

ECON 5360 Problem Set #4

Due: Tuesday, March 5, 2013

Use the consumption function data provided in class to answer the following questions:

1. Find the variance-covariance matrix for the errors assuming an AR(2) process.
2. Use an LM test to check for AR(2) serial correlation. Contrast the results with those from an AR(1) process. Which is the better fit? Defend your answer.
3. Use the Prais-Winsten and Cochrane-Orcutt estimators to re-estimate the consumption function (with linear trend) under AR(2) errors. Comment on the results.
4. Re-estimate the model without the linear trend. Before re-estimating the model, test for both AR(1) and AR(2) errors and use the results to settle on the preferred specification.
5. Considering all the different specifications and estimation techniques, which do you feel is the best? Again, defend your answer.