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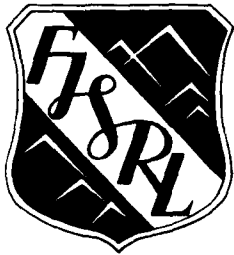
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JANUARY 1980

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USE OF THE BOX-JENKINS APPROACH
FOR PRELIMINARY FOREIGN EXCHANGE RATE DATA
ANALYSIS

FINAL REPORT

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PROJECT 2304



AIR FORCE SYSTEMS COMMAND

UNITED STATES AIR FORCE

FJSRL-TR-80-0003

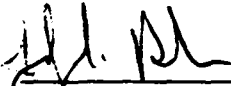
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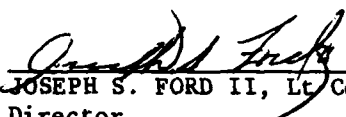
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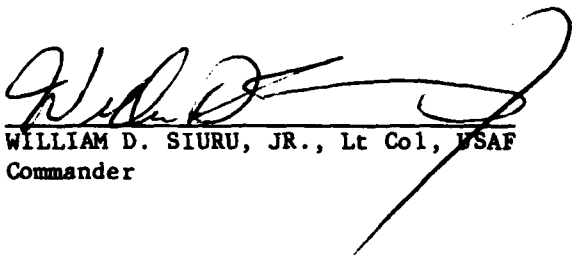
This technical report has been reviewed and is approved for publication.



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USE OF THE BOX-JENKINS APPROACH FOR
PRELIMINARY FOREIGN EXCHANGE RATE DATA
ANALYSIS

- I. OVERVIEW
 - II. DESCRIPTION OF THE 'BOX-JENKINS' APPROACH
 - A. GENERAL PROGRAM FLOW
 - B. BOX-JENKINS METHOD
 - III. APPLICATIONS OF 'BOX-JENKINS' APPROACH TO EXCHANGE RATE DATA
 - A. USE OF 'RUNNER'
 - B. USE OF 'BOX-JENKINS'
 - 1. Seasonality
 - 2. Order of Differencing
 - 3. Choice of Model
 - C. RETURN TO 'RUNNER'
 - IV. CONCLUSION
- APPENDIX A - DATA
- APPENDIX B - AUTO AND PARTIAL CORRELATION COEFFICIENTS
- APPENDIX C - MODELS FOR BELGIUM, DENMARK, NETHERLANDS, AND NORWAY
- APPENDIX D - GRAPHS OF FITTED AND FORECAST EXCHANGE RATES

A

OVERVIEW

The following report concerns a preliminary study with some interesting results in the use of the 'BOX-JENKINS' approach contained in the 'SYBIL-RUNNER' FORECASTING PACKAGE and its application to foreign exchange rate data. Addressed in this study is a general description of the 'BOX-JENKINS' approach, its subsequent application to foreign exchange rate data, and a brief conclusion. The appendix provides tables and graphs for each of the four European countries considered.

DESCRIPTION OF 'BOX-JENKINS' APPROACH

GENERAL PROGRAM FLOW

The control program 'SYBIL' performs preliminary statistical analysis on data provided by the user. Along with the results of this analysis, 'SYBIL' prints a recommended list of time-series forecasting methods which may be suitable for use on the given data.

The second control routine, 'RUNNER', generates forecasts based on summary statistics and gives a listing of available methods. These twenty or more forecasting techniques are contained on over one dozen program segments using chaining or overlay techniques. Once in a selected forecasting routine, the user may be asked to supply more local parametric information required by a specific technique (e.g., alpha weight, seasonal period, short term differences, etc.). More specific information as to what each program can accomplish is contained in the interactive forecasting manual which accompanies 'SYBIL-RUNNER'.

After the completion of the desired program(s), control is then returned to 'RUNNER'. When done, the results file is read back in to 'RUNNER' and listed in a series of tables. The user can review the

summarized material and decide on additional steps.

After running the 'SYBIL-RUNNER' combination, the user will have completed:

1. A general analysis of his data
2. A screening of available forecasting techniques
3. A detailed examination of a few of the most appropriate techniques
4. Final selection of a technique

BOX-JENKINS METHOD

Of the available programs, the 'BOX-JENKINS' approach is a procedure for using autoregressive and/or moving average schemes for forecasting applications. This method identifies the Auto-Regressive, Moving-Average model that best fits a set of data.

There are, however, two points which must be considered when assessing the validity of this method.

1. The 'BOX-JENKINS' approach used in this program is a single variable model and cannot consider additional variables.

2. Because no information on the significance of model coefficient estimates is provided, aggregated fitted error comparisons between models are the only criteria on which model adequacy can be based.

APPLICATION OF 'BOX-JENKINS' TO EXCHANGE RATE DATA

USE OF 'RUNNER'

The first step after accessing 'SYBIL-RUNNER' is to execute 'RUNNER'. At this stage exchange rate data was read from a data file. After identifying the seasonality and any other necessary parameters, 'RUNNER' provides a list of summary statistics. For our investigation of Exchange Rates with respect to the U.S. dollar for Belgium, Denmark, Netherlands, and Norway, we used the 'BOX-JENKINS' method of forecasting.

USE OF 'BOX-JENKINS'

The three critical concerns for this program are: seasonality, order of differencing, and the choice of models.

1. Seasonality: The seasonality for each country is determined individually by the time lag present in the graph of the autocorrelation coefficients. The length of seasonality corresponds to the time lag of the highest autocorrelation coefficient. In the case of Belgium, Denmark, and Norway, a seasonal period of six (6) was apparent while Netherlands showed a seasonal period of five (5).

2. Order of Differencing: Before any model can be applied, the data must be stationary. In the case of all four European countries, the data was stationary at the first difference. The input for short term differencing (period to period) was one (1) while the input for long term differencing (level of seasonal periods apart) was zero (0).

3. Choice of Model: Based upon the auto and partial correlation coefficients and tests of alternate forms, the best model for all countries was:

$$(1 - WB)Y_t = (1 - \theta_s^* B^S) e_t$$

This model is auto-regressive (1) seasonal in moving-average.

After specifying the necessary parameters, 'BOX-JENKINS' provides a graph of the Residual Autocorrelation Coefficients complete with Standard Error, Chi Squared, and Degrees of Freedom. These residuals show the 'fit' of the model. Following the residuals a table of Actual Values vs. Predicted Values is provided. The final portion of the program allows the user to select the number of forecast periods. 'BOX-JENKINS' prints the desired number of predictions.

RETURN TO 'RUNNER'

Once the user has completed the 'BOX-JENKINS' program, the 'SYBIL-RUNNER' chain program returns him to 'RUNNER' for a comparison of results. Forecasting accuracy of 'BOX-JENKINS' is compared to "NAIVE 1" and 'NAIVE 2'. A table of best forecast and corresponding method is provided followed

by an opportunity to combine any of the techniques.

See the Appendices for monthly (Jan 1972 - Sep 1979) data, tables, models, and graphs for the four European countries studied.

CONCLUSION

Consideration of the results indicate an interesting point. All four countries exhibit a roughly six month autoregressive structure. Whether this structure is due to some overt action on the part of governments or to some inherent property of exchange rates is an interesting and open question. Whether this structure will persist in time is also a question of economic interest. We performed some tests on two subperiods and found the same structure in each period. This study should be considered as a preliminary report outlining the specific methodology to be taken to duplicate the results and serve as the basis for further research.

APPENDIX A - DATA

Monthly average exchange rates with respect to the U.S. dollar

<u>Month</u>	<u>Belgium</u>	<u>Denmark</u>	<u>Netherlands</u>	<u>Norway</u>
1.72	44.4	7.0	3.2	6.7
2.72	43.8	7.0	3.2	6.7
3.72	43.9	7.0	3.2	6.6
4.72	44.1	7.0	3.2	6.6
5.72	44.0	7.0	3.2	6.6
6.72	43.9	7.0	3.2	6.5
7.72	43.8	7.0	3.2	6.5
8.72	43.9	6.9	3.2	6.5
9.72	44.0	6.9	3.2	6.6
10.72	44.2	6.9	3.2	6.6
11.72	44.1	6.9	3.2	6.6
12.72	44.1	6.9	3.2	6.6
1.73	44.1	6.9	3.2	6.6
2.73	41.7	6.5	3.0	6.2
3.73	39.7	6.2	2.9	5.9
4.73	40.0	6.2	2.9	5.9
5.73	39.4	6.2	2.9	5.8
6.73	37.5	5.8	2.7	5.5
7.73	35.5	5.5	2.6	5.3
8.73	37.0	5.7	2.7	5.5
9.73	36.9	5.7	2.6	5.5
10.73	36.6	5.6	2.5	5.5
11.73	38.7	6.0	2.7	5.6
12.73	40.0	6.2	2.8	5.7
1.74	42.8	6.7	2.9	6.0
2.74	41.0	6.4	2.8	5.8
3.74	40.0	6.2	2.8	5.7
4.74	39.0	6.1	2.7	5.5
5.74	37.7	5.9	2.6	5.3
6.74	37.9	6.0	2.6	5.4
7.74	37.9	5.9	2.6	5.4
8.74	38.7	6.0	2.7	5.5
9.74	39.4	6.2	2.7	5.6
10.74	38.6	6.0	2.7	5.5
11.74	37.7	5.9	2.6	5.5
12.74	36.9	5.8	2.5	5.3
1.75	35.4	5.6	2.5	5.1
2.75	34.8	5.6	2.4	5.0
3.75	34.4	5.4	2.4	4.9
4.75	35.2	5.5	2.4	5.0
5.75	34.9	5.5	2.5	5.0
6.75	34.9	5.4	2.4	4.9
7.75	36.8	5.7	2.6	5.2
8.75	38.3	6.0	2.6	5.5
9.75	39.2	6.1	2.7	5.6
10.75	38.9	6.0	2.7	5.5
11.75	39.0	6.0	2.7	5.5
12.75	39.5	6.2	2.7	5.6

<u>Month</u>	<u>Belgium</u>	<u>Denmark</u>	<u>Netherlands</u>	<u>Norway</u>
1.76	39.3	6.2	2.7	5.6
2.76	39.1	6.1	2.7	5.5
3.76	39.2	6.1	2.7	5.5
4.76	39.0	6.0	2.7	5.5
5.76	39.2	6.1	2.7	5.5
6.76	39.6	6.1	2.7	5.5
7.76	39.7	6.2	2.7	5.6
8.76	39.0	6.1	2.7	5.5
9.76	38.4	6.0	2.6	5.4
10.76	37.3	5.9	2.5	5.3
11.76	37.0	5.9	2.5	5.3
12.76	36.4	5.8	2.5	5.2
1.77	36.7	5.9	2.5	5.3
2.77	36.9	5.9	2.5	5.3
3.77	36.7	5.9	2.5	5.3
4.77	36.3	6.0	2.5	5.3
5.77	36.1	6.0	2.5	5.3
6.77	36.1	6.0	2.5	5.3
7.77	35.5	6.0	2.4	5.3
8.77	35.6	6.0	2.4	5.3
9.77	35.8	6.2	2.5	5.5
10.77	35.4	6.1	2.4	5.5
11.77	35.2	6.1	2.4	5.5
12.77	33.8	5.9	2.3	5.2
1.78	32.8	5.8	2.3	5.1
2.78	32.3	5.7	2.2	5.3
3.78	31.7	5.6	2.2	5.3
4.78	31.8	5.6	2.2	5.4
5.78	31.9	5.7	2.3	5.4
6.78	32.7	5.6	2.2	5.4
7.78	32.4	5.6	2.2	5.4
8.78	31.5	5.5	2.2	5.3
9.78	31.1	5.4	2.1	5.2
10.78	29.1	5.1	2.0	4.9
11.78	29.9	5.3	2.1	5.1
12.78	29.8	5.3	2.0	5.1
1.79	29.1	5.1	2.0	5.1
2.79	29.3	5.1	2.0	5.1
3.79	29.4	5.2	2.0	5.1
4.79	30.0	5.3	2.0	5.1
5.79	30.5	5.4	2.1	5.2
6.79	30.3	5.4	2.1	5.2
7.79	29.2	5.2	2.0	5.0
8.79	29.3	5.3	2.0	5.0
9.79	28.9	5.2	2.0	5.0

APPENDIX B
 AUTO AND PARTIAL CORRELATION COEFFICIENTS
 FOR FIRST DIFFERENCES IN THE FOUR COUNTRIES

Belgium

<u>Time Lag</u>	<u>Auto Correlation Coefficients</u>	<u>Partial Correlation Coefficients</u>
24	0.05	0.02
23	0.12 *	0.12 *
22	0.09 *	-0.02
21	0.11 *	0.05
20	0.23 **	0.07
19	0.12 *	0.10
18	-0.00	0.00
17	-0.05	-0.03
16	-0.06	-0.17 *
15	-0.02	0.04
14	-0.15 *	-0.14
13	-0.07	-0.01
12	0.06	-0.05
11	-0.04	-0.05
10	-0.02	-0.11 *
9	0.01	-0.02
8	0.06	-0.01
7	-0.03	0.22 **
6	-0.39 **	-0.35 **
5	-0.15 *	0.10
4	-0.10 *	-0.10
3	-0.01	-0.00
2	0.03	-0.06
1	0.30 **	0.30 **

*greater than one sigma
 **greater than two sigma

Denmark

<u>Time Lag</u>	<u>Auto Correlation Coefficients</u>	<u>Partial Correlation Coefficients</u>
24	0.06	0.10
23	0.16 *	0.08
22	0.00	-0.03
21	0.15 *	0.10
20	0.24 *	0.12
19	0.08	0.09
18	0.05	0.02
17	-0.12	-0.15 *
16	-0.04	-0.07
15	0.00	-0.04
14	-0.17 *	-0.14 *
13	0.03	-0.01
12	0.01	-0.04
11	-0.07	-0.12 *
10	0.03	0.06
9	-0.14 *	-0.18 *
8	0.11	0.11
7	-0.07	-0.01
6	-0.28 **	-0.28 **
5	-0.04	-0.03
4	-0.03	-0.04
3	0.01	0.02
2	-0.02	-0.04
1	0.12	0.12 *

*greater than one sigma

**greater than two sigma

Netherlands

<u>Time Lag</u>	<u>Auto Correlation Coefficients</u>	<u>Partial Correlation Coefficients</u>
24	0.04	-0.00
23	0.04	0.06
22	-0.04	-0.05
21	0.14	0.12 *
20	0.20 *	0.15 *
19	-0.04	-0.02
18	0.03	0.01
17	0.00	-0.00
16	0.02	-0.08
15	-0.11	-0.15 *
14	0.02	0.02
13	-0.07	-0.03
12	-0.01	0.01
11	-0.06	-0.16 *
10	-0.01	-0.09
9	-0.04	0.01
8	0.03	0.03
7	0.07	0.08
6	-0.10	-0.12 *
5	-0.29 **	-0.29 **
4	0.10	0.10
3	-0.01	-0.01
2	0.01	0.01
1	-0.03	-0.03

*greater than one sigma

**greater than two sigma

Norway

<u>Time Lag</u>	<u>Auto Correlation Coefficients</u>	<u>Partial Correlation Coefficients</u>
24	0.09	0.11 *
23	0.17 *	0.02
22	0.11	0.08
21	0.10	0.07
20	0.16 *	0.17 *
19	0.09	0.01
18	0.02	0.12 *
17	-0.21 *	-0.26 **
16	-0.09	-0.03
15	-0.00	0.00
14	-0.00	0.03
13	-0.01	-0.07
12	0.05	-0.02
11	-0.02	-0.09
10	0.11	0.08
9	0.05	0.02
8	0.02	-0.01
7	-0.13	0.00
6	-0.33 **	-0.33 **
5	-0.06	-0.05
4	-0.04	-0.03
3	-0.04	-0.01
2	-0.05	-0.09
1	0.21 *	0.21 **

*greater than one sigma

**greater than two sigma

APPENDIX C
MODELS FOR THE FOUR COUNTRIES

The model for each country was of the form

$$(1 - WB)Y_t = (1 - \theta_s^* B^s) e_t$$

In all countries except the Netherlands, the seasonality used was six months. For the Netherlands, five months fit better. Y_t is the one month change in exchange rate.

<u>Coefficient</u>	<u>Belgium</u>	<u>Denmark</u>	<u>Netherlands</u>	<u>Norway</u>
W	.371	.118	.020	.22
θ_s^*	.365	.259	.265	.29
s	6	6	5	6
Std Error	.104	.104	.104	.104
Chi Sqrd	12.43	18.25	17.59	18.91

APPENDIX D
GRAPHS OF RESULTS

