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Vector autoregression with varied frequency data

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Vector Autoregression with Varied Frequency Data

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Abstract

The Vector Autoregression (VAR) model has been extensively applied in macroeconomics. A typical VAR requires its component variables being sampled at a uniformed frequency, regardless of the fact that some macro data are available monthly and some are only quarterly. Practitioners invariably align variables to the same frequency either by aggregation or imputation, regardless of information loss or noises gain. We study a VAR model with varied frequency data in a Bayesian context. Lower frequency (aggregated) data are essentially a linear combination of higher frequency (disaggregated) data. The observed aggregated data impose linear constraints on the autocorrelation structure of the latent disaggregated data. The perception of a constrained multivariate normal distribution is crucial to our Gibbs sampler. Furthermore, the Markov property of the VAR series enables a block Gibbs sampler, which performs faster for evenly aggregated data. Lastly, our approach is applied to two classic structural VAR analyses, one with long-run and the other with short-run identification constraints. These applications demonstrate that it is both feasible and sensible to use data of different frequencies in a new VAR model, the one that keeps the branding

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of the economic ideas underlying the structural VAR model but only makes minimum modification from a technical perspective.

Keywords: Vector Autoregression, Bayesian, Temporal aggregation

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1. Introduction

The Vector Autoregression (VAR) proposed by Christopher Sims (1980) is a workhorse model for forecasting as well as studying cause and effect in the macroeconomy. An autoregression model implicitly assumes data are sampled at the same frequency since variables at date t are regressed on variables dated at $t-1, t-2$, etc. However, macroeconomic data are not always observed at a uniformed frequency. First, each series can be sampled at its own frequency. For example, the best available data of GDP is quarterly, while that of the CPI is monthly, that of financial asset returns might be daily or more frequent. Second, for a given variable, recent data may be observed at a higher frequency while historical data may be coarsely sampled. For instance, quarterly GDP data are not available until 1947. In the presence of varied frequency data, a VAR practitioner aligns the variables either by aggregating the data to a lower frequency or imputing the high frequency data with heuristic rules. The former method discards valuable information in the fine data while the latter introduces noises to the data.

By far the most popular model that handles mixed frequencies data is the Mi(xed) Da(ta) S(ampling), or MIDAS, regression introduced by Ghysels et al. (2007), Andreou et al. (2010). The MIDAS regression projects high frequency data onto low frequencies data with a tightly parameterized weighing scheme. Though the MIDAS regression originally focuses on financial volatil-

ity prediction (e.g., Ghysels et al., 2006), it quickly gains popularity among macroeconomists for improving real-time forecast of key economic variables. See Clements and Galvao (2008, 2009), Marcellino and Schumacher (2010), and Kuzin et al. (2011) for applications.

In the MIDAS regression, the parsimonious declining weights, such as Almon lag polynomial or normalized Beta density, impose a priori structure on the decaying pattern of the regression coefficients. It is true that such a structure is necessary when the aggregation periods are long, say using daily variables to predict quarterly outcomes. Otherwise there will be parameter proliferation. However, for many macroeconomic data aggregation periods are relatively short, say monthly-quarterly, or quarterly-annual aggregation. It is both feasible and sensible to adopt a fully data-driven dynamic model like VAR. We name our model as the Var(ied) Da(ta) S(ampling), or VARDAS, regression, implying we follow the tradition of using the established VAR model in macroeconomic studies.

The MIDAS regression is raised mainly in the context of economic forecasting. The VARDAS model, however, can be used for both forecasting and characterizing dynamic nexus among macroeconomic variables. In fact, the VARDAS model is analogue to a reduced-form VAR. Once its parameters are routinely estimated, it can be restored to a structural model for the impulse response analysis. The economic insights used for identifying structural shocks remain unchanged. In fact, it effectively weakens many short-run identification assumptions such as zero contemporaneous effects, since our VARDAS model operates on an autoregression with higher frequency data and contemporaneity means a shorter time interval.

The VARDAS model is built upon the VAR model, but also takes the temporal aggregation into consideration. The effects of temporal aggregation have been extensively studied in literature over decades. Amemiya and Wu (1972), Tiao (1972), Tiao and Wei (1976), Marcellino (1999), Breitung and Swanson (2002) discuss, as a result of temporal aggregation, the change of lag orders of ARMA models, information loss in estimation and prediction, dynamic causality and integration relations among aggregated variates, etc. Silvestrini and Veredas (2008) provide a comprehensive review on the theory of temporal aggregation of time series models. The focus of our paper is not on the relationship between the aggregated model (estimated by low frequency data) and the disaggregated model (estimated by high frequency data, if available), but instead on an empirical concern: how to estimate a disaggregated model if some data are aggregated?

This question itself is not new. Under the frequentist framework, the mixed frequency VAR and a related factor model have been explored by Zadrozny (1988), Mittnik and Zadrozny (2004), Mariano and Murasawa (2003, 2010), Hyung and Granger (2008). The wisdom is to recast the VAR model with temporally aggregated variates into a state space model so that the likelihood function can be recursively evaluated by the Kalman filter. However, the main difficulty is that a VAR model typically contains many coefficients and numerical algorithms such as the quasi-Newton have limited ability to implement the maximum likelihood estimation.[2]

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[2]As is noted by Chen and Zadrozny (1998), Kalman filter method may perform poorly or not at all on a larger model. In applications, variables included need to be carefully selected; numerical maximization methods need to be carefully designed, and the initial

The mixed frequency VAR with the Kalman filter is essentially the frequentist version of the VARDAS model. The VARDAS model is raised in a Bayesian framework mainly because the Gibbs sampler with data augmentation is ideal for latent variable models. The large number of parameters does not pose major computational difficulties in that conditional on the latent disaggregated data it is a standard VAR model, with its parameters sampled in a way analogue to the linear regression model. The crux of our Gibbs sampler is a constrained multivariate normal distribution characterizing the posterior conditionals of the latent disaggregated variables. Furthermore, a blocking strategy that takes advantage of the Markov property of the VAR series accelerates the sampler, making the algorithm feasible even for a larger scale model.

Compared with the mixed frequency VAR with the Kalman filter, the VARDAS model is flexible and friendly to practitioners. It allows each component series in the VAR system being sampled at its own frequency and may change its frequency at any time. Though it is possible to redesign the state space representation of the frequentist model to reach this level of generality, the design must be tailored and finished by the practitioners, with no guarantee of numerical feasibility of maximizing the likelihood. However,

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values need to be carefully set. Many authors find it crucial to demean the data before applying the Kalman filter. Mittnik and Zadrozny (2004, p.7) report that "the MLE was not automatic and needed intervention". Aruoba and Scotti (2009) discuss in detail the two steps they use to select the initial values before applying the BFGS numerical maximzation. Mariano and Murasawa (2010) use the EM algorithm to obtain an initial estimate and then switch to the quasi-Newton method.

the VARDAS model only requires users to provide the data and specify the aggregation structure, while the estimation is as routine as a standard VAR model.

Our research is closest to a Bayesian estimation of the VAR model with mixed or irregular spaced data proposed by Chiu, Eraker, Foerster, Kim, and Seoane (2011, hereafter CEFKS). However, our econometric model and sampling techniques have two genuine differences from those in CEFKS.

First, CEFKS assume the lower-frequency data are the result of sampling every k periods from the high frequency variable. For example, quarterly data are treated as variables sampled at the end of March, June, September and December. However, most macroeconomic data do not seem to be generated in that fashion. Flow variables such as quarterly GDP is the sum of the latent "monthly GDP" in a quarter. Stock variables such as the monthly CPI are more reasonably viewed as an average of the latent "weekly CPI" in a month instead of the price level in the last week of a month.[3] Even if some variables are really sampled only once in a month, there is no reason to expect it realizes in the last week. If the realized date is the first week, auto-correlations and cross-correlations imply a different posterior distribution of

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[3]in the literature, stock variables are defined as those sampled every k periods from the latent high frequency variables. The examples provided for stock variables are "rates and indexes" such as interest rate, unemployment rate and CPI (Silvestrini and Veredas, 2008). However, all of them seem to be generated by averaging the latent variables in the k periods. Some financial data such as the S&P 500 index and exchange rates in a week or month do have their last-trading-day data available, but the averaged data are offered at the same time.

the latent variable.

CEFKS address the missing disaggregated data in the VAR system. Data aggregation problems bear some similarities to the traditional missing data problems, but a genuine difference is that data aggregation imposes linear temporal constraints on the disaggregated variates, which exhibit auto-correlations and cross-correlations as well. So the posterior latent variables follow a constrained, conditional multivariate normal distribution.

Second, in the CEFKS sampler, single-period (say, date t) latent disaggregated data are drawn conditional on all other latent values. In the VAR(1) model, two neighbors (that is, values in date $t-1$ and $t+1$) are relevant. Though this is a valid sampler, the excessive length of the MCMC chain might result in its slow mixing. Our method is to sample latent variables of all periods at one time, which reduces the nodes and improve the mixing. We also propose a block Gibbs sampler, which does increase the nodes on the MCMC chain, but the block size is at the discretion of the user so as to reach a balance between the sampling efficiency and speed.

The rest of the paper is organized as follows. Section 2 specifies of the VARDAS model. Section 3 explains the Gibbs sampler and Section 4 proposes an alternative block sampler. Section 5 extends the baseline econometric model to various aggregation types other than simple summation and averaging. Section 6 illustrates our approach by two classic applications of structural VAR model, one with long-run and the other with short-run identification constraints. Section 7 concludes the paper.

2. The model

Assume the k dimensional latent $\{\mathbf{Y}_t^*\}_{t=1}^T$ follow a covariance-stationary reduced-form VAR(p) process:

$$\mathbf{Y}_t^* = \mathbf{c} + \sum_{i=1}^p \boldsymbol{\Phi}_i \mathbf{Y}_{t-i}^* + \varepsilon_t,$$

where $\varepsilon_t \sim N(\mathbf{0}, \boldsymbol{\Omega})$. The reference time unit is t, which indexes the highest frequency data in the VAR system. The (column) vector $\mathbf{Y}_t^*$ is unobservable since some of the component series may be observed at some lower frequencies and are allowed to change sampling frequencies at any time. The book-keeping convention of observed data is specified as follows. Let $\{Y_t^*\}_{t=1}^T$ be a component series (say, the first variable) in the VAR system. Suppose in some time interval $[a,b]$, $1 \le a \le b \le T$, $a, b \in \mathbb{N}$, disaggregated latent values $Y_a^*, Y_{a+1}^* ... Y_{b-1}^*, Y_b^*$ are aggregated into a single observable variate $\overline{Y}_{a,b} \equiv \sum_{j=0}^{b-a} Y_{a+j}^*$. We then construct a data series $\{Y_t\}_{t=1}^T$ such that $Y_a = Y_{a+1}... = Y_{b-1} = N.A.$ and $Y_b = \overline{Y}_{a,b}$. As a special case, $a = b$ implies the disaggregated value (highest frequency data) is observed. The data series $\{Y_t\}_{t=1}^T$ contains all the available information with respect to the latent $\{Y_t^*\}_{t=1}^T$. Though data of various frequencies may be present in $\{Y_t\}_{t=1}^T$, there is no ambiguity since counting a run of $N.A.$ preceding a data point reveals the aggregation structure. Sometimes high frequency data are grouped into low frequency data by averaging instead of summation, say $\overline{Y}_{a,b} \equiv \frac{1}{b-a+1} \sum_{j=0}^{b-a} Y_{a+j}^*$. In that case, we simply record $Y_b = (b-a+1)\overline{Y}_{a,b}$ so that it becomes equivalent to aggregation by summation. More complicated data averaging types, such as weighed, noisy, missing and nonlinear aggregation, will be discussed in Section 5.

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Repeat the above process for each of the k component variables in the VAR system, we obtain k data series. A k-by-T data matrix $\mathbf{Y}$ is constructed by pooling all the data series. Each row is a component data series and each column is the data of k variables at a given time. Clearly $\mathbf{Y}$ contains many $N.A.$ entries, and we define a k-by-T logical matrix $\mathbf{E}$ such that the (i, j) entry of $\mathbf{E}$ equals zero if the corresponding entry of $\mathbf{Y}$ is $N.A.$, and equals one otherwise. The notation $\overrightarrow{\mathbf{E}}$ vectorizes the matrix $\mathbf{E}$ column by column, which will be used to select entries of a matrix (vector) to form a submatrix (subvector). Similarly, the operator $\overrightarrow{\mathbf{Y}}$ vectorizes the matrix $\mathbf{Y}$. Let $\mathbf{Y}^* = (\mathbf{Y}_1^*, ..., \mathbf{Y}_T^*)$, and $\overrightarrow{\mathbf{Y}^*}$ vectorizes the matrix $\mathbf{Y}^*$.

Essentially our task to estimate model parameters $\boldsymbol{\Theta} \equiv \{\mathbf{c}, \boldsymbol{\Phi}_1, ..., \boldsymbol{\Phi}_p, \boldsymbol{\Omega}\}$ and recover the latent $\mathbf{Y}^*$ with the observation matrix $\mathbf{Y}$. A Bayesian framework is adopted since the Gibbs sampler with data augmentation can conveniently handle models with latent variables. The Gibbs sampler only requires the full posterior conditionals of model parameters as well as latent disaggregated variables. Clearly, conditional on the latent $\mathbf{Y}^*$, this is a standard VAR model. By convention, treat the initial $\mathbf{Y}_1^*, ..., \mathbf{Y}_p^*$ as given, so the VAR model is equivalent to a seemingly unrelated regression model.[4]

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[4]Strictly speaking, the VAR model is reduced to a multiple-equation linear regression model only if we neglect the contribution of the initial p observations to the likelihood. Otherwise the posterior conditionals of $\mathbf{c}, \boldsymbol{\Phi}_1, ..., \boldsymbol{\Phi}_p$ do not have a closed form. However, conditioning on initial values is also commonly applied in the frequentist framework. Hamilton (1994, p. 291) notes that "Vector autoregressions are invariably estimated on the basis of the conditional likelihood function ... rather than the full-sample unconditional likelihood", so that maximizing the conditional likelihood is equivalent to OLS regressions equation by equation.

Denote a 1-by-$(kp+1)$ vector $\mathbf{x}_t = \begin{pmatrix} 1 & \mathbf{Y}^{*\prime}_{t-1} & \cdots & \mathbf{Y}^{*\prime}_{t-p} \end{pmatrix}$, and a k-by-$(kp+1)\,k$ block-diagonal matrix $\mathbf{X}_t = \begin{pmatrix} \mathbf{x}_t & & \\ & \ddots & \\ & & \mathbf{x}_t \end{pmatrix}$.

Let $\beta = (\mathbf{c}, \mathbf{\Phi}_1, ..., \mathbf{\Phi}_p)'$. With a conjugate proper prior $\overrightarrow{\beta} \sim N\left(\mu_\beta, \mathbf{V}_\beta\right)$, $\mathbf{\Omega}^{-1} \sim Wishart\left(\underline{\mathbf{\Omega}}, \underline{\nu}\right)$, where the operator $\overrightarrow{\beta}$ vectorize β, we have

$$\overrightarrow{\beta}\,|\cdot \sim N\left(\mathbf{D}_\beta \mathbf{d}_\beta, \mathbf{D}_\beta\right),$$

$$\mathbf{\Omega}^{-1}\,|\cdot \sim Wishart\left(\overline{\mathbf{\Omega}}, \overline{\nu}\right),$$

where

$$\mathbf{D}_\beta = \left(\sum_{t=p+1}^{T} \mathbf{X}_t'\mathbf{\Omega}^{-1}\mathbf{X}_t + \mathbf{V}_\beta^{-1}\right)^{-1},$$

$$\mathbf{d}_\beta = \sum_{t=p+1}^{T} \mathbf{X}_t'\mathbf{\Omega}^{-1}\mathbf{Y}_t^* + \mathbf{V}_\beta^{-1}\mu_\beta,$$

$$\overline{\mathbf{\Omega}} = \left[\underline{\mathbf{\Omega}}^{-1} + \sum_{t=p+1}^{T} \left(\mathbf{Y}_t^* - \mathbf{X}_t\overrightarrow{\beta}\right)\left(\mathbf{Y}_t^* - \mathbf{X}_t\overrightarrow{\beta}\right)'\right]^{-1},$$

$$\overline{\nu} = T - p + \underline{\nu}.$$

3. Posterior disaggregated variables

In this section, we describe how to sample the latent $\overrightarrow{\mathbf{Y}^*}$ from its posterior conditional distribution. Before presenting our sampler formally, we motivate our approach by a highly simplified scenario in which the system contains only one variable following an monthly AR(1):

$$Y_t^* = \phi Y_{t-1}^* + \varepsilon_t, \varepsilon_t \sim N\left(0, \sigma^2\right).$$

Suppose we only have one quarterly observation $\overline{Y}_{1,3} = Y_1^* + Y_2^* + Y_3^*$ and one monthly observation $Y_4 = Y_4^*$. Conditional on $\phi, \sigma^2, \overline{Y}_{1,3}, Y_4$ we are interested in the posterior distribution of $\overrightarrow{\mathbf{Y}^*} \equiv (Y_1^*, Y_2^*, Y_3^*, Y_4^*)'$. For notational conciseness, we leave conditioning on ϕ, σ^2 implicit. By our book-keeping convention, $\overrightarrow{\mathbf{Y}} = (N.A., N.A., \overline{Y}_{1,3}, Y_4)'$, $\overrightarrow{\mathbf{E}} = (0, 0, 1, 1)'$.

First note that if Y_1^* comes from the stationary distribution of the AR(1) process, then $\overrightarrow{\mathbf{Y}^*} \sim N(\mathbf{0}, \mathbf{\Gamma})$, where the (i, j) entry of $\mathbf{\Gamma}$ equals $\frac{\sigma^2}{1-\phi}\phi^{|i-j|}$. However, $\overrightarrow{\mathbf{Y}^*}$ is binded by two linear constraints. First, $Y_1^* + Y_2^* + Y_3^*$ must sum up to the known $\overline{Y}_{1,3}$. Second, Y_4^* must equal to the known Y_4. That implies $\overrightarrow{\mathbf{Y}^*}$ follows a constrained multivariate normal distribution, which can be represented as the product of a conditional normal and a degenerated distribution. To this end, construct a transformation matrix such that

$$
\mathbf{A} = \begin{pmatrix} 1 & 0 & 0 & 0 \\ 0 & 1 & 0 & 0 \\ 1 & 1 & 1 & 0 \\ 0 & 0 & 0 & 1 \end{pmatrix}.
$$

Then $\mathbf{A}\overrightarrow{\mathbf{Y}^*} = (Y_1^*, Y_2^*, \overline{Y}_{1,3}, Y_4)' \sim N(\mathbf{0}, \mathbf{A}\mathbf{\Gamma}\mathbf{A}')$.

It follows that

$$
(Y_1^*, Y_2^*)' \,|\, \overline{Y}_{1,3}, Y_4 \sim N\left[\mathbf{\Gamma}_{01}\mathbf{\Gamma}_{11}^{-1} \cdot (\overline{Y}_{1,3}, Y_4)', \mathbf{\Gamma}_{00} - \mathbf{\Gamma}_{01}\mathbf{\Gamma}_{11}^{-1}\mathbf{\Gamma}_{10}\right],
$$

where $\mathbf{\Gamma}_{01}$ is the submatrix of $\mathbf{A}\mathbf{\Gamma}\mathbf{A}'$ with rows selected by $1 - \overrightarrow{\mathbf{E}}$, and columns selected by $\overrightarrow{\mathbf{E}}$, and $\mathbf{\Gamma}_{00}, \mathbf{\Gamma}_{11}, \mathbf{\Gamma}_{10}$ are defined similarly. Practically, in a matrix-based computational environment such as MATLAB, R or GAUSS, a submatrix can be conveniently selected by a logical index (mask).

Lastly, $(Y_3^*, Y_4^*)' \, | Y_1^*, Y_2^*, \overline{Y}_{1,3}, Y_4$ are degenerated since $Y_3^* = \overline{Y}_{1,3} - Y_1^* - Y_2^*$ and $Y_4^* = Y_4$. The posterior distribution of $\overrightarrow{\mathbf{Y}^*}$ is completely characterized by the product of $(Y_1^*, Y_2^*)' \, | \overline{Y}_{1,3}, Y_4$ and $(Y_3^*, Y_4^*)' \, | Y_1^*, Y_2^*, \overline{Y}_{1,3}, Y_4$, so the problem is resolved.

This example demonstrates our idea of sampling the latent $\overrightarrow{\mathbf{Y}^*}$. The disturbances ε_t are multivariate normal, so $\overrightarrow{\mathbf{Y}^*}$ also follows kT dimensional multivariate normal. If we use a kT-by-kT matrix $\mathbf{A}$ to linearly transform $\overrightarrow{\mathbf{Y}^*}$, the resulting matrix $\mathbf{A}\overrightarrow{\mathbf{Y}^*}$ is multivariate normal as well. The purpose of this transformation is to relate the disaggregated and aggregated data. The latter is known so that the former follows a conditional normal distribution. Recall that the logical vector $\overrightarrow{\mathbf{E}}$ indicated which entries in $\overrightarrow{\mathbf{Y}}$ contain aggregation information and which do not. So $\overrightarrow{\mathbf{E}}$ will be used to construct our conditional normal distribution. Our procedure is formally presented as follows.

If the initial $\mathbf{Y}_1^{*\prime}, ..., \mathbf{Y}_p^{*\prime}$ come from the stationary distribution of the VAR system, then $\overrightarrow{\mathbf{Y}^*} \sim N(\mu, \mathbf{\Gamma})$, where $\mu = (\mu_1', ..., \mu_1')'$, $\mu_1 = (\mathbf{I}_k - \sum_{i=1}^{p} \mathbf{\Phi}_i)^{-1} \mathbf{c}$. The kT-by-kT covariance matrix $\mathbf{\Gamma}$ is given by

$$
\mathbf{\Gamma} = \begin{pmatrix} \mathbf{\Gamma}_0 & \mathbf{\Gamma}_1' & ... & \mathbf{\Gamma}_{T-1}' \\ \mathbf{\Gamma}_1 & \mathbf{\Gamma}_0 & ... & \mathbf{\Gamma}_{T-2}' \\ ... & & & \\ \mathbf{\Gamma}_{T-1} & \mathbf{\Gamma}_{T-2} & ... & \mathbf{\Gamma}_0 \end{pmatrix},
$$

where the autocovariance matrix $\mathbf{\Gamma}_j = E\left[(\mathbf{Y}_T - \mu)(\mathbf{Y}_{T-j} - \mu)'\right], j = 0, 1, 2, ...$ can be recursively computed by

$$
\mathbf{\Gamma}_j = \sum_{i=1}^{p} \mathbf{\Phi}_i \mathbf{\Gamma}_{j-i}.
$$

As for the initial $\mathbf{\Gamma}_0, ..., \mathbf{\Gamma}_{p-1}$, we compute a kp-by-kp matrix $\mathbf{G}$ such that $\overrightarrow{\mathbf{G}} = [\mathbf{I}_{k^2 p^2} - (\mathbf{F} \otimes \mathbf{F})]^{-1} \overrightarrow{\mathbf{\Delta}}$, where $\mathbf{F} = \begin{pmatrix} \mathbf{\Phi} \\ \mathbf{C} \end{pmatrix}$, $\mathbf{\Phi} = (\mathbf{\Phi}_1, ..., \mathbf{\Phi}_p)$, $\mathbf{C} = \begin{pmatrix} \mathbf{I}_{k(p-1)} & \mathbf{0}_{k(p-1),k} \end{pmatrix}$, and $\mathbf{\Delta}$ is a kp-by-kp matrix of zeros except for its first (northwest) k-by-k submatrix being $\mathbf{\Omega}$. The first k rows of $\mathbf{G}$ is $(\mathbf{\Gamma}_0, ..., \mathbf{\Gamma}_{p-1})$.

The kT-by-kT transformation matrix $\mathbf{A}$ can be constructed by examining the logical matrix $\mathbf{E}$. First, let the main diagonal of $\mathbf{A}$ be ones and other elements be zeros. Second, examine each row of the logical matrix $\mathbf{E}$. Suppose we are reading row i and column j of $\mathbf{E}$ ($i = 1, ..., k; j = 1, ..., T$). If the (i, j) entry is zero, skip and proceed to column $j + 1$ (or conclude this row). Otherwise, (i, j) entry being one implies a temporally aggregated data is observed. So we search column $j - 1, j - 2, ...$ for a run of zeros. Suppose there are M zeros ($M \geq 0$) in a row immediately before column j; we then add M ones to $\mathbf{A}$. For $M > 0$, the locations in $\mathbf{A}$ are row $(j - 1) k + i$, column $(j - 1) k + i - mk$, $m = 1, ..., M$. Note that $M = 0$ implies one-period trivial aggregation.

The new series $\mathbf{A}\overrightarrow{\mathbf{Y}^*}$ transforms the original series $\overrightarrow{\mathbf{Y}^*}$ in such a way that for a $(M + 1)$-period temporal aggregation, the first M disaggregated variates are retained, while the last disaggregated variate is replaced by the sum of the disaggregated variates in the $M + 1$ periods. As a special case, for a one-period aggregation, the variate is simply retained. Clearly, $\mathbf{A}\overrightarrow{\mathbf{Y}^*}$ can be classified into two blocks: the latent disaggregated variates block and the observed variates block. The latter have their realizations contained in $\overrightarrow{\mathbf{Y}}$. The former block can be learned from those data. To be exact,

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$\mathbf{A}\overrightarrow{\mathbf{Y}^*} \sim N\left(\mathbf{A}\mu, \mathbf{A}\mathbf{\Gamma}\mathbf{A}'\right)$, and

$$\overrightarrow{\mathbf{Y}_0^*}\bigg|\overrightarrow{\mathbf{Y}}, \mathbf{\Theta} \sim N\left[\eta_0 + \mathbf{\Gamma}_{01}\mathbf{\Gamma}_{11}^{-1}\left(\overrightarrow{\mathbf{Y}_1} - \eta_1\right), \mathbf{\Gamma}_{00} - \mathbf{\Gamma}_{01}\mathbf{\Gamma}_{11}^{-1}\mathbf{\Gamma}_{10}\right],$$

where $\overrightarrow{\mathbf{Y}_0^*}$ is the subvector of $\mathbf{A}\overrightarrow{\mathbf{Y}^*}$ selected by the logical vector $1 - \overrightarrow{\mathbf{E}}$, namely the latent disaggregated variates block. The vector $\overrightarrow{\mathbf{Y}_1}$ has double identities: as a random vector, it is the subvector of $\mathbf{A}\overrightarrow{\mathbf{Y}^*}$ selected by $\overrightarrow{\mathbf{E}}$, namely the observed variates block; as a realization of that random vector, it is exactly the subvector of $\overrightarrow{\mathbf{Y}}$ selected by $\overrightarrow{\mathbf{E}}$ (simply the non-$N.A.$ part of our data $\overrightarrow{\mathbf{Y}}$). η_0 and η_1 are two subvectors of $\mathbf{A}\mu$ selected by $1 - \overrightarrow{\mathbf{E}}$ and $\overrightarrow{\mathbf{E}}$ respectively. $\mathbf{\Gamma}_{01}$ is the submatrix of $\mathbf{A}\mathbf{\Gamma}\mathbf{A}'$ with rows selected by $1 - \overrightarrow{\mathbf{E}}$, and columns selected by $\overrightarrow{\mathbf{E}}$, and $\mathbf{\Gamma}_{11}, \mathbf{\Gamma}_{00}, \mathbf{\Gamma}_{10}$ are defined similarly.

Lastly, Note that in the transformation we squeezed out one disaggregated variate at the end of the aggregation periods, and replaced it with an aggregated data. Treat one period aggregation as squeezing out and filling in the same variate. Those squeezed-out variates, denoted as $\overrightarrow{\mathbf{Y}_{-1}^*}$, correspond to the subvector of $\overrightarrow{\mathbf{Y}^*}$ selected by $\overrightarrow{\mathbf{E}}$. However, $\overrightarrow{\mathbf{Y}_{-1}^*}\big|\overrightarrow{\mathbf{Y}_0^*}, \overrightarrow{\mathbf{Y}}, \theta$ is degenerate, since it must equal to the difference between the aggregated value and the sum of the rest disaggregated values. Note that $\overrightarrow{\mathbf{Y}_0^*}$ has another identity, namely the subvector of $\overrightarrow{\mathbf{Y}^*}$ selected by $1 - \overrightarrow{\mathbf{E}}$, which implies the two vectors $\overrightarrow{\mathbf{Y}_0^*}$ and $\overrightarrow{\mathbf{Y}_{-1}^*}$ cover all the elements in the latent $\overrightarrow{\mathbf{Y}^*}$. In other words, by sampling in turn $\overrightarrow{\mathbf{Y}_0^*}\big|\overrightarrow{\mathbf{Y}}, \theta$ from a conditional normal distribution and $\overrightarrow{\mathbf{Y}_{-1}^*}\big|\overrightarrow{\mathbf{Y}_0^*}, \overrightarrow{\mathbf{Y}}, \theta$ from a degenerated distribution, we obtain the posterior conditional sample of $\overrightarrow{\mathbf{Y}^*}$. That finishes the cycle of the Gibbs sampler to the VARDAS model.

4. Gibbs sampler with Blocks

The sampling procedure in the previous section allows us to draw the latent disaggregated values all at once. For macroeconomic data with several hundred observations, the sampler is workable on an ordinary desktop computer. However, if we need to handle a large dataset which contains ten thousand observations, the above procedure requires handling large matrixes and their inversion, which slow down the sampling speed and create burden on the computer memory. In this section we propose an alternative sampler which divide latent variables into blocks. It is fast and memory-efficient, at the price of increasing nodes on the MCMC chain.

The idea of this approach is to explore the Markov property of the series to simplify conditional distributions and thus reduce the size of matrixes. To fix ideas, consider again the simple scenario in Section 3. The system contains only one variable following a monthly AR(1):

$$Y_t^* = \phi Y_{t-1}^* + \varepsilon_t, \varepsilon_t \sim N\left(0, \sigma^2\right).$$

Suppose we observe two quarterly observations $\overline{Y}_{1,3} = Y_1^* + Y_2^* + Y_3^*$, $\overline{Y}_{4,6} = Y_4^* + Y_5^* + Y_6^*$ and one monthly observation $Y_7 = Y_7^*$. Conditional on $\phi, \sigma^2, \overline{Y}_{1,3}, \overline{Y}_{4,6}, Y_7$ we are interested in the posterior distribution of $\overrightarrow{\mathbf{Y}^*} \equiv (Y_1^*, ..., Y_7^*)'$. If we sample the latent variates all at once, we need to work on a 7-by-7 transformation matrix and covariance matrix.

Now we partition the seven latent variables into three blocks and consecutively sample variates in one block conditional on other two blocks. We

need to specify the posterior conditional of

$$(Y_1^*, Y_2^*, Y_3^*)' \left| \overline{Y}_{1,3}, \overline{Y}_{4,6}, Y_7, Y_4^*, Y_5^*, Y_6^*, Y_7^* \right.,$$

$$(Y_4^*, Y_5^*, Y_6^*)' \left| \overline{Y}_{1,3}, \overline{Y}_{4,6}, Y_7, Y_1^*, Y_2^*, Y_3^*, Y_7^* \right.,$$

$$Y_7^* \left| \overline{Y}_{1,3}, \overline{Y}_{4,6}, Y_7, Y_1^*, ..., Y_6^* \right..$$

The last block has a degenerate distribution, so we focus on the first two blocks. To sample $(Y_1^*, Y_2^*, Y_3^*)'$ conditional on all other disaggregated values, we note that the Markov property of an AR(1) process implies that once we know Y_4^*, further knowledge on Y_5^*, Y_6^*, Y_7^* is irrelevant. So it is equivalent to work on $(Y_1^*, Y_2^*, Y_3^*)' \left| \overline{Y}_{1,3}, Y_4^* \right.$. By a linear transformation, $\left(Y_1^*, Y_2^*, \overline{Y}_{1,3}, Y_4^*\right)'$ follows a multivariate normal, so we first sample $(Y_1^*, Y_2^*)'$ conditional on $\overline{Y}_{1,3}, Y_4^*$, and then sample the degenerated Y_3^*, a procedure essentially the same as that in the previous section. Note that this process only requires us to construct a 4-by-4 transformation matrix and covariance matrix.

Similarly, to sample $(Y_4^*, Y_5^*, Y_6^*)'$ conditional on all other disaggregated values, we work on $(Y_4^*, Y_5^*, Y_6^*)' \left| \overline{Y}_{4,6}, Y_3^*, Y_7 \right.$, with a 5-by-5 transformation matrix $\mathbf{A}$ which takes $(Y_3^*, Y_4^*, Y_5^*, Y_6^*, Y_7^*)'$ into $\left(Y_3^*, Y_4^*, Y_5^*, \overline{Y}_{4,6}, Y_7\right)'$ with the distribution $N\left(\mathbf{0}, \frac{\sigma^2}{1-\phi}\mathbf{A}\mathbf{\Gamma}\mathbf{A}'\right)$, where the (i, j) entry of $\mathbf{\Gamma}$ equals $\phi^{|i-j|}$. So we first sample $(Y_4^*, Y_5^*)' \left| \overline{Y}_{4,6}, Y_3^*, Y_7 \right.$ from a conditional normal distribution and then sample the degenerated Y_6^*.

This example illustrates the ideas of our block Gibbs sampler, though the computational saving is mild in that we only have two quarterly observations. However, if we instead have 100 quarterly observations, the computational advantage will be more obvious. If latent variates are sampled at one time we

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need to construct an at least 300-by-300 transformation matrix. However, we can group 3 latent monthly variables in a block, say $\left(Y_t^*, Y_{t+1}^*, Y_{t+2}^*\right)'$, $t = 1, 4, 7, ..., 298$, with the quarterly observation $\overline{Y}_{t,t+2}$. The Markov property implies that $\left(Y_t^*, Y_{t+1}^*, Y_{t+2}^*\right)'$ conditional on all the other disaggregated variates is equivalent to that conditional on Y_{t-1}^*, Y_{t+3}^* (with proper modifications to the two ends of the series). Once we build a 5-by-5 matrix $\mathbf{A}$ that transforms $\left(Y_{t-1}^*, Y_t^*, Y_{t+1}^*, Y_{t+2}^*, Y_{t+3}^*\right)'$ into $\left(Y_{t-1}^*, Y_t^*, Y_{t+1}^*, \overline{Y}_{t,t+2}, Y_{t+3}^*\right)'$, we can sample $\left(Y_t^*, Y_{t+1}^*\right)'$ from a conditional normal and Y_{t+2}^* from a degenerated distribution. Furthermore, the stationarity of the series implies the covariance matrix of $\left(Y_{t-1}^*, Y_t^*, Y_{t+1}^*, \overline{Y}_{t,t+2}, Y_{t+3}^*\right)'$ is time invariant, which offers another major computational advantage in addition to the reduced matrix dimensions.

Also note that the size of the block is not necessarily equal to an aggregation cycle. For example, it is legitimate to partition the series as $\left(Y_t^*, ..., Y_{t+5}^*\right)'$, $t = 1, 7, 13..., 295$. Larger block size increases computation time, but reduces the nodes on the MCMC chain as well and thus improves the mixing of the chain. If the entire series are treated as one block, we go back to the sampler specified in Section 3.

In a general VAR(p)-based VARDAS model, the blocking strategy still applies. Let $\mathbf{Y}, \mathbf{E}, \mathbf{A}, \mu, \mathbf{\Gamma}$ as defined in Section 3. Suppose we intend to sample $\left(\mathbf{Y}_t^*, \mathbf{Y}_{t+2}^* ..., \mathbf{Y}_{t+j}^*\right)$ in one block, conditional on disaggregated draws of all other blocks. The integer j should be picked such that all the aggregation constraints in the time interval $[t, t + j]$ does not involve disaggregated variates outside that time interval. For example, if monthly, quarterly, semi-annual data are simultaneously in use, the minimum block size is 6 and

the actual size might be $12, 18, 24$, and so on. The Markov property of the VAR(p) model suggest that we only need to use the joint distribution of $\left(\mathbf{Y}_{t-p}^*, ..., \mathbf{Y}_t^*..., \mathbf{Y}_{t+j}^*, ..., \mathbf{Y}_{t+j+p}^*\right)$ to formulate the conditional normal distribution. Let $\widetilde{\mathbf{e}}$ be a k-by-$(j+1)$ submatrix of $\mathbf{E}$ using its columns t to $t+j$. Let $\mathbf{e} = (\iota, \widetilde{\mathbf{e}}, \iota)$, where ι is a k-by-p matrix of ones. Then we can use the vectorized $\overrightarrow{\mathbf{e}}$ to select submatrixes to form the conditional normal distribution.

$$\overrightarrow{\mathbf{Y}_0^*} \Big| \overrightarrow{\mathbf{Y}}, \theta \sim N \left[\eta_0 + \mathbf{\Gamma}_{01}\Gamma_{11}^{-1}\left(\overrightarrow{\mathbf{Y}_1} - \eta_1\right), \mathbf{\Gamma}_{00} - \mathbf{\Gamma}_{01}\Gamma_{11}^{-1}\mathbf{\Gamma}_{10}\right],$$

where $\overrightarrow{\mathbf{Y}_0^*}$ is the subvector of $\mathbf{A}\overrightarrow{\mathbf{Y}^*}$ selected by the logical vector $1 - \overrightarrow{\mathbf{e}}$, namely all the unobserved disaggregated variates within $\left(\mathbf{Y}_t^*, \mathbf{Y}_{t+2}^*..., \mathbf{Y}_{t+j}^*\right)$. The vector $\overrightarrow{\mathbf{Y}_1}$ is the subvector of $\overrightarrow{\mathbf{Y}}$ selected by $\overrightarrow{\mathbf{e}}$. η_0 and η_1 are two subvectors of $\mathbf{A}\mu$ selected by $1 - \overrightarrow{\mathbf{e}}$ and $\overrightarrow{\mathbf{e}}$ respectively. $\mathbf{\Gamma}_{01}$ is the submatrix of $\mathbf{A}\mathbf{\Gamma}\mathbf{A}'$ with rows selected by $1 - \overrightarrow{\mathbf{e}}$, and columns selected by $\overrightarrow{\mathbf{e}}$, and $\mathbf{\Gamma}_{11}, \mathbf{\Gamma}_{00}, \mathbf{\Gamma}_{10}$ are defined similarly.

Of course, practitioners does not necessarily need to start from those giant matrix $\mathbf{Y}, \mathbf{E}, \mathbf{A}, \mu, \mathbf{\Gamma}$ and use $\overrightarrow{\mathbf{e}}$ to select submatrixes. The joint distribution of $\left(\mathbf{Y}_{t-p}^*, ..., \mathbf{Y}_t^*..., \mathbf{Y}_{t+j}^*, ..., \mathbf{Y}_{t+j+p}^*\right)$ can be worked out directly by examining the VAR(p) covariance structure. Furthermore, in a balanced aggregation the transformation matrix and covariance matrix are time invariant, so that it only needs to be computed once per Gibbs sampler cycle.

5. Other aggregation types

Macroeconomic data may exhibit more complicated aggregation types other than summation and simple average. In this section, we extend the VARDAS model to various aggregation types that an empirical researcher may encounter.

5.1. Weighed aggregation

In the baseline model, the time interval $[t, t+1]$ is equidistant over time. However, calender days vary in a month, and working days are affected by holidays. Suppose latent daily values of some variable are simple-averaged to generate latent quarterly data and observable annual data. Assume $66, 66, 66, 60$ working days in the four quarters, and then the latent quarterly values $\{Y_t^*\}_{t=1}^T$ are linked to the annual data $\{\overline{Y}_{4i+1,4i+4}\}_{i=0}^{T/4-1}$ by the relation $\overline{Y}_{4i+1,4i+4} = \frac{66}{252}Y_{4i+1}^* + \frac{66}{252}Y_{4i+2}^* + \frac{66}{252}Y_{4i+3}^* + \frac{60}{252}Y_{4i+4}^*$.

In a general setting, let $\{Y_t^*\}_{t=1}^T$ be a component series in the VAR system. Suppose in some time interval $[a, b]$, disaggregated latent values $Y_a^*, Y_{a+1}^* \dots Y_{b-1}^*, Y_b^*$ are grouped into an aggregated observed data $\overline{Y}_{a,b} \equiv \sum_{j=0}^{b-a} \omega_{a+j} Y_{a+j}^*$, where $\{\omega_t\}_{t=1}^T$ is a deterministic weight series. In the above example, the weight series looks like $\left\{\dots, \frac{66}{252}, \frac{66}{252}, \frac{66}{252}, \frac{60}{252}, \dots\right\}$. The data series $\{Y_t\}_{t=1}^T$ and the matrixes $\mathbf{Y}, \mathbf{Y}^*, \mathbf{E}$ are constructed in the same way as in Section 3, but the transformation matrix $\mathbf{A}$ needs to incorporate the weights information. The matrix $\mathbf{A}$ can be constructed based on a kT-by-kT identity matrix. Then we examine the logical matrix $\mathbf{E}$ row by row to modify $\mathbf{A}$ as appropriate. Suppose we are reading row i and column j of $\mathbf{E}$. If the (i, j) entry is zero, skip and proceed to column $j+1$ (or conclude this row). Otherwise, we search column $j-1, j-2, \dots$ for a run of zeros. Suppose there are M zeros in a row $(M \geq 0)$ immediately before column j. By reading the weight series $\{\omega_t\}_{t=1}^T$ of variable i, we extract $\omega_j, \omega_{j-1}, \dots, \omega_{j-M}$ and add them to $\mathbf{A}$. The locations in $\mathbf{A}$ are row $(j-1)k + i$, column $(j-1)k + i - mk$, $m = 0, \dots, M$. The rest sampling procedure remains the same.

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5.2. Differenced data and weighed aggregation

The VAR model in use is covariance stationary. However, many macroe-conomic variables contain unit roots. It is common to put the first-differenced variables in the VAR system, though in the current model cointegration relations and error correction terms are not included. The VARDAS model with cointegration is left for future research.

Consider an example. Let $\{Y_t^*\}_{t=1}^T$ be the latent monthly GDP series and we actually put $\Delta Y_t^* \equiv Y_t^* - Y_{t-1}^*$ as a component variable in the VAR model. We observe the quarterly GDP series $\overline{Y}_{t,t+2} = Y_t^* + Y_{t+1}^* + Y_{t+2}^*$, $t = 1, 4, 7, \ldots$. Define the quarterly-differenced data $\Delta^3 \overline{Y}_{t,t+2} = \overline{Y}_{t,t+2} - \overline{Y}_{t-3,t-1}$. The observable quarterly-differenced data and the unobservable monthly-differenced data are linked by the relation

$$
\begin{aligned}
\Delta^3 \overline{Y}_{t,t+2} &= \sum_{j=1}^3 \left(Y_t^* - Y_{t-3}^* \right) \\
&= \sum_{j=1}^3 \left(\Delta Y_t^* + \Delta Y_{t-1}^* + \Delta Y_{t-2}^* \right) \\
&= \Delta Y_{t+2}^* + 2\Delta Y_{t+1}^* + 3\Delta Y_t^* + 2\Delta Y_{t-1}^* + \Delta Y_{t-2}^*.
\end{aligned}
$$

In other words, the observed quarterly GDP growth series is a weighed sum of the unobserved monthly GDP growth series. Similarly, suppose the aggregated value is formed by taking average instead of summation, that is, $\overline{Y}_{t,t+2} = \frac{1}{3} \left(Y_t^* + Y_{t+1}^* + Y_{t+2}^* \right)$. The quarterly-monthly differenced data are linked by the relation

$$
\Delta^3 \overline{Y}_{t,t+2} = \frac{1}{3}\Delta Y_{t+2}^* + \frac{2}{3}\Delta Y_{t+1}^* + \Delta Y_t^* + \frac{2}{3}\Delta Y_{t-1}^* + \frac{1}{3}\Delta Y_{t-2}^*.
$$

In principle, the approach handling weighed averaged data in the previous subsection applies to the current problem. We just put quarterly differenced

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data in the data series $\{Y_t\}_{t=1}^T$ every three entries (with other entries being *N.A.*). As for the transformation matrix $\mathbf{A}$, suppose we are reading row i and column j of $\mathbf{E}$ and (i, j) is a non-zero entry. Then for summation-type aggregation we add $(1, 2, 3, 2, 1)$ to $\mathbf{A}$ at row $(j-1)\,k + i$ and column $(j-1)\,k + i - mk$, $m = 0, ..., 4$. The rest sampling procedure remains the same.

In practice, it is preferable to estimate the differenced-data VARDAS model using a block Gibbs sampler.[5] However, in this case the block sampler differs slightly from the previous one. If we define an aggregation cycle as the periods that level data aggregate (say 3 months in the above example), the aggregation of differenced data spans across two aggregation cycles, which implies that two aggregated data are relevant when we sample a block of variables in an aggregation circle.

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[5]It seems that there are some numerical issues if the disaggregated, differenced data are sampled all at once. Consider a univariate AR(1) with $\phi = 0.5, \sigma^2 = 1$. Let the covariance matrix of T observations be $\mathbf{\Gamma}$, where the (i, j) entry of $\mathbf{\Gamma}$ equals $\frac{\sigma^2}{1-\phi}\phi^{|i-j|}$. Construct the transformation matrix $\mathbf{A}$ with weights $(1, 2, 3, 2, 1)$ assigned as appropriate. The transformed covariance matrix $\mathbf{A\Gamma A}'$ is positive definite in theory. However, it seems that when T is larger than 100, MATLAB cannot perform the cholesky decomposition and produces a non-positive definite error, though we know theoretically the cholesky factor in this case is $\mathbf{AL}$, where $\mathbf{LL}' = \mathbf{\Gamma}$. The puzzle is that regardless of T MATLAB can always cholesky decompose $\mathbf{\Gamma}$ and $\mathbf{A\Gamma A}'$ for level-data aggregation specified in the previous section. We are not aware of the source of this numerical problem, so currently we estimate the differenced-data model using the blocking strategy, in which the transformed covariance matrix is relatively small in size and no obvious numerical problem is detected.

For illustration, consider again a monthly AR(1) model such that

$$\Delta Y_t^* = \phi \cdot \Delta Y_{t-1}^* + \varepsilon_t,$$

while only quarterly-differenced variables $\Delta^3 \overline{Y}_{t,t+2}$, $t = 4, 7, 10, ...$ are observed. Suppose we intend to sample the block $\left(\Delta Y_t^*, \Delta Y_{t+1}^*, \Delta Y_{t+2}^*\right)$ conditional on all the other monthly-differenced data as well as quarterly-differenced data. In this case, two aggregated values $\Delta^3 \overline{Y}_{t,t+2}$, $\Delta^3 \overline{Y}_{t+3,t+5}$ binds disaggregated $\left(\Delta Y_t^*, \Delta Y_{t+1}^*, \Delta Y_{t+2}^*\right)$ such that

$$\Delta Y_{t+2}^* + 2\Delta Y_{t+1}^* + 3\Delta Y_t^* = \Delta^3 \overline{Y}_{t,t+2} - 2\Delta Y_{t-1}^* - \Delta Y_{t-2}^*,$$

$$2\Delta Y_{t+2}^* + \Delta Y_{t+1}^* = \Delta^3 \overline{Y}_{t+3,t+5} - \Delta Y_{t+5}^* - 2\Delta Y_{t+4}^* - 3\Delta Y_{t+3}^*.$$

In others words, $\left(\Delta Y_t^*, \Delta Y_{t+1}^*, \Delta Y_{t+2}^*\right)$ follows a condition normal distribution subject to two linear constraints. So we first explore the Markov property of AR(1) process and use the (unconditional) joint normal distribution of $\left(\Delta Y_{t-1}^*, \Delta Y_t^*, \Delta Y_{t+1}^*, \Delta Y_{t+2}^*, \Delta Y_{t+3}^*\right)$ to find out the distribution of $\left(\Delta Y_t^*, \Delta Y_{t+1}^*, \Delta Y_{t+2}^*\right)$ conditional on all the other disaggregated data. Then we build a transformation matrix with the purpose of taking $\left(\Delta Y_t^*, \Delta Y_{t+1}^*, \Delta Y_{t+2}^*\right)$ into $\left(\Delta Y_{t+2}^* + 2\Delta Y_{t+1}^* + 3\Delta Y_t^*, \Delta Y_{t+1}^*, 2\Delta Y_{t+2}^* + \Delta Y_{t+1}^*\right)$. Note that the first term has a realized value $\Delta^3 \overline{Y}_{t,t+2} - 2\Delta Y_{t-1}^* - \Delta Y_{t-2}^*$, and the third term has its realization $\Delta^3 \overline{Y}_{t+3,t+5} - \Delta Y_{t+5}^* - 2\Delta Y_{t+4}^* - 3\Delta Y_{t+3}^*$, so we first sample $\Delta Y_{t+1}^* \left| \left(\Delta Y_{t+2}^* + 2\Delta Y_{t+1}^* + 3\Delta Y_t^*\right), \left(2\Delta Y_{t+2}^* + \Delta Y_{t+1}^*\right)\right.$ and then sample the degenerated ΔY_{t+2}^*, $3\Delta Y_t^*$.

In a general VAR(p)-based VARDAS model with differenced data, the blocking strategies still applies. First, choose a block size. Second, use Markov property of VAR(p) to find out the distribution of the disaggregated

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variables within the block conditional on all the other disaggregated variables. Third, find out all the aggregation constraints that bind the variables within the block. Fourth, make linear transformations to accommodate those constraints. Fifth, sample disaggregated variables from a conditional normal distribution and degenerated distribution.

5.3. Data revision and noisy aggregation

If the VAR model is mainly used for real-time forecasting, it is necessary to incorporate all the recent data. However, some latest macroeconomic data might be less accurate and subject to revision. In that case the most recent aggregated data might be viewed as the summation of the latent disaggregated values plus a noise. The noisy aggregation can be modeled as follows. Let $\{Y_t^*\}_{t=1}^T$ be a component series. Suppose in some time interval $[a, b]$ disaggregated latent values $Y_a^*, Y_{a+1}^* ... Y_{b-1}^*, Y_b^*$ are grouped into an aggregated observed data $\overline{Y}_{a,b} \equiv u_a + \sum_{j=0}^{b-a} Y_{a+j}^*$, where u_a follows an independent $N(0, \eta)$ regardless of the time script a. At a later stage, the authority revises the aggregated data so as to remove the noise u_a. In other words, historical noises are known, leaving only the latest noise unknown. Suppose a researcher has realizations of historical noises $\{u_a\}_{a=1}^J$ in hand. With a conjugate prior $\eta \sim IG(c_1, c_2)$, the posterior conditional distribution is $\eta \sim IG\left[\frac{J}{2} + c_1, \left(c_2^{-1} + \frac{1}{2}\sum_{a=1}^J u_a^2\right)^{-1}\right]$. To sample the latent disaggregated values from their posterior conditional distribution, we take the previous draw of η as given. The data series $\{Y_t\}_{t=1}^T$ are constructed by filling in the corresponding entries with revised data except for the most recent one with noise-ridden data. Transformation matrix is constructed as usual, but we modify the covariance matrix of $\mathbf{A}\overrightarrow{\mathbf{Y}^*}$, which is $\mathbf{A\Gamma A'}$ originally. Sup-

pose this noise-ridden data happens to variable i at date j. By adding the $((j-1)\,k+i,(j-1)\,k+i)$ entry of $\mathbf{A\Gamma A}'$ by η, we obtain the new covariance matrix of $\mathbf{A}\overrightarrow{\mathbf{Y}^*}$. The rest sampling procedure remains the same.

5.4. Missing data and no aggregation

Though the missing data problem is more common in survey, industrial or regional data at micro level, missing macroeconomic data may be present in the oldest or latest data. Consider the real-time forecasting again. Many economic indicators are published with a time lag. At the time when a forecasting must be made, some latest variables may be available while some are not, hence the missing data. Our model can conveniently handle missing data by classifying them into latent disaggregated variates block. In the data matrix $\mathbf{Y}$, record the missing data as, say, $M.S.$. Then define logical matrix $\mathbf{E}$ such that the (i,j) entry in $\mathbf{E}$ equals zero if the corresponding entry in $\mathbf{Y}$ is $N.A.$, and equals one if that in $\mathbf{Y}$ contains data, and equals two if that in $\mathbf{Y}$ is $M.S.$. The construction of the transformation matrix $\mathbf{A}$ still starts from an identity matrix and we modify it by examining $\mathbf{E}$. If the (i,j) entry of $\mathbf{E}$ entry is zero or two, skip and proceed to column $j+1$ (or conclude this row). Otherwise, we search column $j-1, j-2, ...$ for a run of zeros and insert ones into $\mathbf{A}$ in the same way as before. Once the transformation matrix is constructed, replace all the twos with zeros in $\mathbf{E}$ and use it to select a submatrix or subvector. The rest sampling procedure remains the same.

5.5. Logarized data and nonlinear aggregation

Using logarized variables in the VAR has many merits, but it also introduces nonlinearity in the aggregation structure. Our model is a linear

model that handles temporal aggregation by exploring the fact that normality is preserved under linear transformations. Suppose three monthly data are averaged into a quarterly data such that $\overline{Y}_{1,3} = \frac{1}{3}(Y_1^* + Y_2^* + Y_3^*)$. If logarized monthly variable $(\ln Y_1^*, \ln Y_2^*, \ln Y_3^*)$ are used in the VAR system, they follow multivariate normal but conditional on $\overline{Y}_{1,3}$ they do not, for $\ln \overline{Y}_{1,3} \neq \frac{1}{3}(\ln Y_1^* + \ln Y_2^* + \ln Y_3^*)$ due to Jensen's inequality. Mariano and Murasawa (2003, 2010), in a similar state-space model, document this nonlinear aggregation problem and suggest redefining the disaggregated data as the geometric mean (instead of the arithmetic mean) of the disaggregated data such that $\ln \overline{Y}_{1,3} = \frac{1}{3}(\ln Y_1^{**} + \ln Y_2^{**} + \ln Y_3^{**})$, where $\{\ln Y_t^{**}\}_{t=1}^T$ are used as a component series in the VAR system. Under this definition the disaggregated data cannot be interpreted as the calendar monthly data. They only bear a statistical interpretation such that the geometric average of latent $\ln Y_1^{**}$, $\ln Y_2^{**}$, $\ln Y_3^{**}$ equals to the observed $\ln \overline{Y}_{1,3}$. Camacho and Perez-Quiros (2010) argue that the approximation error is almost negligible if monthly changes are small and the geometric averaging works well in practice.

6. Two applications

In this section, we consider two classic structural VAR models, one with long-run identification constraints proposed by Blanchard and Quah (1989) and the other using short-run constraints to identify monetary shocks as in Christiano et al. (1998). We want to show a better estimate can be obtained by using mixed data with minimum modification to the original VAR model.

Blanchard and Quah (1989) consider a VAR model consisting of the real GNP growth and unemployment rate. The demand and supply shocks are identified by the assumption that the demand shock has no long-run effects on the output level. GNP data are quarterly while the unemployment data are monthly. In their paper, "the monthly unemployment data are averaged to provide quarterly observations" (p. 661). We use data of the same sample period (1950:2 to 1987:4) and follow their methods to filter the data and remove the effects of trend and structural breaks. The only difference is that we mix quarterly GNP growth and monthly unemployment rate, allowing for 16 lags.[6] Once the parameters are estimated, the VARDAS model becomes a standard VAR model and the structural shocks can be identified with the long-run constraint without modification. The responses of output and unemployment to the demand and supply shocks are plotted in Figure 2. For comparison, the results of a Bayesian version of the quarterly data VAR are shown in Figure 1, which is essentially a replication of Blanchard and Quah (1989). Note that in their paper the confidence interval is based on one standard deviation, while we plot the Bayesian 95% credible interval with highest posterior density (HPD). The dynamic patterns are consistent with those in the original paper but the HPD bands are narrower, which demonstrates efficiency gains due to making full use of the monthly unemployment data.

The second application is a structural VAR model with short-run restrictions. Christiano et al. (1998) propose a block diagonal recursiveness assumption to identify monetary policy shocks. The variables in the VAR system are

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[6]Estimation with 8, 12, 24 lags produces little difference in the shape of the impulse response function.

classified into three groups. The second group consists of only one monetary policy instrument, whose innovations reflect monetary policy shocks. The identification assumption is that the policy instrument has no contemporaneous effect on the variables in the first group, and the third group has no contemporaneous effect on the previous two groups. This assumption enables a partial identification of monetary shocks by cholesky decomposition, leaving other shocks unidentified. We put GDP and the CPI in the first group, federal funds rate (FF) as the policy instrument and the money stock M1 in the third group. Monthly data of the CPI, FF and M1 are available while GDP data are quarterly. The sample period is chosen as 1974:01 to 2006:12 since there might be structural breaks before and after that time interval. Data are Hodrick-Prescott filtered for we are interested in the cyclical component of the data. There is a tradeoff between richer dynamics with more lags and harder estimation with more parameters. In a four-variable VAR, an additional lag means 16 more parameters. We allow 4 lags in the quarterly data VAR (by averaging the monthly data other than GDP) and 6 lags in the monthly VARDAS model. Impulse response functions using quarterly data are reported in Figure 3 and the results with mixed data are plotted in Figure 4. Unlike the case of long-run identification, Figure 3 and 4 are not directly comparable in that the short-run identification constraints, though in the same format, should be interpreted differently. In the quarterly data VAR, to identify the monetary shocks we require monetary shocks have no contemporaneous effects on the output and price in a *quarter*, while in the VARDAS we only require no such effect in a *month*. Clearly, the VARDAS model imposes a weaker identification assumption on the contemporaneous

effects, so there are grounds for believing Figure 4 presents a more reliable dynamic picture on how the economy responds to monetary shocks. This is a major advantage of the VARDAS model in structural shocks identification with short-run economic constraints. After a contractionary monetary shock, GDP and M1 react negatively as expected, but the CPI rises steadily, a phenomenon long documented in the literature as the price puzzle (Sims, 1992; Eichenbaum, 1992). Christiano et al. (1998) suggest including an index of sensitive commodity prices can resolve the anomaly, a topic beyond the current paper.
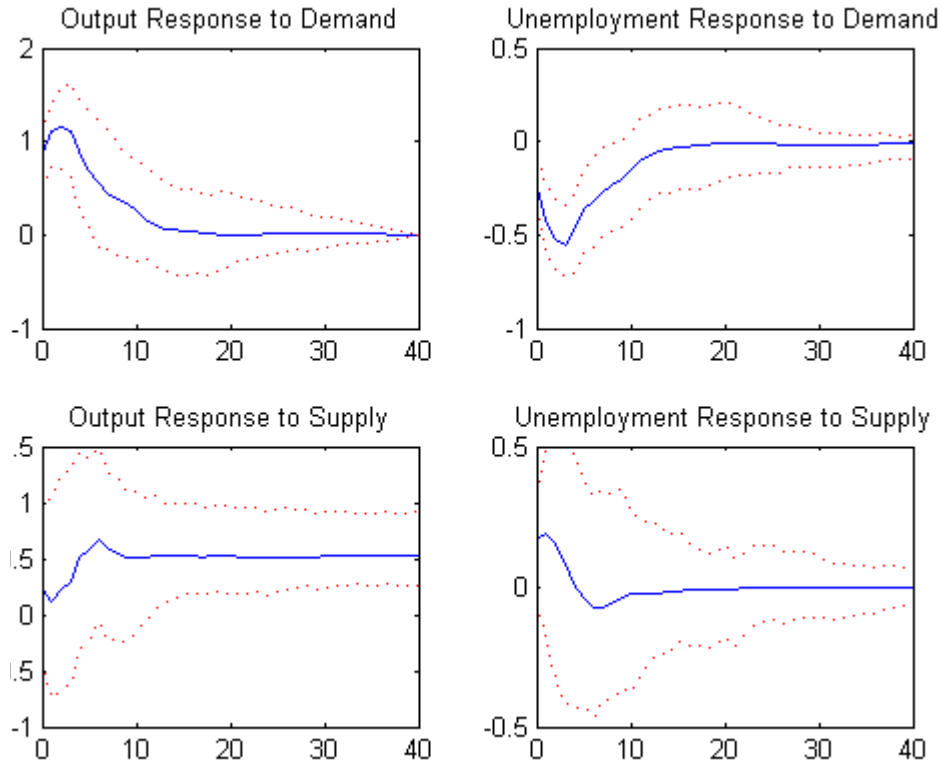
Figure 1: The dynamic effects of demand and supply shocks with the quarterly GNP growth and quarterly unemployment data. The solid line plots the posterior mean of the impulse-response function and the dotted lines are the 95% HPD credible bands. Figure 1 is essentially a replication of Blanchard and Quah (1989, p. 663).
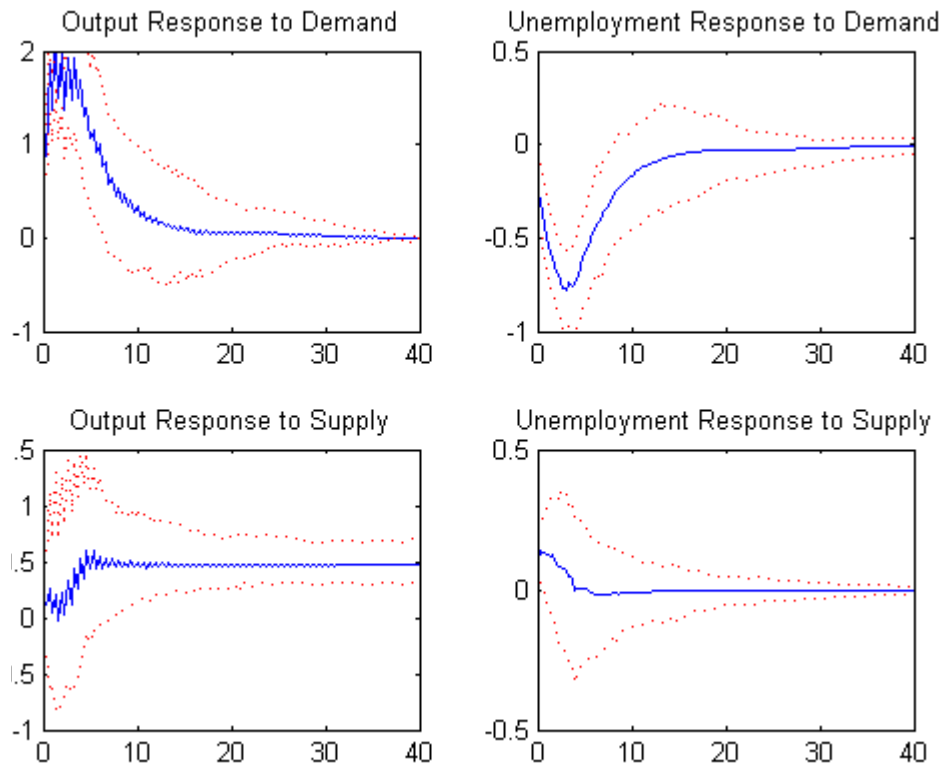
Figure 2: The dynamic effects of demand and supply shocks with the quarterly GNP growth and monthly unemployment data. The solid line plots the posterior mean of the impulse-response function and the dotted lines are the 95% HPD credible bands. It is estimated by the monthly VARDAS model, but the unit of the horizontal axis is adjusted to a quarter for comparison with Figure 1.
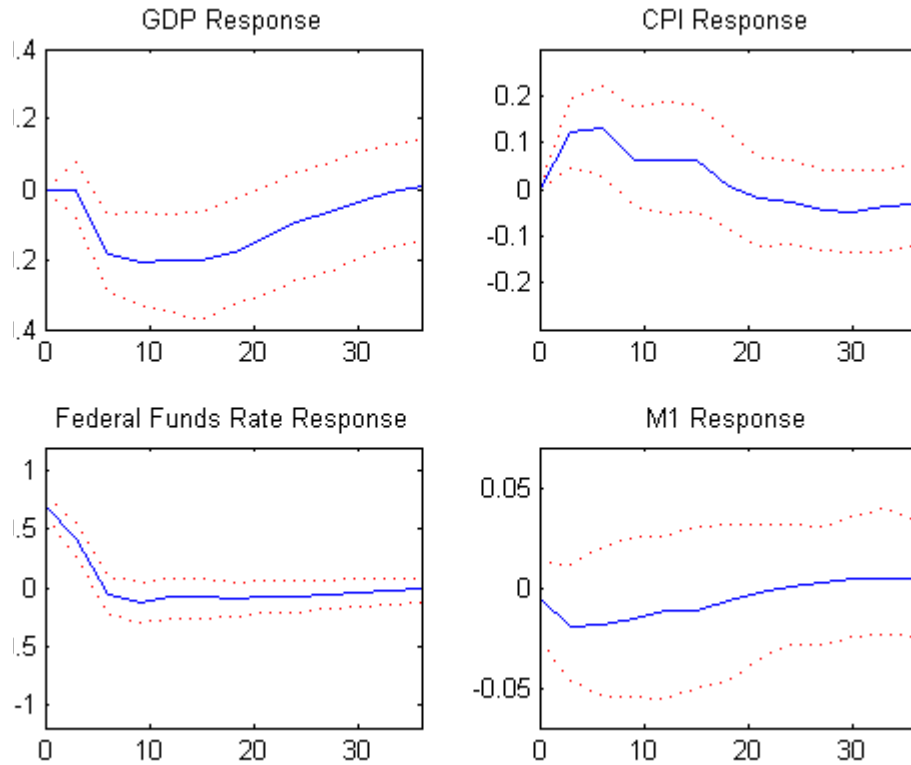
Figure 3: The dynamic effects of monetary policy shocks with the quarterly data. The identification constraints are monetary shocks have no contemporaneous effects on the output and price in a *quarter*. The solid line plots the posterior mean of the impulse-response function and the dotted lines are the 95% HPD credible bands.
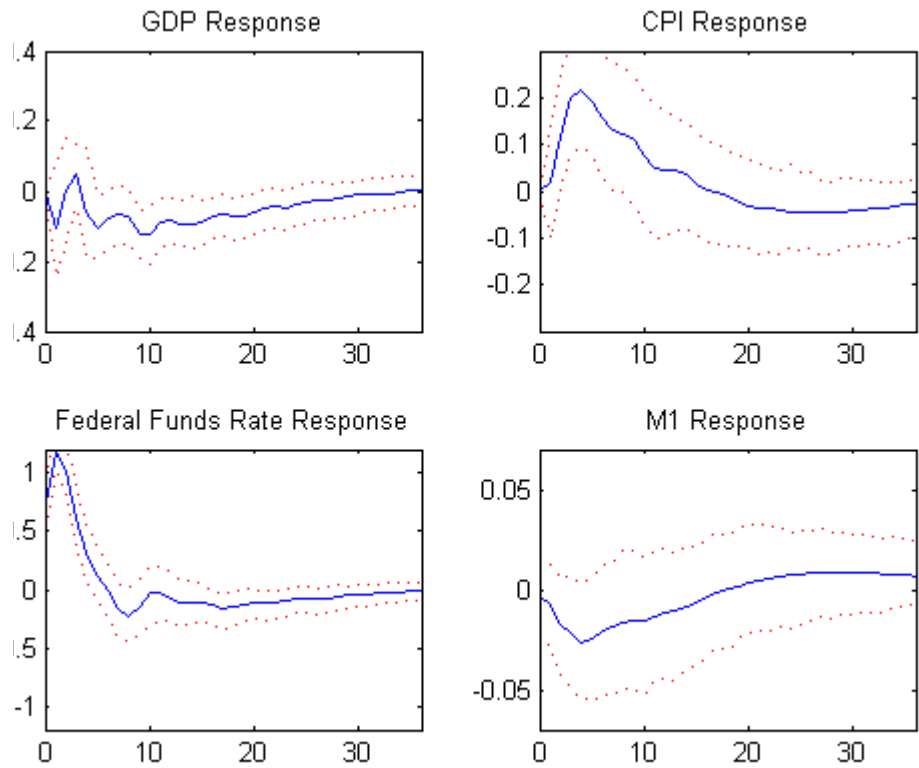
Figure 4: The dynamic effects of monetary policy shocks with the monthly data except for quarterly GDP, estimated by the VARDAS model. The identification constraints are monetary shocks have no contemporaneous effects on the output and price in a *month*. The solid line plots the posterior mean of the impulse-response function and the dotted lines are the 95% HPD credible bands.

7. Conclusion

The structural VAR model has been fruitfully applied in macroeconomics to unveil the dynamic paths of economic variables responding to nominal or real shocks. Such an analysis involves two stages in general. The first stage is to estimate a reduced-form VAR model and invert to its moving average representation. In the second stage, restrictions are imposed to identify structural shocks so as to conduct impulse response analysis. The second stage embodies scientific insights of the macroeconomists and is undoubtedly the core of the VAR analysis, while the first stage is largely statistical and mechanical. However, a better estimate of the reduced-form VAR model translates to a more accurate impulse-response curve, and thus presents a more transparent picture of dynamic relations in the macroeconomy. The VARDAS model only operates on the first stage. Varied frequency data are reconciled neither in an aggregated model by averaging nor in a disaggregated model by imputation. They are harmonized in one Bayesian model that makes full use of the available information to sample the latent variables. Technical details aside, the VARDAS approach just provides a more precise estimate of the model parameters, leaving intact the economic insights that hallmark the structural VAR analysis.

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