An Example Question on Cointegration Analysis

Background information

Question One requires use of the EViews file *house_prices.wf1*. This file contains quarterly observations on regional houses in the UK over the period 1973(4) to 2010(3). The files contains observations for six regions, with all data expressed in natural logarithmic terms. The following list presents the six regions with the names used for them within the EViews file given in brackets:

East Anglia (ea); East Midlands (em); London (lon);
North West (nw); West Midlands (wm); Yorkshire and Humberside (yh).

For this question, you are required to consider two variables according to the following allocation rule:

If the sixth digit of your student number is:	**You must use the variables:**
0 or 9	lon, ea
1 or 8	lon, em
2 or 7	lon, nw
3 or 6	lon, wm
4 or 5	lon, yh

Tasks

- Provide a full and critical account of the Engle-Granger approach to the analysis of cointegration, illustrating your answer by applying the method to the specific pairing of series allocated to you above. You can assume the individual house price series allocated to you are unit root processes (do **not** test this).
- When using EViews, firstly provide your empirical results **without** using the 'automated' option available within EViews.
- With empirical results for your series now derived, use the 'automated' option within EViews to re-perform Engle-Granger analysis. Show that you can replicate your earlier results.
- Provide a *very* brief discussion of the ripple effect in the UK housing market and whether the results you have derived are supportive of this notion (use no more than 150 words for this *very* brief discussion of the ripple effect and your results).