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TESTING CAUSALITY BETWEEN TWO VECTORS IN MULTIVARIATE GARCH MODELS

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Abstract

Spillover and contagion effects have gained significant interest in the recent years of financial crisis. Attention has not only been directed to relations between returns of financial variables, but to spillovers in risk as well. I use the family of Constant Conditional Correlation GARCH models to model the risk associated with financial time series and to make inferences about Granger causal relations between second conditional moments. The restrictions for second-order Granger noncausality between two vectors of variables are derived. To assess the credibility of the noncausality hypotheses, I employ posterior odds ratios. This Bayesian method constitutes an alternative for classical tests that makes such testing possible, regardless of the form of the restrictions on the parameters of the model. Moreover, it relaxes the assumptions about the existence of higher-order moments of the processes required in classical tests. In the empirical example, I find that the pound-to-Euro exchange rate second-order causes the US dollar-to-Euro exchange rate, which confirms the meteor shower hypothesis of Engle, Ito & Lin (1990).

Keywords: Second-Order Causality, Volatility Spillovers, Posterior Odds, GARCH Models

JEL classification: C11, C12, C32, C53,
of the former cannot improve the forecast of conditional variances of the latter. The definition of the second-order noncausality assumes that Granger causal relations might exist in the conditional mean process, however, they should be modeled and filtered out. Otherwise, such relations may impact on the parameters responsible for causal relations in conditional variances (see the empirical illustration of the problem in Karolyi, 1995).

Restrictions already exist for the one-period-ahead second-order noncausality for the family of BEKK-GARCH models, delivered by Comte & Lieberman (2000). They have a form of several nonlinear functions of original parameters of the model. However, no good test has been established for such restrictions. The problem is that the matrix of the first partial derivatives of the restrictions, with respect to the parameters of the model, may not be of full rank. This fact translates to the unknown asymptotic properties of classical tests, even if the asymptotic distribution of the estimator is normal. As a consequence, the testing strategy developed by Comte & Lieberman (2000) and Hafner & Herwartz (2008b) is to derive linear (zero) restrictions on the parameters, which would be a sufficient condition for the original restrictions, and then to apply to them the Wald test.

I derive the conditions for the one-period-ahead second-order noncausality for the family of Extended Constant Correlation GARCH models of Jeantheau (1998). In this setting, all the considered variables are split in two vectors, between which we investigate causal relations in conditional variances. Then, the conditions for the one-period-ahead second-order noncausality appear to be the same as those for second-order noncausality in all future periods. When compared with the work of Comte & Lieberman (2000), these conditions result in a smaller number of restrictions. This has a practical meaning in computing the restricted models and may also potentially have a significant impact on the properties of tests applied to the problem.

In order to assess the credibility of the noncausality hypotheses, I employ posterior odds ratios, a standard Bayesian procedure. In the context of Granger noncausality hypothesis testing, Bayes factors and Posterior Odds Ratios were used by Droumaguet & Woźniak (2012) for Markov-switching VAR models. In the same context, Woźniak (2011) used a Lindley-type test for VARMA-GARCH models. Moreover, in order to assess the hypotheses of exogeneity, a concept related to Granger noncausality, Pajor (2011) used Bayes factors for models with latent variables and in particular to multivariate Stochastic Volatility models, whereas Jarociński & Maćkowak (2011) used a Savage-Dickey Ratios for the VAR model.

Since the inference is performed using the posterior odds ratios, it is based on the exact finite sample results. Therefore, referring to the asymptotic results becomes pointless. This finding enables a relaxing of the assumptions required in the classical inference about the existence of the higher-order moments. For instance, in order to test the second-order noncausality hypothesis, the existence of the fourth order unconditional moments is required in Bayesian inference, whereas in classical testing the currently existing solutions require the existence of sixth-order moments. Notice that this assumption for testing such a hypothesis cannot be further relaxed in the context of the causal inference on second-conditional moments modeled with GARCH models. I justify this finding with the fact that this assumption does not come from the properties of the test, but from the derivation of the restrictions for the second-order noncausality.

The structure of the paper is as follows. Section 2 introduces the considered model and the main theoretical finding of this work: namely, the restrictions for the second-order Granger noncausality. The assumptions behind the causal analysis are discussed. In Section 3, I present and discuss the existing classical approaches to testing the Granger noncausality. Since they have limited use in the considered context, I further present the posterior odds ratios as the solution. In Section 4, the empirical illustration of the methodology for two main exchange rates of the Eurozone is presented, and Section 5 concludes. The proofs are presented in Appendix A, while Appendix B and Appendix C report figures and tables.

2. Second-order noncausality for multivariate GARCH models

Model. First, I set the notation, following Boudjellaba et al. (1994). Let \( \{y_t : t \in \mathbb{Z}\} \) be a \( N \times 1 \) multivariate square integrable stochastic process on the integers \( \mathbb{Z} \). Let \( y = (y_1, \ldots, y_T) \) denote a time series of \( T \) observations. Write

\[
y_t = (y^t_1, y^t_2)',
\]

(1)
for all \( t = 1, \ldots, T \), where \( y_{\cdot t} \) is a \( N \times 1 \) vector such that \( y_{\cdot t} = (y_{1t}, \ldots, y_{N_{t}, t})^\prime \) and \( y_{2t} = (y_{N_{t}+1,t}, \ldots, y_{N_{t}+N_{2}, t})^\prime \) (\( N_{1}, N_{2} \geq 1 \) and \( N_{1} + N_{2} = N \)). \( y_{1} \) and \( y_{2} \) contain the variables of interest between which we want to study causal relations. Further, let \( I(t) \) be the Hilbert space generated by the components of \( y_{\cdot t} \), for \( \tau \leq t \), i.e. an information set generated by the past realizations of \( y_{\cdot} \). Then, \( \epsilon_{t+h} = y_{t+h} - \hat{P}(y_{t+h} | I(t)) \) is an error component. Let \( \hat{P}(t) \) be the Hilbert space generated by the product of variables \( \epsilon_{i}, \epsilon_{j}, r_{\cdot t}, 1 \leq i, j \leq N \) for \( \tau \leq t \). \( I_{-1}(t) \) is the closed subspace of \( I(t) \) generated by the components of \( y_{2} \). \( \hat{I}_{-1}(t) \) is the closed subspace of \( \hat{P}(t) \) generated by the variables \( \epsilon_{i}, \epsilon_{j}, N_{1} + 1 \leq i, j \leq N \) for \( \tau \leq t \). For any subspace \( I_{\cdot t} \) of \( I(t) \) and for \( N_{1} + 1 \leq i \leq N_{1} + N_{2} \), we denote by \( P(y_{t+h} | I_{\cdot t}) \) the affine projection of \( y_{t+h} \) on \( I_{\cdot t} \), i.e. the best linear prediction of \( y_{t+h} \) based on the variables in \( I_{\cdot t} \) and a constant term.

The model under consideration is the Vector Autoregressive process of Sims (1980) for conditional mean, and the Extended Constant Conditional Correlation Generalized Autoregressive Conditional Heteroskedasticity process of Jeantheau (1998) for conditional variances. The conditional mean part models linear relations between current and lagged observations of the considered variables:

\[
y_{t} = \alpha_{0} + a(L)y_{\cdot t} + \epsilon_{t} \quad (2a)
\]

\[
\epsilon_{t} = D_{t} r_{t} \quad (2b)
\]

\[
r_{t} \sim i.i.d. N(0, C, \nu) \quad (2c)
\]

for all \( t = 1, \ldots, T \), where \( y_{\cdot} \) is a \( N \times 1 \) vector of data at time \( t \), \( a(L) = \sum_{i=1}^{p} \alpha_{i}L^{i} \) is a lag polynomial of order \( p \), \( \epsilon_{t} \) and \( r_{t} \) are \( N \times 1 \) vectors of residuals and standardized residuals respectively, \( D_{t} = \text{diag}(\sqrt{h_{1t}}, \ldots, \sqrt{h_{N_{t}}}) \) is a \( N \times N \) diagonal matrix with conditional standard deviations on the diagonal. The standardized residuals follow a \( N \)-variate \( t \) distribution with a vector of zeros as a location parameter, a matrix \( C \) as a scale matrix and \( \nu > 2 \) a degrees of freedom parameter. The choice of the distribution is motivated, on the one hand, by its ability to model potential outlying observations in the sample (for \( \nu < 30 \)). On the other hand, it is a good approximation of the normal distribution when the value of degrees of freedom parameter exceeds \( 30 \).

The conditional covariance matrix of the residual term \( \epsilon_{t} \) is decomposed into:

\[
H_{t} = D_{t} \Sigma_{t} D_{t}^\prime \quad \forall t = 1, \ldots, T.
\]

(3)

For the matrix \( H_{t} \) to be a positive definite covariance matrix, \( h_{t} \) must be positive for all \( t \) and \( C \) positive definite (see Bollerslev, 1990). A \( N \times 1 \) vector of current conditional variances is modeled with lagged squared residuals, \( \epsilon_{t}^{(2)} = (\epsilon_{1t}^{2}, \ldots, \epsilon_{N_{t}}^{2})^\prime \), and lagged conditional variances:

\[
h_{t} = \omega + A(L)\epsilon_{t}^{(2)} + B(L)h_{t},
\]

(4)

for all \( t = 1, \ldots, T \), where \( \omega \) is a \( N \times 1 \) vector of constants, \( A(L) = \sum_{i=1}^{q} A_{i}L^{i} \) and \( B(L) = \sum_{i=1}^{r} B_{i}L^{i} \) are lag polynomials of orders \( q \) and \( r \) of ARCH and GARCH effects respectively. The vector of conditional variances is given by \( E[\epsilon_{t+1}^{(2)} | \hat{I}(t)] = \nu \frac{h_{t+1}}{h_{t}}h_{t+1} \), and the best linear predictor of \( \epsilon_{t+1}^{(2)} \) in terms of a constant and \( \epsilon_{t+1}^{(2)} \) for \( i = 1, 2, \ldots \) is \( P(\epsilon_{t+1}^{(2)} | \hat{I}(t)) = h_{t+1} \). Equation (4) has a form respecting the partitioning of the vector of data (1):

\[
\begin{bmatrix}
  h_{1t} \\
  h_{2t}
\end{bmatrix} =
\begin{bmatrix}
  \alpha_{1} \\
  \alpha_{2}
\end{bmatrix} +
\begin{bmatrix}
  A_{11}(L) & A_{12}(L) \\
  A_{21}(L) & A_{22}(L)
\end{bmatrix}
\begin{bmatrix}
  \epsilon_{t}^{(2)} \\
  \epsilon_{t+1}^{(2)}
\end{bmatrix} +
\begin{bmatrix}
  B_{11}(L) & B_{12}(L) \\
  B_{21}(L) & B_{22}(L)
\end{bmatrix}
\begin{bmatrix}
  h_{1t} \\
  h_{2t}
\end{bmatrix}.
\]

(5)

Assumptions and properties. Let \( \theta \in \Theta \subset \mathbb{R}^{k} \) be a vector of size \( k \), collecting all the parameters of the model described with equations (2)–(4). Then the likelihood function has the following form:

\[
p(y | \theta) = \prod_{t=1}^{T} \frac{\Gamma\left(\frac{\nu}{2}\right)}{\Gamma\left(\frac{\nu}{2}\right)} (\nu - 2)\nu^{\nu/2} |H_{t}|^{-\frac{\nu}{2}} \left(1 + \frac{1}{\nu - 2} \epsilon_{t}^{\prime} H_{t}^{-1} \epsilon_{t}\right)^{-\frac{\nu}{2}}.
\]

(6)
This model has its origins in the Constant Conditional Correlation GARCH (CCC-GARCH) model proposed by Bollerslev (1990). That model consisted of $N$ univariate GARCH equations describing the vector of conditional variances, $h_t$. The CCC-GARCH model is equivalent to equation (4) with diagonal matrices $A(L)$ and $B(L)$. Its extended version, with non-diagonal matrices $A(L)$ and $B(L)$, was analyzed by Jeantheau (1998). He & Teräsvirta (2004) call this model the Extended CCC-GARCH (ECCC-GARCH). Such a formulation of the GARCH process allows for the modeling of volatility spillovers, as matrices of the lag polynomials $A(L)$ and $B(L)$ are not diagonal. Therefore, causality between variables in second-conditional moments may be analyzed.

For the purpose of deriving the restrictions for second-order Granger noncausality, I impose four assumptions on the parameters of the conditional variance process.

**Assumption 1.** Parameters $\omega, A = (\text{vec}(A_1)', \ldots, \text{vec}(A_q)')'$ and $B = (\text{vec}(B_1)', \ldots, \text{vec}(B_q)')'$ are such that the conditional variances, $h_t$, are positive for all $t$ (see Conrad & Karanasos, 2010, for the detailed restrictions).

**Assumption 2.** All the roots of $|L_N - A(z)| = 0$ are outside the complex unit circle.

**Assumption 3.** All the roots of $|L_N - B(z)| = 0$ are outside the complex unit circle.

**Assumption 4.** The multivariate GARCH$(r,s)$ model is minimal, in the sense of Jeantheau (1998).

Define a process $v_t = \epsilon_t^{(2)} - h_t$. Then $\epsilon_t^{(2)}$ follows a VARMA process given by:

$$\phi(L)\epsilon^{(2)}_t = \omega + \psi(L)v_t,$$

where $\phi(L) = I_N - A(L) - B(L)$ and $\psi(L) = I_N - B(L)$ are matrix polynomials of the VARMA representation of the GARCH$(q,r)$ process. Suppose that $\epsilon_t^{(2)}$ and $v_t$ are partitioned as $y_t$ in (1). Then (7) can be written in the following form:

$$\begin{bmatrix} \phi_{11}(L) & \phi_{12}(L) \\ \phi_{21}(L) & \phi_{22}(L) \end{bmatrix} \begin{bmatrix} \epsilon_t^{(2)} \\ \epsilon_{t-1}^{(2)} \end{bmatrix} = \begin{bmatrix} \omega_1 \\ \omega_2 \end{bmatrix} + \begin{bmatrix} \psi_{11}(L) & \psi_{12}(L) \\ \psi_{21}(L) & \psi_{22}(L) \end{bmatrix} \begin{bmatrix} v_{1,t} \\ v_{2,t} \end{bmatrix}.$$  

(8)

Given Assumption 3, the VARMA process (7) is invertible and can be written in a VAR form:

$$\Pi(L)\epsilon_t^{(2)} - \omega' = v_t,$$

(9)

where $\Pi(L) = \psi(L)^{-1}\phi(L) = [I_N - B(L)]^{-1}[I_N - A(L) - B(L)]$ is a matrix polynomial of the VAR representation of the GARCH$(q,r)$ process and $\omega' = \psi(L)^{-1}\omega$ is a constant term. Again, partitioning the vectors, we can rewrite (9) in the form:

$$\begin{bmatrix} \Pi_{11}(L) & \Pi_{12}(L) \\ \Pi_{21}(L) & \Pi_{22}(L) \end{bmatrix} \begin{bmatrix} \epsilon_t^{(2)} \\ \epsilon_{t-1}^{(2)} \end{bmatrix} - \begin{bmatrix} \omega_1' \\ \omega_2' \end{bmatrix} = \begin{bmatrix} v_{1,t} \\ v_{2,t} \end{bmatrix}.$$  

(10)

Under Assumptions 2 and 3, processes (7) and (9) are both stationary. One more assumption is required for the inference about second-order noncausality in the GARCH model:

**Assumption 5.** The process $v_t$ is covariance stationary.

The GARCH model has well-established properties under Assumptions 1–5. Under Assumption 1, conditional variances are positive. This result does not hold if all the parameters of the model are positive (see Conrad & Karanasos, 2010). Further, Jeantheau (1998) proves that the GARCH$(r,s)$ model, as in (4), has a unique, ergodic, weakly and strictly stationary solution when Assumption 2 holds. Under Assumptions 2–4 the GARCH$(r,s)$ model is stationary and identifiable. Jeantheau (1998) showed that the minimum contrast estimator for the multivariate GARCH model is strongly consistent under conditions of, among others, stationarity and identifiability. Ling & McAleer (2003) proved strong consistency of the Quasi Maximum Likelihood Estimator (QMLE) for the VARMA-GARCH model under Assumptions 2–4, and when all the parameters of the GARCH process are positive. Moreover, they have set asymptotic normality of QMLE, provided that $E[|y_t|^4] < \infty$. The extension of the asymptotic results under the conditions of (Conrad & Karanasos, 2010) has not yet been established. Finally, He & Teräsvirta (2004) give sufficient conditions for the existence of the fourth moments and derive complete fourth-moment structure.
**Estimation.** Classical estimation consists of maximizing the likelihood function (6). This is possible, using one of the available numerical optimization algorithms. Due to the complexity of the problem, the algorithms require derivatives of the likelihood function. Hafner & Herwartz (2008a) give analytical solutions for first and second partial derivatives of normal likelihood function, whereas Fiorentini, Sentana & Calzolari (2003) derive numerically reliable analytical expressions for the score, Hessian and information matrix for the models with conditional multivariate $t$ distribution. Bayesian estimation requires numerical methods in order to simulate the posterior density of the parameters. Unfortunately, neither the posterior distribution of the parameters nor full conditional distributions have the form of some known distribution. Therefore, the application of the Metropolis-Hastings algorithm (see Chib & Greenberg, 1995, and references therein) was proposed by Vrontos, Dellaportas & Politis (2003).

The posterior distribution of the parameters of the model is proportional to the product of the likelihood function (6) and the prior distribution of the parameters:

$$p(\theta|y) \propto p(y|\theta)p(\theta).$$

For the unrestricted VAR-GARCH model, I assume the following prior specification. All the parameters of the VAR process are a priori normally distributed with a vector of zeros as a mean and a diagonal covariance matrix with 100s on the diagonal. A similar prior distribution is assumed for the constant term of the GARCH process, with the $\bar{\omega}$ distribution. Therefore, the application of the Metropolis-Hastings algorithm (see Chib & Greenberg, 1995, and references therein) was proposed by Deschamps (2006). To summarize, the prior specification for the considered model has a detailed form of:

$$p(\theta) = p(\alpha)p(\omega,A,B)p(\nu) \prod_{i=1}^{N(N-1)/2} p(\rho_i),$$

where each of the prior distributions is assumed:

$$\alpha \sim N^{N+pN^2}(0,100 \cdot I_{N+pN^2})$$

$$\omega \sim N^{N+pN^2}(0,100 \cdot I_{N+pN^2})I(\theta \in \Theta)$$

$$(A',B')' \sim N^{N+pN^2}(0,s \cdot I_{N+pN^2})I(\theta \in \Theta)$$

$$\nu \sim .04 \exp \left[-.04(v-2)\right]I(v \geq 2)$$

$$\rho_i \sim U(-1,1) \quad \text{for } i = 1, \ldots, N(N-1)/2,$$

where $\alpha = (a_0', \text{vec}(\alpha_1)', \ldots, \text{vec}(\alpha_p)')'$ stacks all the parameters of the VAR process in a vector of size $N+pN^2$. $I_\nu$ is an identity matrix of order $\nu$. $I(.)$ is an indicator function taking value equal to 1 if the condition in the brackets holds and 0 otherwise. Finally, $\rho_i$ is an $i$th element of a vector stacking all the elements below the diagonal of the correlation matrix, $\rho = (\text{vec}(C))$.

Such prior assumptions, with only proper distributions, have serious consequences. First, together with the bounded likelihood function, the proposed prior distribution guarantees the existence of the posterior distribution (see Geweke, 1997). Second, the proper prior distribution for the degrees of freedom parameter of the $t$-distributed likelihood function is required for the posterior distribution to be integrable, as proven by Bauwens & Lubrano (1998). Finally, it gives raise to subjective interpretation of the probability, which is a controversial feature of the Bayesian inference. However, note that prior distributions for all the parameters,
Second-Order Noncausality Conditions. We focus on the question of the causal relations between variables in conditional variances. Therefore, the proper concept to refer to is second-order Granger noncausality:

**Definition 1.** \( y_1 \) does not second-order Granger-cause \( h \) periods ahead \( y_2 \) if:

\[
P[e^{(2)}(y_{2+h}|l(t))[I^2(t)] = P[e^{(2)}(y_{2+h}|l(t))[I_{2+1}^2(t)],
\]

for all \( t \in \mathbb{Z} \), where \( e_{2+h} = e(y_{2+h}|l(t)) = y_{2+h} - P(y_{2+h}|l(t)) \) is an error component and \([ \cdot ]^{(2)}\) means that we square each element of a vector and \( h \in \mathbb{Z} \).

A common part of both sides of (13) is that, in the first step, the potential Granger causal relations in the conditional mean process are filtered out. This is represented by a projection of the forecasted value, \( y_{2+h} \), on the Hilbert space generated by the full set of variables, \( P(y_{2+h}|l(t)) \). In the second stage, the square of the error component, \( e^{(2)}(y_{2+h}|l(t)) \), is projected on the Hilbert space generated by cross-products of the full vector of the error component, \( I^2(t) \) (on the LHS), and on the Hilbert space generated by the cross-products of a sub-vector of the error component, \( I_{2+1}^2(t) \) (on the RHS). If the two projections are equivalent, it means that \( e^{(2)}(y_{2+h}|l(t)) - P[e^{(2)}(y_{2+h}|l(t))[I_{2+1}^2(t)] \) is orthogonal to \( I^2(t) \) for all \( t \) (see Florens & Mouchart, 1985; Comte & Lieberman, 2000).

The definition, in its original form, for one-period-ahead noncausality \((h = 1)\), was proposed by Robins et al. (1986) and distinguished from Granger noncausality in variance by Comte & Lieberman (2000). The difference is that in the definition of Granger noncausality in variance there is another assumption of Granger noncausality in mean. On the contrary, in the definition of second-order noncausality there is no such assumption. However, any existing causal relation in conditional means needs to be modeled and filtered out before causality for the conditional variances process is analyzed.

The main theoretical contribution of this study is the theorem stating the restrictions for second-order Granger noncausality for the ECCC-GARCH model.

**Theorem 1.** Let \( e^{(2)}_t \) follow a stationary vector autoregressive moving average process as in (7) partitioned as in (8) that is identifiable and invertible (assumptions 1–5). Then \( y_1 \) does not second-order Granger-cause one period ahead \( y_2 \) if and only if:

\[
\Gamma_{ij}^{\nu}(z) = \det \left[ \begin{array}{cc} \phi_{i1}^j(z) & \psi_{i1}(z) \\ \phi_{n_{i,j}}(z) & \psi_{21}^j(z) \end{array} \right] = 0 \quad \forall z \in \mathbb{C}
\]

for \( i = 1, ..., N_2 \) and \( j = 1, ..., N_1 \); where \( \phi_{i1}^j(z) \) is the \( i \)th column of \( \varphi_{ik}(z) \), \( \psi_{i1}(z) \) is the \( i \)th row of \( \psi_{ik}(z) \), and \( \varphi_{n_{i,j}}(z) \) is the \((i, j)\)-element of \( \phi_{21}(z) \).

Theorem 1 establishes the restrictions on parameters of the ECCC-GARCH model for the second-order noncausality one period ahead between two vectors of variables. Its proof, presented in Appendix A, is based of the theory introduced by Florens & Mouchart (1985) and applied by Boudjellaba et al. (1992) to VARMA models for conditional mean. It is applicable to any specification of the GARCH\((q,r)\) process, irrespective of the order of the model, \((q,r)\), and the size for the time series, \(N\).

Due to the setting proposed in this study, in which the vector of variables is split in two parts, the establishment of one-period-ahead second-order Granger noncausality is equivalent to establishing the noncausality relation at all horizons up to infinity. This result is formalised in a corollary.

**Corollary.** Suppose that the vector of observations is partitioned as in (1), and that \( y_1 \) does not second-order Granger-cause one period ahead \( y_2 \), such that the condition (14) holds. Then \( y_1 \) does not second-order Granger-cause \( h \) periods ahead \( y_2 \) for all \( h = 1, 2, \ldots \).
Corollary 1 is a direct application of Corollary 2.2.1 of (Lütkepohl, 2005, p. 45) to the GARCH process in the VAR form (10). For the proof of the restrictions for second-order Granger noncausality for the GARCH process in the VAR form, the reader is referred to Appendix A.

Corollary 1 shows the feature of the particular setting considered in this work, i.e. the setting in which all the variables are split between two vectors. If one is interested in the second-order causality relations at all the horizons at once, then one may use just one set of restrictions. The restrictions, however, imply the very strong result. If a more detailed analysis is required, then one must consider deriving other solutions.

The theorem has equivalent for other models from the GARCH family, namely the BEKK-GARCH models. The restrictions were introduced by Comte & Lieberman (2000). There are, however, serious differences between the approaches presented by Comte & Lieberman and by this study. First, in a bivariate model for the hypothesis that one variable does not second-order cause the other, the restrictions of Comte & Lieberman lead to six restrictions, whereas, in Example 1, I show that in order to test such a hypothesis, only two restrictions are required. The difference in the number of restrictions increases with the dimension of the time series. Secondly, due to the formulation of the BEKK-GARCH model, the noncausality conditions are much more complicated than the conditions for the ECCC-GARCH model considered here. They are simply much more complex functions of the original parameters of the model. Both these arguments have consequences in testing that require estimation of the restricted model or employment of the delta method. A high number of restrictions may have a strongly negative impact on the size and power properties of tests. However, the ECCC-GARCH model assumes that the correlations are time invariant, which is not the case for the BEKK-GARCH model.

Nakatani & Teräsvirta (2009) propose the Lagrange Multiplier test for the hypothesis of no volatility spillovers in a bivariate ECCC-GARCH model. The restrictions they test are zero restrictions on the off-diagonal elements of matrix polynomials $A(L)$ and $B(L)$ from the GARCH equation (5). Consequently, the null hypothesis is represented by the CCC-GARCH model of Bollerslev (1990) and the alternative hypothesis by ECCC-GARCH of Jeantheau (1998). Note, that if all the parameters on the diagonal of the matrices of the lag polynomial $A_{11}(L)$ are assumed to be strictly greater than zero (which can be tested and which in fact is the case for numerous time series considered in applied studies), then the null hypothesis of Nakatani & Teräsvirta (2009) is equivalent to the second-order Granger noncausality condition, as in the Example 1. In a general case, for any dimension of the time series, the zero restrictions on the off-diagonal elements of matrix polynomials $A(L)$ and $B(L)$ represent a sufficient condition for the second-order noncausality.

To conclude, the condition (14) leads to the finite number of nonlinear restrictions on the original parameters of the model. Several examples will clarify how they are set.

**Example 1.** Suppose that $y_1$ follows a bivariate GARCH(1,1) process, $(N = 2, p = q = 1)$. The VARMA process for $e_t^{(2)}$ is as follows:

$$
\begin{bmatrix}
1 - (A_{11} + B_{11})L & -(A_{12} + B_{12})L \\
-(A_{21} + B_{21})L & 1 - (A_{22} + B_{22})L
\end{bmatrix}
\begin{bmatrix}
e_t^{2,1} \\
\epsilon_t^{2,2}
\end{bmatrix}
= 
\begin{bmatrix}
\omega_1 \\
\omega_2
\end{bmatrix}
+ 
\begin{bmatrix}
1 - B_{11}L & -B_{12}L \\
-B_{21}L & 1 - B_{22}L
\end{bmatrix}
\begin{bmatrix}
v_t^{1,1} \\
v_t^{2,1}
\end{bmatrix}.
$$

(15)

From Theorem 1, we see, that $y_1$ does not second-order Granger-cause $y_2$ if and only if:

$$
\det
\begin{bmatrix}
1 - (A_{11} + B_{11})z & 1 - B_{11}z \\
-(A_{21} + B_{21})z & -B_{21}z
\end{bmatrix} \equiv 0,
$$

which leads to the following set of restrictions:

$$
R^1_1(\theta) = A_{21} = 0, \quad \text{and} \quad R^1_2(\theta) = B_{21}A_{11} = 0.
$$

(16)

**Example 2.** Let $y_t$ follow a trivariate GARCH(1,1) process $(N = 3$ and $r = s = 1)$. The VARMA process for
\( \epsilon_t^{(2)} \) is as follows:

\[
\begin{bmatrix}
1 - (A_{11} + B_{11})L & -(A_{12} + B_{12})L & -(A_{13} + B_{13})L \\
-(A_{21} + B_{21})L & 1 - (A_{22} + B_{22})L & -(A_{23} + B_{23})L \\
-(A_{31} + B_{31})L & -(A_{32} + B_{32})L & 1 - (A_{33} + B_{33})L
\end{bmatrix}
\begin{bmatrix}
\epsilon_t^1 \\
\epsilon_t^2 \\
\epsilon_t^3
\end{bmatrix}
= \begin{bmatrix}
\omega_1 \\
\omega_2 \\
\omega_3
\end{bmatrix} + \begin{bmatrix}
1 - B_{11}L & -B_{12}L & -B_{13}L \\
-B_{21}L & 1 - B_{22}L & -B_{23}L \\
-B_{31}L & -B_{32}L & 1 - B_{33}L
\end{bmatrix}
\begin{bmatrix}
v_{1t} \\
v_{2t} \\
v_{3t}
\end{bmatrix}. \tag{18}
\]

From Theorem 1, we see, that \( y_1 = y_1 \) does not second-order Granger-cause \( y_2 = (y_2, y_3) \) if and only if:

\[
\det \begin{bmatrix}
1 - (A_{11} + B_{11})z & 1 - B_{11}z \\
-(A_{13} + B_{13})z & -B_{13}z
\end{bmatrix} = 0 \quad \text{for } i = 2, 3, \tag{19}
\]

which results in the following restrictions:

\[
R_I^{\text{II}}(\psi) = A_{11}B_{11} = 0 \quad \text{and} \quad R_I^{\text{II}}(\psi) = A_{21} = 0 \tag{20a}
\]

\[
R_I^{\text{II}}(\psi) = A_{11}B_{31} = 0 \quad \text{and} \quad R_I^{\text{II}}(\psi) = A_{31} = 0. \tag{20b}
\]

However, \( y_1 = (y_1, y_2) \) does not second-order Granger-cause \( y_2 = y_3 \) if and only if:

\[
\det \begin{bmatrix}
1 - (A_{11} + B_{11})z & 1 - B_{11}z & -B_{13}z \\
-(A_{21} + B_{21})z & -B_{21}z & -B_{23}z \\
-(A_{31} + B_{31})z & -B_{31}z & 1 - B_{33}z
\end{bmatrix} \equiv 0, \tag{21}
\]

which leads to the following set of restrictions:

\[
R_1^{\text{III}}(\psi) = A_{11}(B_{23}B_{31} - B_{21}B_{33}) + A_{31}(B_{13}B_{21} - B_{11}B_{23}) = 0 \tag{22a}
\]

\[
R_2^{\text{III}}(\psi) = A_{11}B_{21} + A_{31}B_{23} = 0 \tag{22b}
\]

\[
R_3^{\text{III}}(\psi) = A_{21} = 0. \tag{22c}
\]

3. Bayesian hypotheses assessment

The restrictions derived in Section 2 can be tested. I propose to use the Bayesian approach to assess the hypotheses of second-order noncausality represented by the restrictions. Before the approach is presented, however, the classical tests proposed so far and their limitations are discussed.

Classical testing. Testing of second-order noncausality has been considered only for the family of BEKK-GARCH and vec-GARCH models. Comte & Lieberman (2000) did not propose any test because asymptotic normality of the maximum likelihood estimator had not been established at that time. The asymptotic result was presented in Comte & Lieberman (2003). This finding, however, does not solve the problem of testing the nonlinear restrictions imposed on the parameters of the model. In the easy case, when the restrictions are linear, the asymptotic normality of the estimator implies that the Wald, Lagrange Multiplier and Likelihood Ratio test statistics have asymptotic \( \chi^2 \) distributions. Therefore, the Wald test statistic for the linear restrictions (which are the only sufficient condition for the original restrictions) proposed by Comte & Lieberman is \( \chi^2 \)-distributed. A similar procedure was presented in Hafner & Herwartz (2008b) for the Wald test, and in Hafner & Herwartz (2006) for the LM test. For the ECCC-GARCH model, Nakatani & Teräsvirta (2009) proposed the Lagrange Multiplier test for the hypothesis of no volatility spillovers. The test statistic is shown to be asymptotically normally distributed. Again, Nakatani & Teräsvirta (2009) tested only the linear zero restrictions.
In this study, the necessary and sufficient conditions for second-order noncausality between variables are tested. The restrictions, contrary to the conditions of Comte & Lieberman, Hafner & Herwartz and Nakatani & Teräsvirta, may be nonlinear (see Example 2). In such a case, a matrix of the first partial derivatives of the restrictions with respect to the parameters may not be of full rank. Thus, the asymptotic distribution of the Wald test statistic is no longer normal. In fact, for the time being it is unknown. Consequently, the Wald test statistic cannot be used to test the necessary and sufficient conditions for second-order noncausality in multivariate GARCH models.

This problem is well known in the studies on the testing of parameter conditions for Granger noncausality in multivariate models. Boudjellaba et al. (1992) derive conditions for Granger noncausality for VARMA models that result in multiple nonlinear restrictions on original parameters of the model. As a solution to the problem of testing the restrictions, they propose a sequential testing procedure. There are two main drawbacks in this method. First, despite being properly performed, the test may still appear inconclusive, and second, the confidence level is given in the form of inequalities. Dufour et al. (2006) propose solutions based on the linear regression techniques that are applied for h-step ahead Granger noncausality for VAR models. The proposed solutions, unfortunately, are only applicable to linear models for first conditional moments. Lütkepohl & Burda (1997) proposed a modified Wald test statistic as a solution to the problem of testing the nonlinear restrictions for the h-step ahead Granger noncausality for VAR models. This method could be applied to the problem of testing the nonlinear restrictions for the second-order noncausality in GARCH models. More studies are required, however, on the applicability and properties of this test.

Asymptotic results for the models and tests discussed here are established under the following moment conditions. For the BEKK-GARCH models, the Wald tests proposed by Hafner & Herwartz (2008b) and Comte & Lieberman (2000) require asymptotic normality of the Quasi Maximum Likelihood Estimator. This result is derived under the existence of bounded moments of order 8 by Comte & Lieberman (2003). For the CCC-GARCH model considered in this study, the asymptotic normality of the Quasi Maximum Likelihood Estimator is derived in Ling & McAleer (2003) under the existence of moments of order 6. This assumption is, however, relaxed for the purpose of testing the existence of volatility spillovers by Nakatani & Teräsvirta (2009). Their Lagrange Multiplier test statistic requires the existence of fourth-order moments. This result is derived under the existence of bounded moments of order 8 by Comte & Lieberman (2003). For the ECCC-GARCH model considered in this study, the asymptotic normality of the Quasi Maximum Likelihood Estimator is derived in Ling & McAleer (2003) under the existence of moments of order 6. This assumption is, however, relaxed for the purpose of testing the existence of volatility spillovers by Nakatani & Teräsvirta (2009). Their Lagrange Multiplier test statistic requires the existence of fourth-order moments. The Bayesian test presented below further relaxes this assumptions.

Bayesian hypotheses assessment. In order to compare the models restricted according to the noncausality restrictions derived in Theorem 1 I use Bayes factors. Whereas, in order to assess hypotheses of noncausality, posterior odds ratios of the hypotheses are employed.

Bayes factors are a well-known method for comparing econometric models (see Kass & Raftery, 1995; Geweke, 1995). Denote by \( M_i \), for \( i = 1, \ldots, m \), the \( m \) models representing competing hypotheses. Let

\[
p(y|M_i) = \int_{\theta \in \Theta} p(y|\theta, M_i)p(\theta|M_i) \, d\theta
\]

be marginal distributions of data corresponding to each of the model, for \( i = 1, \ldots, m \). \( p(y|\theta, M_i) \) and \( p(\theta|M_i) \) are the likelihood function (6) and the prior distribution (12) respectively. The extended notation respecting conditioning on one of the models is used here. The marginal density of data is a constant normalizing kernel of the posterior distribution (11).

A Bayes factor is a ratio of the marginal densities of data for the two selected models:

\[
B_{ij} = \frac{p(y|M_i)}{p(y|M_j)}, \tag{24}
\]

where \( i, j = 1, \ldots, m \) and \( i \neq j \). The Bayes factor takes positive values, and its value above 1 is interpreted as evidence for model \( M_i \), whereas its value below 1 is evidence for model \( M_j \). For further interpretation of the value of the Bayes factor, the reader is referred to the paper of Kass & Raftery (1995).

Posterior probability of \( i \)th model can be easily computed using the Bayes formula:

\[
Pr (M_i|y) = \frac{p (y|M_i) Pr (M_i)}{\sum_{j=1}^{m} p (y|M_j) Pr (M_j)}, \tag{25}
\]
where Pr(\(M_i\)) is a probability a priori of model \(j\).

Hypotheses of interest, \(H_i\), for \(i\) denoting the particular hypothesis, may be assessed using posterior probabilities of hypotheses, \(Pr(H_i|y)\). They are computed summing the posterior probabilities of the non-nested models representing hypothesis \(i\):

\[
Pr(H_i|y) = \sum_{j \notin H_i} Pr(M_j|y).
\]

This approach to assessment of hypotheses requires the estimation of all the models represented considering hypotheses, as well as the estimation of the corresponding to the models marginal densities of data (23).

**Bartlett’s paradox.** Using Bayes factors for the comparison of the models is not uncontroversial. It appears that Bayes factors are sensitive to the specification of the prior distributions for the parameters being tested. The more diffuse a prior distribution the more informative it is about the the parameter tested with a Bayes factor. This phenomenon is called Bartlett’s paradox (see Bartlett, 1957) and is a version of the Lindley’s paradox. Moreover, Strachan & van Dijk (2011) show that assuming a diffuse prior distribution for the parameters of the model, results in wrongly defined Bayes factors. As a solution to this problem Strachan & van Dijk recommend using a prior distribution belonging to a class of shrinkage distributions.

I check the sensitivity of the model assessment with respect to the specification of the prior distribution assuming for each of the estimated model two different prior distributions for the matrices of parameters \(A\) and \(B\). The distributions, defined in Section 2, differ in the variances of the of the distributions. One of the variances is equal to 0.1, representing a shrinkage prior distribution, and the other is equal to 100, representing a diffuse prior distribution.

**Estimation of models.** The form of the posterior distribution (11) for all the parameters, \(\theta\), for the GARCH models, even with the prior distribution set to a proper distribution function, as in (12), is not in a form of any known distribution function. Moreover, none of the full conditional densities for any sub-group of the parameter vector has a form of some standard distribution. Still, the posterior distribution, although it is known only up to a normalizing constant, exists; this is ensured by the bounded likelihood function and the proper prior distribution. Therefore, the posterior distribution may be simulated with a Monte Carlo Markov Chain (MCMC) algorithm. Due to the above mentioned problems with the form of the posterior and full conditional densities, a proper algorithm to sample the posterior distribution (11) is, e.g. the Metropolis-Hastings algorithm (see Chib & Greenberg, 1995, and references therein). The algorithm was adapted for multivariate GARCH models by Vrontos et al. (2003).

Suppose the starting point of the Markov Chain is some value \(\theta_0 \in \Theta\). Let \(q(\theta^{(s)}, \theta'|y, M_s)\) denote the proposal density (candidate-generating density) for the transition from the current state of the Markov chain \(\theta^{(s)}\) to a candidate draw \(\theta'\). The candidate density for model \(M_s\) depends on the data \(y\). In this study, I use a multivariate Student’s t distribution with the location vector set to the current state of the Markov chain, \(\theta^{(s)}\), the scale matrix \(\Omega_s\) and the degrees of freedom parameter set to five. The scale matrix, \(\Omega_s\), should be determined by preliminary runs of the MCMC algorithm, such that it is close to the covariance matrix of the posterior distribution. Such a candidate-generating density should enable the algorithm to draw relatively efficiently from the posterior density. A new candidate \(\theta'\) is accepted with the probability:

\[
\alpha(\theta^{(s)}, \theta'|y, M_s) = \min \left[ 1, \frac{p(y|\theta', M_s) p(\theta'|M_s)}{p(y|\theta^{(s)}, M_s) p(\theta^{(s)}|M_s)} \right],
\]

and if it is rejected, then \(\theta^{(s+1)} = \theta^{(s)}\). The sample drawn from the posterior distribution with the Metropolis-Hastings algorithm, \(\{\theta^{(s)}\}_{s=1}^S\), should be diagnosed to ensure that it is a good sample from the stationary posterior distribution (see e.g. Geweke, 1999; Plummer, Best, Cowles & Vines, 2006).

**Estimation of the marginal distribution of data.** Having estimated the models, the marginal densities of data may be computed using one of the available methods. Since the estimation of the models is performed using the Metropolis-Hastings algorithm, the suitable estimator of the marginal density of data is presented
by Geweke (1997). However, any estimator of the marginal density of data applicable to the problem might be used (see Miazhynskaia & Dorffner, 2006, who review the estimators of marginal density of data for univariate GARCH models). The Bayesian comparison of bivariate GARCH models using Bayes factors was presented by Osiewalski & Pipień (2004).

The Modified Harmonic Mean estimator of the marginal density of data was presented by Geweke (1997). It can be computed, using the very simple formula:

$$
\hat{p}(y|M_i) = \left[ S^{-1} \sum_{s=1}^{S} \frac{f(\theta^{(s)})}{p(y|\theta^{(s)}, M_i)p(\theta^{(s)}|M_i)} \right]^{-1},
$$

where $f(\theta^{(s)})$ is a multivariate truncated normal distribution, with the mean vector set to posterior mean and covariance matrix set to posterior covariance matrix. The truncation is set such that $f(\theta^{(s)})$ have thinner tails than the posterior distribution.

**Discussion.** The proposed approach to testing the second-order noncausality hypothesis for GARCH models has several appealing features. First of all, the proposed Bayesian testing procedure makes testing of the parameter conditions possible. It avoids the singularities that may appear in classical tests, in which the restrictions imposed on the parameters are nonlinear.

Secondly, since the competing hypotheses are compared with Bayes factors, they are treated symmetrically. Thanks to the interpretation of the Bayes factors coming from the Posterior Odds Ratio, the outcome of the test is a positive argument in favour of the most likely a posteriori hypothesis. Moreover, contrary to classical testing, a choice is being made between all the competing hypotheses at once, not only between the unrestricted and one of the restricted models (see Hoogerheide, van Dijk & van Oest R.D., 2009, for a discussion of the argument).

Further, as the testing outcome is based on the posterior analysis, the inference has an exact finite sample justification. Thus, there is no need to refer to the asymptotic theory. In consequence, the assumptions required to test the restrictions may now be relaxed. In order to test the second-order noncausality hypothesis, the assumptions 1–5 must hold. They require the existence of the fourth-order unconditional moment that is ensured by the restrictions derived by He & Teräsvirta (2004). No classical test of the restrictions has been proposed so far for the ECCC-GARCH model. Note that the Bayesian testing in the proposed form may be applied to BEKK-GARCH and vec-GARCH models without any complications, and while preserving all the advantages. Then, the assumption of existence of moments of order four is a significant improvement, in comparison with the result of Comte & Lieberman (2003). There, the asymptotic distribution of the QMLE is established under the existence of the eighth-order moments. For the testing of volatility spillovers in the ECCC-GARCH model, the assumption may be further relaxed. Here, the strict assumption for the linear theory for noncausality of Florens & Mouchart (1985) need not hold. In fact, for testing the zero restrictions for the no volatility spillovers hypothesis, the only required assumption about the moments of the process is that the conditional variances must exist and be bounded. Not even the existence of the second unconditional moments of the process is required. Again, this result is an improvement, in comparison with the test of Nakatani & Teräsvirta (2009), which required the existence of fourth-order moments for the Lagrange Multiplier test statistic to be asymptotically $\chi^2$-distributed.

The improvements in moment conditions are, therefore, established for both kinds of hypothesis. This fact may be crucial for the testing of the hypotheses on the financial time series. In multiple applied studies, such data are shown to have the distribution of the residual term, with thicker tails than those of the normal distribution. Then, distributions modeling this property, such as the $t$ distribution function, are employed. I follow this methodological finding, assuming exactly this distribution function.

As the main costs of the proposed approach, I name the necessity to estimate all the unrestricted and restricted models. This simply requires some time-consuming computations. While bivariate GARCH models may (depending on the order of the process, and thus on the number of the parameters) be estimated reasonably quickly, trivariate models require significant amounts of time and computational power.
Table 1: Data: summary statistics

<table>
<thead>
<tr>
<th></th>
<th>GBP/EUR</th>
<th>USD/EUR</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mean</td>
<td>0.012</td>
<td>-0.006</td>
</tr>
<tr>
<td>Median</td>
<td>0.011</td>
<td>0.016</td>
</tr>
<tr>
<td>Standard Deviation</td>
<td>0.707</td>
<td>0.819</td>
</tr>
<tr>
<td>Correlation</td>
<td>.</td>
<td>0.368</td>
</tr>
<tr>
<td>Minimum</td>
<td>-2.657</td>
<td>-4.735</td>
</tr>
<tr>
<td>Maximum</td>
<td>3.461</td>
<td>4.038</td>
</tr>
<tr>
<td>Excess kurtosis</td>
<td>2.430</td>
<td>2.683</td>
</tr>
<tr>
<td>Skewness (robust)</td>
<td>0.060</td>
<td>0.085</td>
</tr>
<tr>
<td>Skewness (robust)</td>
<td>0.344</td>
<td>-0.091</td>
</tr>
<tr>
<td>Excess kurtosis (robust)</td>
<td>0.010</td>
<td>-0.016</td>
</tr>
<tr>
<td>LJB test</td>
<td>206.525</td>
<td>234.063</td>
</tr>
<tr>
<td>LJB p-value</td>
<td>0.000</td>
<td>0.000</td>
</tr>
<tr>
<td>T</td>
<td>777.0</td>
<td>777.0</td>
</tr>
</tbody>
</table>

Note: The excess kurtosis (robust) and the skewness (robust) coefficients are outlier-robust versions of the excess kurtosis and the skewness coefficients, as described in Kim & White (2004). LJB test and LJB p-values describe the test of normality by Lomnicki (1961) and Jarque & Bera (1980).

4. Granger causal analysis of exchange rates

The restrictions derived in Section 2 for second-order noncausality for GARCH models, along with the Bayesian testing procedure described in Section 3, are now used in an analysis of the bivariate system of two exchange rates.

Data. The system under consideration consists of daily exchange rates of the British pound (GBP/EUR) and the US dollar (USD/EUR), both denominated in Euro. I analyze logarithmic rates of return expressed in percentage points, $y_{it} = 100(ln x_{it} - ln x_{i,t-1})$ for $i = 1, 2$, where $x_{it}$ are levels of the assets. The data spans the period from 16 September 2008 to 22 September 2011, which gives $T = 777$ observations, and was downloaded from the European Central Bank website (http://sdw.ecb.int/browse.do?node=2018794). The analyzed period starts the day after Lehman Brothers filed for Chapter 11 bankruptcy protection.

The data set contains the two most liquid exchange rates in the Eurozone. The chosen period of analysis starts just after an event that had a very strong impact on the turmoil in the financial markets; the bankruptcy of Lehman Brothers Holding Inc. The proposed analysis of the second-order causality between the series may, therefore, be useful for financial institutions as well as public institutions located in the Eurozone whose performance depends on the forecast of exchange rates. Such institutions include the governments of the countries belonging to the Eurozone that keep their debts in currencies, mutual funds and banks, and all the participants of the exchange rates market.

Figure B.2 from Appendix B plots the time series. It clearly shows the first period of length – of nearly a year – which may be characterized by the high level of volatility of the exchange rates. The subsequent period is characterized by a slightly lower volatility for both of the series. The evident heteroskedasticity, as well as the volatility clustering, seem to provide a strong argument in favor of the employment of the GARCH models that are capable of modeling such features of the data.

Table 1 reports the summary statistics of the two considered series. Both of the series of the rates of returns have sample means and medians close to zero. The US dollar has a slightly larger sample standard deviation than the British pound. Both the series are leptokurtic, which is evidenced by the excess kurtosis coefficient of around 2.5. The pound is slightly positively and the dollar slightly negatively skewed. Neither series can be well described with a normal distribution function. These features of the series seem to confirm the choice of a $t$-distributed likelihood function, which, however, neglects the small skewness of the series.
Table 2: Summary of the estimation of the unrestricted VAR(1)-ECCC-GARCH(1,1) models

Panel A: Estimation results for model $\mathcal{M}_0$ with diffuse prior distribution

<table>
<thead>
<tr>
<th></th>
<th>VAR(1)</th>
<th>GARCH(1,1)</th>
<th>$\nu$</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>$\alpha_0$</td>
<td>$\alpha_1$</td>
<td>$\omega$</td>
</tr>
<tr>
<td>GBP/EUR</td>
<td>0.010</td>
<td>0.083</td>
<td>-0.021</td>
</tr>
<tr>
<td></td>
<td>(0.021)</td>
<td>(0.040)</td>
<td>(0.033)</td>
</tr>
<tr>
<td>USD/EUR</td>
<td>0.009</td>
<td>0.067</td>
<td>-0.006</td>
</tr>
<tr>
<td></td>
<td>(0.026)</td>
<td>(0.048)</td>
<td>(0.041)</td>
</tr>
</tbody>
</table>

Panel B: Estimation results for model $\mathcal{M}_0$ with shrinkage prior distribution

<table>
<thead>
<tr>
<th></th>
<th>VAR(1)</th>
<th>GARCH(1,1)</th>
<th>$\nu$</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>$\alpha_0$</td>
<td>$\alpha_1$</td>
<td>$\omega$</td>
</tr>
<tr>
<td>GBP/EUR</td>
<td>0.011</td>
<td>0.083</td>
<td>-0.022</td>
</tr>
<tr>
<td></td>
<td>(0.021)</td>
<td>(0.041)</td>
<td>(0.033)</td>
</tr>
<tr>
<td>USD/EUR</td>
<td>0.009</td>
<td>0.066</td>
<td>-0.007</td>
</tr>
<tr>
<td></td>
<td>(0.026)</td>
<td>(0.049)</td>
<td>(0.041)</td>
</tr>
</tbody>
</table>

Note: The table summarizes the estimation of the VAR(1)-ECCC-GARCH(1,1) model described by the equations (2), (3), (4) and the likelihood function (6). The prior distributions are specified as in equation (12). The posterior means and the posterior standard deviations (in brackets) of the parameters are reported. A summary of the characteristics of the simulations of the posterior densities of the parameters for all the models are reported in Appendix C, in Tables C.5 and C.6.

Testing strategy and estimation results. To the bivariate time series of exchange rates I fit the VAR(1)-ECCC-GARCH(1,1) model with two different assumptions regarding the prior distribution. The first prior distribution, referred to as a diffuse prior, is as specified in Section 2 and equation (12) with the value of the hyper-parameter $\bar{s}$ set to 100. The second assumed prior distribution, referred to as shrinkage distribution, has the value of this hyper-parameter set to 0.1. The models that are estimated are as follows. The unrestricted model defined by equations (2), (3) and (4) allows variables to impact on each other in both conditional mean and conditional variance processes. It represents a hypothesis of second-order causality in both directions: from GBP/EUR to USD/EUR and conversely. Restricted models represent different hypotheses of noncausality, and are restricted according to the conditions stated in Theorem 1. All the models, the unrestricted and restricted, are estimated twice with the two different prior distributions.

For the considered data and model three hypotheses of second-order noncausality are formed. The restrictions resulting from Theorem 1 for the hypothesis of second-order noncausality from the British pound to the US dollar, denoted by GBP/EUR $\not\rightarrow$ USD/EUR, are presented in Example 1, and are given by two restrictions:

$$A_{21} = 0 \quad \text{and} \quad B_{21}A_{11} = 0.$$  

Whereas the restrictions for the hypothesis of second-order noncausality from dollar to pound, denoted by USD/EUR $\not\rightarrow$ GBP/EUR, are:

$$A_{12} = 0 \quad \text{and} \quad B_{12}A_{22} = 0.$$  

The third hypothesis of second-order noncausality in both of the directions results in the restrictions being a logical conjunction of the two restrictions presented above.

The strategy for the assessment of the hypotheses is the following. For each of the hypotheses, a full set of sufficient conditions of the restrictions representing the hypothesis is derived. The sufficient conditions are in the form of zero restrictions imposed on single parameters. All the restricted models are estimated and the respective marginal distributions of data are computed. Posterior probabilities of the models and of the hypotheses are computed. The hypotheses are compared using Posterior Odds Ratios. Table 3 presents
Figure 1: Marginal posterior densities of parameter $B_{21}$

Note: Marginal posterior densities for both of the prior specifications represent the marginal posterior densities of $B_{21}$, for the models that do not restrict $B_{21}$ to zero, weighted by the posterior probabilities of the models:

$$p(B_{21}|y) = \sum_i \Pr(M_i|y)p(B_{21}|y, M_i),$$

for $i$ such that in model $M_i$ parameter $B_{21}$ is not restricted to zero.

all the hypotheses and the models representing them with restrictions being a sufficient condition of the conditions resulting from Theorem 1 for each of the hypotheses.

I start the analysis of the results with several comments on the parameters of the unrestricted models. Table 2 reports the posterior means and the posterior standard deviations of the parameters of these models estimated with the two different prior assumptions. Note that there are no significant differences in the parameters’ values between these two models. All the following comments, thus, concern both of the specifications. Among the parameters of the vector autoregressive part, only parameter $\alpha_{1,1}$ can be considered statistically different from zero. This finding proves that the two exchange rates do not Granger cause each other in conditional means.

All the parameters of the GARCH(1,1) part are assumed nonnegative. However, for most of parameters of matrices $\omega$, $A$ and $B$, a significant part of the posterior probability mass is concentrated around zero. Only one parameter, namely $B_{21}$, has its posterior probability mass concentrated far from zero for both of the specifications, with diffuse and shrinkage prior distribution. Figure 1 plots the marginal posterior densities for both assumed prior densities. This parameter is responsible for the volatility transmission from the lagged value of the conditional variance of the GBP/EUR exchange rate on the current conditional variance of variable USD/EUR. Regardless of the prior density specification, this is the only parameter significantly different from zero. These findings, especially regarding the parameters of matrices $A$ and $B$, are reflected in the results of the assessment of the hypotheses of second-order noncausality.

Hypotheses assessment. The credibility of the hypotheses of second-order noncausality between the exchange rates of the British pound and the US dollar to Euro is evaluated. All together four different hypotheses are formed and assessed within the framework of the VAR-GARCH model. Due to the adopted strategy
higher than any other estimated model. In effect, this hypothesis is expected to have the highest posterior probability mass of the hypotheses. Table 4, reporting Posterior Odds Ratios of hypotheses one, two and three to the null hypothesis, confirms this claim. Hypothesis $H_2$ has the highest value of the posterior odds ratio relative to the null hypothesis, and thus, it attracts the biggest part of the posterior probability mass of the hypotheses.

Other hypotheses gained a negligible part of the posterior probability mass. Also the rank of the credibility of the hypotheses is not entirely robust to the specification of the prior distributions for the parameters of the model. Note, however, that the unrestricted model is rejected by data. Also the hypotheses that include the restrictions of second-order noncausality from pound to dollar are rejected. Most of the models representing these two hypotheses restrict the parameter $B_{21}$ to zero. Therefore, if the posterior probability mass of the hypotheses is not entirely robust to the specification of the prior distributions for the parameters of the model. Note, however, that the unrestricted model is rejected by data. Also the hypotheses that include the restrictions of second-order noncausality from pound to dollar are rejected. Most of the models representing these two hypotheses restrict the parameter $B_{21}$ to zero. Therefore, if the posterior

| $M_j$ | Restrictions | $\ln p(y|M_j)$ diffuse prior | $\ln p(y|M_j)$ shrinkage prior |
|-------|--------------|-------------------------------|-------------------------------|
| $H_0$: Unrestricted model | - | -1649.034 | -1649.100 |
| $H_1$: GBP/EUR $\rightarrow$ USD/EUR | $A_{21} = B_{21} = 0$ | -1652.868 | -1658.230 |
| $M_1$ | $A_{11} = A_{21} = 0$ | -1653.773 | -1654.851 |
| $M_2$ | $A_{11} = A_{21} = B_{21} = 0$ | -1653.170 | -1655.024 |
| $H_2$: USD/EUR $\rightarrow$ GBP/EUR | $A_{12} = B_{12} = 0$ | -1646.750 | -1652.790 |
| $M_4$ | $A_{12} = A_{22} = 0$ | -1646.377 | -1646.501 |
| $M_5$ | $A_{12} = A_{22} = B_{12} = 0$ | -1645.714 | -1645.737 |
| $H_3$: GBP/EUR $\rightarrow$ USD/EUR and USD/EUR $\rightarrow$ GBP/EUR | $A_{12} = A_{21} = B_{12} = B_{21} = 0$ | -1650.702 | -1658.387 |
| $M_7$ | $A_{12} = A_{21} = A_{22} = B_{12} = B_{21} = 0$ | -1676.102 | -1676.266 |
| $M_8$ | $A_{12} = A_{21} = A_{22} = B_{12} = B_{21} = 0$ | -1672.589 | -1672.623 |
| $M_9$ | $A_{12} = A_{21} = A_{22} = B_{12} = B_{21} = 0$ | -1680.278 | -1680.443 |
| $M_{10}$ | $A_{12} = A_{21} = A_{22} = B_{12} = B_{21} = 0$ | -1685.885 | -1685.335 |
| $M_{11}$ | $A_{12} = A_{21} = A_{22} = B_{12} = B_{21} = 0$ | -1681.618 | -1681.671 |
| $M_{12}$ | $A_{12} = A_{21} = A_{22} = B_{12} = B_{21} = 0$ | -1681.372 | -1681.238 |
| $M_{13}$ | $A_{12} = A_{21} = A_{22} = B_{12} = B_{21} = 0$ | -1687.385 | -1687.276 |
| $M_{14}$ | $A_{12} = A_{21} = A_{22} = B_{12} = B_{21} = 0$ | -1693.491 | -1695.578 |

Note: An estimator of the marginal densities of data is the Modified Harmonic Mean estimator by Geweke (1997), defined by equation (27). A summary of the characteristics of the simulations of the posterior densities of the parameters of the models are reported in Appendix C, in Tables C.5 and C.6.
Table 4: Summary of the hypotheses testing

| $H_i$ | Hypothesis | Models | $Pr(H_i|y)$ | $Pr(H_0|y)$ |
|-------|------------|--------|-------------|-------------|
| $H_0$ | Unrestricted model | $M_0$ | 1 | 1 |
| $H_1$ | GBP/EUR $\not\rightarrow$ USD/EUR | $M_1$–$M_3$ | 0.0463 | 0.006 |
| $H_2$ | USD/EUR $\not\rightarrow$ GBP/EUR | $M_4$–$M_6$ | 51.7058 | 42.338 |
| $H_3$ | GBP/EUR $\not\rightarrow$ USD/EUR and USD/EUR $\not\rightarrow$ GBP/EUR | $M_7$–$M_{15}$ | 0.1885 | 0.0001 |

Note: Posterior Probabilities of the hypotheses were computed using a formula of equation (26) that uses posterior probabilities of models, (25), and assuming flat prior distributions of the models: $Pr(M_i) = m^{-1}$ for $i = 1, \ldots, m$.

probability mass for this parameter is far from zero, the restriction cannot hold. In effect, such hypotheses are not supported by data.

The most important finding of the empirical analysis is that the exchange rate of the US dollar to Euro does not second-order cause the exchange rate of the British pound to Euro. This means that past information of the variability of dollar’s exchange rate is dispensable for the forecast of the conditional variance of pound’s exchange rate constructed with the bivariate VAR-GARCH model. This finding is robust to the specification of the prior distribution for the parameters of the model. How to explain this somehow surprising result?

This phenomenon is in line with the meteor shower hypothesis of Engle et al. (1990) that links the hours of trading activity to the structure of forecasting model of volatility. Despite the fact that the exchange rate market is open 24 hours a day, traders on different continents are active mainly during their working hours. Over one day, first agents in Australia and Asia are active, then agents in Europe (and Africa) start being active; and finally, traders in both Americas start working. Therefore, coming back to our example, on a particular day, first agents in Europe trade between Euro zone and United Kingdom and only after that, when working hours in the United States commence, agents start trading between Euro zone and the USA. Such a pattern is captured by the models representing the hypothesis of second-order noncausality from pound to dollar. Note that the triangular GARCH model of Engle et al. (1990), representing the meteor shower hypothesis, is just one of the models, namely $M_4$, representing hypothesis $H_2$.

5. Conclusions

In this work I have derived the conditions for analyzing the Granger noncausality for the second conditional moments modeled with the GARCH process. The presented restrictions for one period ahead second-order noncausality, due to the specific setting of the system, in which all the considered variables belong to one of the two vectors, appear to be the restrictions for the second-order noncausality at all future horizons. These conditions may result in several nonlinear restrictions on the parameters of the model, which results in the fact that the available classical tests have limited uses.

Therefore, in order to test these restrictions, I have applied the basic Bayesian procedure that consists of the estimation of the models representing the hypotheses of second-order causality and noncausality, and then of the comparison of the models and hypotheses with posterior odds ratios. This well-known procedure overcomes the difficulties that the classical tests applied so far to this problem have met. The Bayesian inference about the second-order causality between variables is based on the finite-sample analysis. Moreover, although the analysis does not refer to the asymptotic results, the strict assumptions about the existence of the higher-order moments of the series that are required in the asymptotic analysis may be relaxed in the Bayesian inference. In effect, the existence of fourth unconditional moments is assumed for the second-order noncausality analysis, and of second conditional moments for the volatility spillovers analysis.
The proposed approach has several limitations, however. These come from the fact that all the variables in the system are divided into only two vectors, between which the causality inference is performed. With such a setting, not all the hypotheses of interest may be formulated in the system that contains more than two variables (see Example 2). Another limitation is the fact that the presented restrictions serve as the restrictions for the second-order noncausality at all future horizons at once. This feature is caused by the particular setting considered in this work.

This critique is a motivation for further research on the topic of Granger causality in second conditional moments. First, one might consider the setting in which the causality between two variables is analyzed, when there are also other variables in the system that might be used for the purpose of modeling and forecasting. This may be particularly necessary for the analysis of the robustness of the causal or noncausal relations found, as the values of the parameters in the GARCH models are exposed to the omitted variables problem. Second, the second-order noncausality could be analyzed separately at each of the future horizons. Such a decomposition could provide further insights into causal relations between economic relations. However, the setting considered in this work does not allow for such an analysis.

Appendix A. Proof

Proof of Theorem 1. The first part of the proof sets the second-order noncausality restrictions for the GARCH process in the VAR form (9). Let \( \epsilon^{(2)}(t) \) follow a stationary VAR process as in (9), partitioned as in (10), that is identifiable. Then, \( y_1 \) does not second-order Granger-cause \( y_2 \) if and only if:

\[
\Pi_{21}(z) \equiv 0 \quad \forall z \in \mathbb{C}. \tag{A.1}
\]

Condition (A.1) may be proven by the application of Proposition 1 of Boudjellaba et al. (1992). Several changes are, however, required to adjust the proof of that Proposition for the vector autoregressive process to the setting considered in Theorem 1 for the GARCH models. Here, one projects the squared elements of the residual term, \( \epsilon^{(2)}(y_{2t+1} | I(t)) = [y_{2t+1} - P(y_{2t+1} | I(t))]^{(2)} \), on the Hilbert spaces \( P(t) \) or \( P_{-1}(t) \), both defined in Section 2.

The proven condition still leads to infinite number of restrictions on parameters. This property excludes the possibility of testing these restrictions. In order to obtain the simplified condition (14), apply to (A.1) the matrix transformations, first of Theorem 1 and then of Theorem 2 of Boudjellaba et al. (1994).
Appendix B. Data

Figure B.2: Data plot: (GBP/EUR,USD/EUR)

The graph presents the daily logarithmic rates of return, expressed in percentage points $y_t = 100(\ln x_t - \ln x_{t-1})$ for $i = 1, 2$, where $x_t$ denotes the level of an asset of two exchange rates: the British pound and the US dollar, all denominated in Euro. The data spans the period from 16 September 2008 to 22 September 2011, which gives $T = 777$ observations. It was downloaded from the European Central Bank website (http://sdw.ecb.int/browse.do?node=2018794).

Appendix C. Summary of the simulation
Table C.5: Properties of the simulations of the posterior densities of the models with diffuse prior distributions

<table>
<thead>
<tr>
<th>Model</th>
<th>RNE median</th>
<th>min</th>
<th>max</th>
<th>Autocorrelation at lag 1 median</th>
<th>min</th>
<th>max</th>
<th>Geweke’s z median</th>
<th>min</th>
<th>max</th>
<th>s</th>
</tr>
</thead>
<tbody>
<tr>
<td>$M_0$</td>
<td>0.203</td>
<td>0.034</td>
<td>0.745</td>
<td>0.531</td>
<td>0.361</td>
<td>0.830</td>
<td>0.047</td>
<td>-0.032</td>
<td>0.386</td>
<td>0.074</td>
</tr>
<tr>
<td>$M_1$</td>
<td>0.683</td>
<td>0.225</td>
<td>1.008</td>
<td>0.208</td>
<td>0.089</td>
<td>0.571</td>
<td>0.004</td>
<td>-0.017</td>
<td>0.026</td>
<td>0.454</td>
</tr>
<tr>
<td>$M_2$</td>
<td>0.035</td>
<td>0.017</td>
<td>0.147</td>
<td>0.834</td>
<td>0.717</td>
<td>0.937</td>
<td>0.370</td>
<td>0.045</td>
<td>0.722</td>
<td>-0.096</td>
</tr>
<tr>
<td>$M_3$</td>
<td>0.204</td>
<td>0.027</td>
<td>0.339</td>
<td>0.623</td>
<td>0.541</td>
<td>0.841</td>
<td>0.024</td>
<td>-0.011</td>
<td>0.450</td>
<td>0.140</td>
</tr>
<tr>
<td>$M_4$</td>
<td>0.639</td>
<td>0.228</td>
<td>0.922</td>
<td>0.188</td>
<td>0.124</td>
<td>0.472</td>
<td>-0.004</td>
<td>-0.050</td>
<td>0.045</td>
<td>-0.175</td>
</tr>
<tr>
<td>$M_5$</td>
<td>0.138</td>
<td>0.025</td>
<td>0.322</td>
<td>0.703</td>
<td>0.551</td>
<td>0.879</td>
<td>0.112</td>
<td>0.017</td>
<td>0.470</td>
<td>0.171</td>
</tr>
<tr>
<td>$M_6$</td>
<td>0.638</td>
<td>0.414</td>
<td>0.834</td>
<td>0.195</td>
<td>0.131</td>
<td>0.335</td>
<td>0.005</td>
<td>-0.012</td>
<td>0.025</td>
<td>-0.001</td>
</tr>
<tr>
<td>$M_7$</td>
<td>0.081</td>
<td>0.055</td>
<td>0.107</td>
<td>0.767</td>
<td>0.731</td>
<td>0.859</td>
<td>0.152</td>
<td>0.078</td>
<td>0.265</td>
<td>-0.307</td>
</tr>
<tr>
<td>$M_8$</td>
<td>0.501</td>
<td>0.267</td>
<td>0.992</td>
<td>0.113</td>
<td>-0.007</td>
<td>0.546</td>
<td>-0.001</td>
<td>-0.020</td>
<td>0.036</td>
<td>0.105</td>
</tr>
<tr>
<td>$M_9$</td>
<td>0.222</td>
<td>0.052</td>
<td>0.457</td>
<td>0.449</td>
<td>0.249</td>
<td>0.799</td>
<td>0.031</td>
<td>0.008</td>
<td>0.262</td>
<td>-0.086</td>
</tr>
<tr>
<td>$M_{10}$</td>
<td>0.147</td>
<td>0.024</td>
<td>0.352</td>
<td>0.534</td>
<td>0.326</td>
<td>0.921</td>
<td>0.050</td>
<td>-0.016</td>
<td>0.546</td>
<td>-0.286</td>
</tr>
<tr>
<td>$M_{11}$</td>
<td>0.302</td>
<td>0.027</td>
<td>0.478</td>
<td>0.484</td>
<td>0.413</td>
<td>0.877</td>
<td>0.020</td>
<td>-0.015</td>
<td>0.537</td>
<td>-0.418</td>
</tr>
<tr>
<td>$M_{12}$</td>
<td>0.464</td>
<td>0.028</td>
<td>0.992</td>
<td>0.206</td>
<td>0.011</td>
<td>0.755</td>
<td>-0.009</td>
<td>-0.030</td>
<td>0.411</td>
<td>-0.732</td>
</tr>
<tr>
<td>$M_{13}$</td>
<td>0.586</td>
<td>0.114</td>
<td>0.991</td>
<td>0.128</td>
<td>0.044</td>
<td>0.662</td>
<td>0.006</td>
<td>-0.028</td>
<td>0.167</td>
<td>0.199</td>
</tr>
<tr>
<td>$M_{14}$</td>
<td>0.498</td>
<td>0.049</td>
<td>1.233</td>
<td>0.121</td>
<td>0.060</td>
<td>0.783</td>
<td>0.030</td>
<td>-0.012</td>
<td>0.327</td>
<td>-0.231</td>
</tr>
<tr>
<td>$M_{15}$</td>
<td>0.387</td>
<td>0.145</td>
<td>0.589</td>
<td>0.204</td>
<td>0.156</td>
<td>0.471</td>
<td>0.037</td>
<td>0.012</td>
<td>0.126</td>
<td>-0.134</td>
</tr>
</tbody>
</table>

Note: The table summarizes the properties of the numerical simulation of the posterior densities of all the considered models. For each of the statistics, the median of all the parameters of the model, as well as minimum and maximum, are reported. The table reports the relative numerical efficiency coefficient (RNE), by Geweke (1989), autocorrelations of the MCMC draws at lags 1 and 10, as well as Geweke’s z scores for the hypothesis of equal means of the first 10% and the last 50% of draws that follow the standard normal distribution (see Geweke, 1992). The numbers presented in this table were obtained using the package coda by Plummer et al. (2006).
Table C.6: Properties of the simulations of the posterior densities of the models with shrinkage prior distribution

<table>
<thead>
<tr>
<th>Model</th>
<th>RNE</th>
<th>Autocorrelation at lag 1</th>
<th>Autocorrelation at lag 10</th>
<th>Geweke's z</th>
</tr>
</thead>
<tbody>
<tr>
<td>M0</td>
<td>0.238</td>
<td>0.036 0.81 0.414 0.178 0.814 0.037 0.007 0.38 0.056 -1.954 1.86 4500</td>
<td></td>
<td></td>
</tr>
<tr>
<td>M1</td>
<td>0.559</td>
<td>0.138 1.055 0.215 0.049 0.514 0.011 -0.019 0.102 -0.028 -1.323 2.231 5500</td>
<td></td>
<td></td>
</tr>
<tr>
<td>M2</td>
<td>0.084</td>
<td>0.013 0.270 0.757 0.577 0.908 0.132 -0.014 0.679 -0.021 -1.833 1.701 5000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>M3</td>
<td>0.692</td>
<td>0.092 1.120 0.179 0.076 0.534 -0.005 -0.038 0.131 -0.600 -1.956 1.649 4100</td>
<td></td>
<td></td>
</tr>
<tr>
<td>M4</td>
<td>0.672</td>
<td>0.294 1.198 0.109 0.041 0.470 0.002 -0.034 0.023 -0.129 -1.651 1.525 5500</td>
<td></td>
<td></td>
</tr>
<tr>
<td>M5</td>
<td>0.234</td>
<td>0.013 0.618 0.476 0.275 0.941 0.051 -0.038 0.719 0.173 -2.022 1.691 5000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>M6</td>
<td>0.686</td>
<td>0.235 0.987 0.196 0.089 0.528 -0.000 -0.040 0.023 -0.508 -1.898 1.668 4300</td>
<td></td>
<td></td>
</tr>
<tr>
<td>M7</td>
<td>0.071</td>
<td>0.016 0.137 0.765 0.700 0.940 0.167 0.043 0.618 0.512 -1.689 1.556 5500</td>
<td></td>
<td></td>
</tr>
<tr>
<td>M8</td>
<td>0.225</td>
<td>0.012 0.506 0.495 0.312 0.984 0.034 -0.033 0.907 -0.057 -1.588 1.329 4500</td>
<td></td>
<td></td>
</tr>
<tr>
<td>M9</td>
<td>0.427</td>
<td>0.175 0.735 0.196 0.124 0.578 0.005 -0.006 0.080 0.201 -1.889 2.308 5000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>M10</td>
<td>0.456</td>
<td>0.013 0.886 0.162 0.067 0.966 0.026 -0.014 0.903 -0.262 -2.399 2.802 4300</td>
<td></td>
<td></td>
</tr>
<tr>
<td>M11</td>
<td>0.343</td>
<td>0.012 0.520 0.466 0.404 0.970 0.016 -0.037 0.807 -0.079 -1.954 1.706 4500</td>
<td></td>
<td></td>
</tr>
<tr>
<td>M12</td>
<td>0.825</td>
<td>0.637 1.269 0.075 0.007 0.229 -0.003 -0.031 0.031 -0.352 -2.221 2.272 4500</td>
<td></td>
<td></td>
</tr>
<tr>
<td>M13</td>
<td>0.430</td>
<td>0.091 0.954 0.244 0.112 0.775 0.017 -0.041 0.151 0.193 -1.922 2.158 5000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>M14</td>
<td>0.748</td>
<td>0.015 1.115 0.069 0.038 0.955 0.008 -0.028 0.705 0.097 -0.756 1.763 4000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>M15</td>
<td>0.143</td>
<td>0.010 0.501 0.465 0.235 0.974 0.058 -0.012 0.921 0.179 -1.134 1.043 4500</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Note: The table summarizes the properties of the numerical simulation of the posterior densities of all the considered models. For each of the statistics, the median of all the parameters of the model, as well as minimum and maximum, are reported. The table reports the relative numerical efficiency coefficient (RNE), by Geweke (1989), autocorrelations of the MCMC draws at lags 1 and 10, as well as Geweke’s Z-scores for the hypothesis of equal means of the first 10% and the last 50% of draws that follow the standard normal distribution (see Geweke, 1992). The numbers presented in this table were obtained using the package coda by Plummer et al. (2006).


