


Journal of Statistical Computation and Simulation >
Volume 86, 2016 - Issue 8229 | 8 | 0
Views CrossRef citations to date Altmetric

Original Articles

A robust closed-form estimator for the GARCH(1,1) model






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Pages 1605-1619 | Received 07 Feb 2015, Accepted 25 Jul 2015, Published online: 19 Aug 2015

 Cite this article  <https://doi.org/10.1080/00949655.2015.1077387> Check for updates

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Abstract

In this paper we extend the closed-form estimator for the generalized autoregressive conditional heteroscedastic (GARCH(1,1)) proposed by Kristensen and Linton [A closed-form estimator for the GARCH(1,1) model. *Econom Theory*. 2006;22:323–337] to deal with additive outliers. It has the advantage that is per se more robust than the maximum likelihood estimator (ML) often used to estimate this model, it is easy to implement and does not require the use of any numerical optimization procedure. The robustification of the closed-form estimator for the GARCH(1,1) model is achieved by a robust estimator of the scale parameter. The robustness of the estimator is evaluated via intensive simulation studies. The results show that the proposed estimator outperforms the maximum likelihood estimator in terms of efficiency. Finally, we fit the

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returns and analyse their performances in estimating and forecasting the volatility and the value-at-risk.

Keywords: additive outliers autocorrelations robustness value-at-risk volatility forecasting

JEL Classifications: C22 C53 C58

Disclosure statement

No potential conflict of interest was reported by the authors.

Funding

Financial support from the Spanish Ministry of Education and Science, research projects MTM2010-17323, ECO2012-32401 and Campus Iberus. The usual disclaimer applies. This work was supported by project FONDECYT 11121531.

Notes

1. See [19] for dealing with estimates of ϕ that are in the intervals $]-\infty;0[$ and $]1;+\infty[$.
2. Results are available from the authors upon request.
3. The Kiefer and Salmon [30] test is given by $KSN=(KSS)^2+(KSK)^2$, where $KSS=T/6[(1/T)\sum_{t=1}^T y_{t\cdot}^3-(3/T)\sum_{t=1}^T y_{t\cdot}]$, $KSK=T/24[(1/T)\sum_{t=1}^T y_{t\cdot}^4-(6/T)\sum_{t=1}^T y_{t\cdot}^2+3]$ and $y_{t\cdot}$ are the standardized returns. If the distribution of $y_{t\cdot}$ is conditional $N(0,1)$, then KSS and KSK are standard normal variables.
4. The first likelihood ratio test statistic is $LRuc=\frac{1}{n}\sum_{i=1}^n \ln \frac{f(y_i|\hat{\theta}_n)}{f(y_i|\hat{\theta}_n)}$, where f is the density function of the standardized residuals y_i and n is the number of observations.

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of ones in the sequence $\{I_t\}_{t=1}^n$. The second tests for the independence part of the conditional coverage hypothesis (denoted LRind) and it is also a likelihood ratio test

$$LR_{ind} = -2 \log \frac{L(\hat{\Pi}^2; I_1, I_2, \dots, I_n)}{L(\hat{\Pi}^1; I_1, I_2, \dots, I_n)} \sim \text{asy} \chi^2(1), \text{ where}$$

$\hat{\Pi}^1 = \frac{n_{00}(n_{00}+n_{01})n_{01}(n_{00}+n_{01})n_{10}(n_{10}+n_{11})n_{11}(n_{10}+n_{11})}{n_{ij}}$ is the number of observations with value i followed by j and $\hat{\pi}^2 = \frac{(n_{01}+n_{11})}{(n_{00}+n_{10}+n_{01}+n_{11})}$. Finally, the third is a joint test of coverage and independence (denoted LRcc) given by

$$LR_{cc} = -2 \log \frac{L(p; I_1, I_2, \dots, I_n)}{L(\hat{\Pi}^1; I_1, I_2, \dots, I_n)} \sim \text{asy} \chi^2(1).$$

5. For computing [32]'s Dynamic Quantile test, $H_t(\alpha)$ is defined as $H_t(\alpha) = I_t(\alpha) - \alpha$ where $I(\alpha)$ is a vector composed by ones (VaR violations) and zeros (VaR no violations). By the definition of VaR, we expect that the conditional expectation of $H_t(\alpha)$ given the past information must be zero. This assumption can be tested with the following linear regression model:

$$(20)$$

$H_t(\alpha) = \beta_0 + \sum_{i=1}^P \beta_i H_{t-i}(\alpha) + \sum_{j=1}^K \gamma_j g_j(z_t - j) + \varepsilon_t$, (20) where ε_t is an i.i.d process with zero mean and $g(\cdot)$ is a function of the past of variable z_t . Consider $H_0: \beta_0 = \beta_1 = \dots = \beta_P = \gamma_1 = \dots = \gamma_K = 0$, and denote $\Psi = (\beta_0, \beta_1, \dots, \beta_P, \gamma_1, \dots, \gamma_K)^T$ the vector of the $P+K+1$ parameters of the model. The test statistics is given by

$DQ = \hat{\Psi}^T X^T X \hat{\Psi} \alpha(1-\alpha) \rightarrow L \chi^2(P+K+1)$, where X denotes the covariates matrix in Equation (20). In our study, we select $P=4$, $K=4$ and $g(z_t) = \text{VaR}_t$ to account the influence of past exceedances up to four days (see [34], for more details).

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