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MarSwitching.jl: A Julia package for Markov switching dynamic models

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Software

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Summary

`MarSwitching.jl` is the first package in Julia programming language s(Bezanson et al., 2017) implementing Markov switching dynamic models. It provides a set of tools for estimation, simulation and forecasting of Markov switching models. This class of models is the principal tool for modelling time series with regime changes. The time-variation of model parameters is governed by the limited memory Markov process. Because of non-trivial likelihood function and the amount of model parameters, Julia is a perfect language to implement this class of models due to its performance.

Currently, the package provides model estimation with a combination of switching or non-switching intercept, error variance and exogenous variables. The transition matrix can be either constant or time-varying. The package also provides a set of functions for model diagnostics and forecasting. Further development of the package is considered, conditional on the interest in thereof.

Statement of need

The Markov switching regression (also referred to as regime switching) was first introduced in the seminal work of (Hamilton, 1989). Since then, it has been extensively used in empirical research. Although the model was introduced as an application to economic data, the range of applications has expanded significantly since the first publication. These fields include finance (Buffington & Elliott, 2002), political science (Brandt et al., 2014), hydrology (Wang et al., 2023), epidemiology (Shiferaw, 2021) and even bibliometrics (Delbianco et al., 2020).

The popularity of these models among applied scientists and industry professionals is reflected in the availability of implementations. There are several packages in R (R Core Team, 2017) such as `MSwM` (Josep A. Sanchez-Espigares, 2021) or `dynr` (Ou et al., 2019). For the Python language, the Markov switching model is implemented as part of the `statsmodels` package (Seabold & Perktold, 2010). MATLAB users may also estimate these models with `MS_Regress` (Perlin, 2012) package. Most of the well-established closed-source statistical applications also have their own implementations of Markov switching models. These include EViews, Stata, and SAS.

Despite the popularity of the method, `MarSwitching.jl` is, at the moment, the only package dedicated to estimation of Markov switching models available in the Julia programming language. At the same time, it is implemented purely in this language.

Background

Markov switching models are a class of regression models that allow for time variation of parameters in an otherwise linear model. More specifically, the current state is determined only by the state from the previous period, which is described in the transition matrix.

Consider a general model:

$$
\begin{aligned}
\mathbf{y}_t &= \mathbf{X}_{t,i}\beta_{S,i} + \epsilon_t \\
\epsilon &\sim f(0, \Sigma_s)
\end{aligned}
$$

Where $\mathbf{y}_t$ is N size vector of dependent variable indexed by time t. $\mathbf{X}_{t,i}$ is $N \times M$ matrix of exogenous regressors. $\beta_{S,i}$ is K size vector of parameters. ϵ_t is N size vector of errors. The errors are distributed according to some distribution $f(0, \Sigma_s)$ with mean zero and covariance matrix Σ_s. The state S is a latent (unobservable) variable that can take values from 1 to K. Parameters indexed by S are different for each state.

The state S_t is governed by the Markov process. The probability of transition from state i to state j is given by the $K \times K$ left-stochastic transition matrix $\mathbf{P}$:

$$
\mathbf{P} = P(S_t = i | S_{t-1} = j) = \begin{pmatrix} p_{1,1} & p_{1,2} & \cdots & p_{1,k} \\ p_{2,1} & p_{2,2} & \cdots & p_{2,k} \\ \vdots & \vdots & \ddots & \vdots \\ p_{k,1} & p_{k,2} & \cdots & p_{k,k} \end{pmatrix}
$$

With standard constraints: $0 < p_{i,j} < 1, \forall j, i \in \{1, \dots, K\}$ and $\sum_i^K p_{i,j} \forall j \in \{1, \dots, K\}$.

In a standard model, the transition matrix is assumed to be constant over time. However, it is possible to allow for time variation of the transition matrix itself, as described in (Filardo, 1994) (and as implemented in the package). In this case, each of the transition probabilities is modeled as a function of the exogenous variables $\mathbf{Z}_t$:

$$
p_{i,j,t} = \frac{\exp(\delta_{i,j}' \mathbf{Z}_t)}{\sum_{j=1} \exp(\delta_{i,j}' \mathbf{Z}_t)}
$$

Where $\delta_{i,j}$ is a vector of coefficients. The exponentiation and sum division of the coefficients ensure that the probabilities are non-negative and sum to one. For this model, the expected duration of the state is time-varying as well.

Quick start

The package allows for simulation of data from the Markov switching model. The user can specify the number of states, observations, and model parameters (both transition and regression parameters). The package will return a simulated dataset and the standardized exogenous variables.

```julia
using MarSwitching
using Random
import Statistics: quantile

k = 2             # number of regimes
T = 400           # number of generated observations
μ = [1.0, -0.5]  # regime-switching intercepts
β = [-1.5, 0.0]  # regime-switching coefficient for β
σ = [1.1,  0.8]  # regime-switching standard deviation
P = [0.9 0.05     # transition matrix (left-stochastic)
     0.1 0.95]
```

```julia
Random.seed!(123)

# generate artificial data with given parameters
y, s_t, X = generate_msm(μ, σ, P, T, β = β)
```

The model is estimated using `MSModel()` function. The user needs to specify the dependent variable `y`, the number of states `k`. The exogenous variables are passed to either `exog_vars` or `exog_switching_vars` argument, depending wether the variable is expected to have a switching parameter. In a similar vein the user may pass exogenous variable for time-varying transition matrix into `exog_tvtp`. However, in order to have an intercept the column of ones needs to be added explicitly.

```julia
# estimate the model
model = MSModel(y, k, intercept = "switching", exog_switching_vars = X[:,2])
```

Thanks to Julia's multiple dispatch, the `generate_msm()` function works by either providing the parameters as in the first code chunk or using the previously estimated model. This is useful e.g. for assessing the statistical properties of the model by Monte Carlo simulation.

```julia
quantile(generate_msm(model, 1000)[1], 0.05)
```

There are several functions for printing statistics of the estimated model. Each of the functions has a `digits` argument specifying a rounding number. `state_coeftable()` shows model coefficients' statistics for a given state and the expected duration of the state. For a standard model with constant transition matrix, the function `transition_mat()` prints a formatted matrix of estimated transition probabilities. For models with time-varying transition probabilities, the coefficients can be inspected with `coeftable_tvtp()`. The function `summary_mars()` prints all the relevant information about the model for each of the states. Additionally, it shows basic information about the model and fitness statistics.

The package also provides a function for filtered transition probabilities $(P(S_t = i|\Psi_t))$, as well as smoothed ones $(P(S_t = i|\Psi_T))$(Kim, 1994). Where the former is estimated using the data up to time t and the latter using the whole dataset. The functions to get these probabilities are `filtered_probs()` and `smoothed_probs()` respectively.

```julia
using Plots

plot(filtered_probs(model),
     label     = ["Regime 1" "Regime 2"],
     title     = "Regime probabilities",
     linewidth = 2)
```

Figure Figure 1 presents the output of the code above.

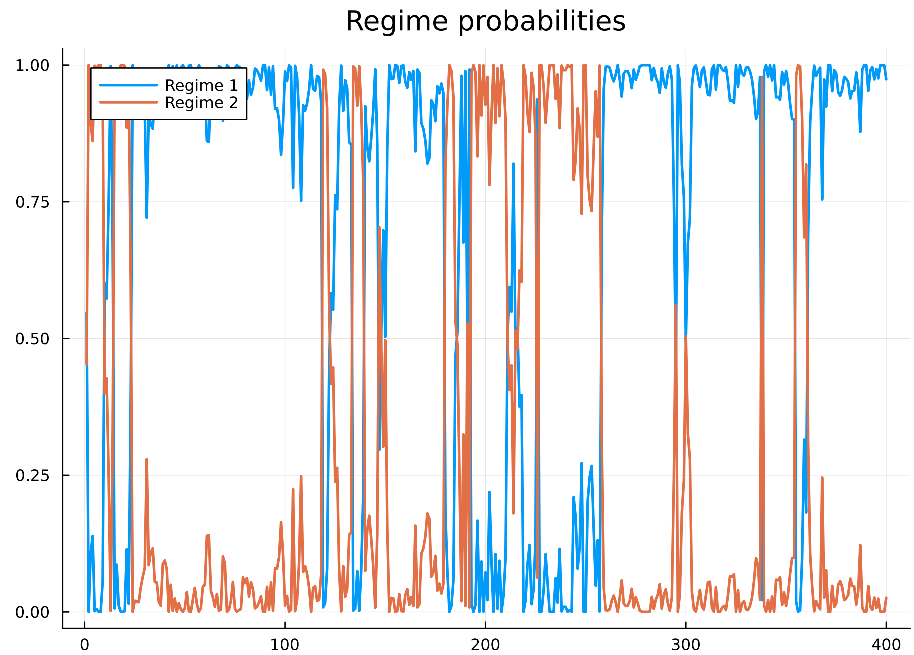

Figure 1: Filtered probabilites.

The package also provides a function for forecasting the dependent variable. However, for the Markov switching models, the prediction is not as intuitive as in less complex models. The reason is that the model requires also a forecast of state at time $t+1$.

`predict()` function returns the forecasted values either calculated in the instantaneous way:

$$\hat{y}_t = \sum_{i=1}^{k} \hat{\xi}_{i,t} X_t' \hat{\beta}_i$$

Or as a one step ahead forecast, where the states are predicted themselves:

$$\hat{y}_{t+1} = \sum_{i=1}^{k} (P\hat{\xi}_{i,t}) X_{t+1}' \hat{\beta}_i$$

For more details, the user is referred to the package documentation. Alternatively, in order to inspect the description of a particular function, the help operator - `?` in Julia's REPL may come in handy (e.g., `?MSModel`).

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