. See also Prices. See also Inflation Bounded-influence estimators and causality in mean vs. in variance, 2-SEDS data base, 160-161 6, 12, 14 Sensitivity for energy, 69, 79, 80 due to collinearity, 119, 120, 121, 128 and Keynesian view, 68 and geometry of centering, 127-128 monetarist view of, 70, 71-72 lower bound of, 150-151 for oil, 69, 72, 155 and scaled condition number, 122, 130-131 and unemployment, 82 and structurally interpretable data, Prior information, special vs. routine 124-126, 142-143 sources of, xiii Sensitivity analysis Priors Bayesian, 74-76 in analysis of inflation, 62 global, 64 and Bayesian inference, 80 Serial dependence tests, 25, 27, 36, 43 classical, 82, 87 Small relative changes, 121, 122-124, 131 vs. data, 62, 68, 87 Spectral condition number, 146 diffuse, 64, 80 Stability. See also Instability; Recursive Friedmaniac, 82, 87 stability analysis in general inflation model, 64, 65 and demand for money, 19 Keynesian, 62, 64, 68, 70, 72, 73, 74, 76, and exploratory methods, 18 79-80, 81, 82, 87 and linear models, 157 monetarist, 64, 70-72, 73-74, 76, 79-80, Static forecasts, and outside information, 81, 87 105-109 and sensitivity analysis, 64, 74-76, 80 Stochastic simulation, in comparing for unemployment equation, 73-74 equations, 192 Structurally interpretable data, 124-126 Quarterly forecasting model, 90, 91-92 and centering, 117, 138 and first-differencing, 117, 142-143 ρ function, 173–174 and origin of measurement, 125 Rational-expectations logic, 68 Student *t* test, 25, 26 Recession and recovery (1974-75), and outside information, 113-114 Transformations, and conditioning, 126, Recursive stability analysis, 18, 22-28, 54 140, 142. See also Centering; Firstof money demand, 28-51 differencing Regional Demand Forecasting (RDFOR) TROLL econometric modeling system, xi, Model, 156-162 172, 198, 213 empirical results with, 177-189 Truncation errors, centering as avoidance inaccuracy of, 171-172 of, 140-141 inadequate assumptions in, 177 Regression model, 126-127 Uncertainty for MQEM, 199 estimating of, 128-130 Residuals, analysis of, 18 sources of, 191 Robust estimators, 154, 155-156, 171, 176-Unemployment and inflation, 65 177 BIF estimators as, 171 and inflation model, 65, 69-70, 72, 73-74, 79, 82-87 and data quality, 160 vs. omissions and constraints, 158-159 and money level, 82 Robustifying criterion function (p in MQEM and Fair model, 193, 195, 198 function), 173-174 and prices, 82

Variables
dependent, 154
dummy, 155, 19 - 195, 209, 211
omitted, 158
Variance
causality in, 2, 5-6, 12
conditional, 1, 9
forecast error, 103, 105
sources of, 2-6
time-series properties of, 16
Variance decomposition, 162–163, 165
Variates, structural role of, 132–133
Vectors, algorithmic role of, 133

Wilcoxon signed-rank test, 25, 26, 27