Crisis-Contingent Dynamics of Connectedness: An SVAR-Spatial-Network “Tripod” Model with Thresholds (Job Market Paper)

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In recent years a growing number of methodologies have been proposed to empirically measure the connectedness among financial entities. However, few of them capture the dynamics of the financial connectedness. This paper aims to fill this gap and proposes a novel and systematic model to portray not only the connectedness in a given regime but also its transitions across different regimes. The model is based on an improved version of a “tripod” model, which unifies structural vector auto-regressions (SVARs), spatial models, and network models under one framework. I introduce a transition mechanism into my model, thus making it possible to observe how the interconnections among financial entities vary with certain threshold variables. My model may be applied to various issues regarding the financial and non-financial interconnections among certain entities. As an illustration, I show how my model can shed some new light on the modeling of the recent Eurozone contagions. I reveal a clear causal map of the propagation of shocks among the stock markets in five selected Eurozone countries in both contagion and non-contagion periods, which are determined automatically. The unique roles played by each selected market under both the contagion and non-contagion regimes are efficiently summarized.

JEL: C30;C59;G01;G15

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I. Introduction

Economic entities are often interconnected and these interconnections can have significant economic consequences. Particularly, the interconnections among financial entities, whether they are asset markets, firms, financial institutions, or economies, have drawn much attention since the 2008 financial crisis. A growing number of methodologies have been proposed to empirically measure financial connectedness, e.g., [Billio et al. (2012), Diebolda and Yılmaz (2014), Giraitis et al. (2016), and Barigozzi and Brownlees (2016)]. Following this strand of literature, Scidá (2016) finds that financial connectedness can not only be depicted with

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network models but also with spatial econometric models, and both approaches are unified by an underlying structural vector auto-regression (structural VAR, SVAR) model. In this paper, I call her model a “SVAR-spatial-network” model, or a “tripod” model, as it is an integration of these three econometric models. However, most of these existing literature only tries to depict a static state of financial connectedness and seldom attempts to model the dynamic evolution of the connectedness of a financial system. As an exception, Giraitis et al. (2016) indeed considers a dynamic model, but unlike most other literature, they assume the connections among the entities are known a priori, which is not realistic for many applications.

As the first contribution of this paper, I propose a novel and systematic way to empirically depict and analyze the connectedness among economic or financial entities in a given regime and its transitions across different regimes. Thus, the dynamics of connectedness are captured in a regime-switching model. With this model, we can figure out how the interconnections in an economic or financial system are decided by some threshold variables that we are interested in, and make comparisons among the interconnections in different regimes.

The model in this paper is rooted in the tripod model of Scidá (2016). Since it contains a regime-switching mechanism that is described by a threshold function, my model may be called a SVAR-spatial-network model with thresholds, or a “threshold tripod” model. As a secondary contribution of this paper, the threshold tripod model improves the original model of Scidá (2016) in various ways, on top of the dynamic regime-switching mechanism. First, the solution to the identification problem of an SVAR model in Scidá (2016) only works for a special class of networks. In this paper, I propose a much more general solution to the identification problem in the SVAR part, which is fundamental to the whole tripod model, with a novel strategy that exploits the normal-mixture structure of the residuals. Second, I show that the tripod model actually provides a benchmark to test a broad class of interesting hypotheses on the spatial weight matrices. And third, since the networks implied by the tripod model in this paper are usually complete and often have negative edges, I suggest that such networks can still be analyzed by some novel approaches devised recently.

The threshold tripod model should be particularly useful for applications where it is as important to study transitions of connectedness as the connectedness itself. A typical example is the empirical modeling of financial contagion: a large body of literature agrees that a definition of contagion should emphasize the change of entity interrelationship between crisis and non-crisis periods, rather than the relationship in each period. In fact, as an illustration of my model, I show how it sheds some new light on the topic of financial contagions in the EU, which has become a hotly discussed topic since the start of the Eurozone crisis in late 2009. While many existing studies rely on manual choice of crisis start points and  

\[\text{See, e.g., Forbes and Rigobon (2002), Dungey et al. (2005), Chiang et al. (2007), Caporin et al. (2013). For an in-depth discussion, see Section VI.A.}\]
end points, I pick a European credit default swap (CDS) index as the threshold variable and let the threshold variable determine two distinctive regimes where the five selected countries, namely Germany, Italy, Spain, Ireland, and Greece, have different interconnections. Under each regime, the mutual connectedness among the five countries is portrayed clearly. Furthermore, I construct statistical tests of two hypotheses. The first test confirms the existence of contagion among the countries; and the second test demonstrates that the contagions are not solely spread through the cross-border interbank channel. The existence of contagion is reconfirmed by global network measures. Moreover, centrality analyses and clustering analyses reveal clearly the distinctive roles played by the selected countries in different regimes.

Besides the contagion among markets in different countries, my model may be applied to profiling the transitions of many other instances of financial interconnections as well. For instance, many studies focus on the interconnections among financial institutions or firms (e.g. Diebolda and Yılmaz 2014, Barigozzi and Brownlees 2016). With my model, we may clearly see how these interconnections among institutions or firms change in different situations. As another interesting application of my model, we may also try to see how the spillover effect across different asset markets shifts. As an example, the volatility transmission among different commodity markets is decided by various macroeconomic and financial factors and is known to shift significantly in different environment (Nazlioglu et al. 2011). It might be interesting to draw a dynamic sketch of it over time with the model in this paper.

Applications of the threshold tripod model are certainly not limited to the finance area. In various fields of economics, we encounter issues concerning interconnections of entities. For example, there is a large number of studies of the connections among firms or regions through which knowledge spillover takes place (e.g. Lee 2006, Maliranta et al. 2009). It is possible to document the transitions of such connections as well.

A not-so-technical overview of the threshold tripod model is presented in the following section. The rest of this paper is organized as follows. Section III reviews the basics of an SVAR model and shows how the T-SVAR model used in the following sections is identified. Section IV introduces the restricted SAR model and the way to construct tests based on it. Section V presents the network analyses. Section VI reports the empirical results of the application of the model in the Eurozone markets. Section VII concludes this paper. And in the end, the appendices collect the necessary mathematical proofs.

II. A Not-So-Technical Overview of the Threshold Tripod Model

Before I start to introduce the model formally, I present an overview of it in a more descriptive manner here.

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2CDS is a swap agreement, with which the seller insures the buyer against certain reference debts.
As its name suggests, the SVAR-spatial-network model is composed of three steps. First, the entities of interest form an SVAR model. As we identify the SVAR, the responses of the entities to the structural shocks with clear economic interpretations are revealed. This provides a baseline for the following steps. Second, by adding some extra restrictions to the SVAR model, we get a spatial auto-regression (SAR) model, which shows clearly the interconnections implied by the SVAR structure. Third, we use certain network analytical techniques to further analyze the connectedness revealed by the SAR model. Since the tripod model in this paper has thresholds that model the dynamics of the interconnections, I add threshold functions to both the SVAR and SAR steps, and thereby upgrade them to threshold SVAR (T-SVAR) and threshold SAR (T-SAR) models. In this section, I try to introduce these steps one by one.

A. The T-SVAR Step

Now it has become a popular practice to start inferring the structure of connectedness of a system from a VAR-type model. Most of the existing literature, such as Billio et al. (2012) and Diebolda and Yılmaz (2014), uses reduced-form VARs. In contrast, the tripod model starts from a structural VAR model. Compared to reduced-form VARs, an SVAR allows the variables in the system to react instantaneously to shocks from elsewhere, which is closer to reality if the frequency of observations is not so high that the shocks and responses cannot be separated temporally.

In this paper, I add a threshold function to the SVAR model, thus upgrading it to a T-SVAR model. In the T-SVAR model, regimes are decided by the values of the threshold function that maps one or more exogenous variables to the probabilities of each state. There is no requirement of the form of the threshold function except that its value must be a probability, i.e., a real number ranging from zero to one. Therefore, we can pick all kinds of threshold functions of convenience, which can be transilient (similar to Hansen [1997], smooth (see van Dijk et al. [2002] for a survey), or even more complex forms. And there is no restriction on the number of threshold variables. This feature of my model can in fact be employed to construct a regime indicator based on the shift of variable connectedness. If we abstract from the structural part, the remaining reduced-form VAR part of the model will be similar to the threshold VAR models widely used in empirical studies such as Li and St-Amant (2010) and Afonso et al. (2011).

Compared with reduced-form VARs, there is always an identification problem accompanying SVAR models, as the data do not provide enough information to estimate all the parameters in an SVAR, unless we impose some additional assumptions on the model a priori. With proper prior assumptions, all the parameters of an SVAR can be estimated, and then we call the SVAR “identified.” The literature has proposed a number of identification strategies, but common strategies such as identifications based on recursive restrictions or sign restrictions, either require very strong prior assumptions that are rarely justified in reality, or does
not result in unique identifications (see Kilian (2013) for a review). Scidda (2016) suggests using a machine-learning algorithm called “PC-algorithm” to select an optimum set of restrictions. This algorithm assumes that there does not exist any cyclic causal relationship among the variables we consider, which is still often too strong in reality.

In my model, the SVAR is identified by assuming that the residuals follow normal-mixture distributions. I assume the simplest case, where the normal-mixture distribution of the reduced-form residuals under each regime follow a mixture of two normal distributions with different covariances and zero mean. This is an even weaker assumption than the regular assumption, since an ordinary normal distribution is a special case of a mixture-normal distribution and mixture distributions can be used to approach random distributions in the real world (e.g. Kon (1984) on distributions of asset returns). In an SVAR model with normal-mixture distributed residuals, Lanne and Lütkepohl (2010) show that we can achieve a unique local identification without any prior restriction on the interrelationship among the variables. Indeed, this only leads to local rather than global identifications and therefore we cannot know which variable is responding to which shock merely from identification results. But fortunately this problem can still be handled in actual empirical applications. In this paper, I follow Kohonen (2013) and fully identify the T-SVAR model by referring to some external source of information.

B. The T-SAR Step

In the tripod model, the connectedness is recorded by the spatial weight matrix in a SAR model. The spatial weight matrix records the inverse distance between each pair of entities in the system, and the inverse distance can either be an inverse of the real geographical distance, or some closeness in the figurative sense, such as the amount of trade. There is in fact no substantial difference between the “inverse distance” and the “connectedness” discussed in this paper. Unlike traditional spatial modeling where the user must designate a spatial weight matrix (e.g. Tonzer (2015)), the spatial weight matrix in the tripod model becomes endogenous and can be estimated from the SVAR identification obtained in the previous SVAR step. This step can be compared with some recent attempts to infer spatial weight matrices from data such as Manresa (2015) and Lam and Souza (2015).

Specifically, the SAR in the tripod model is obtained by imposing some additional linear constraints on the estimation of the SVAR. This step is carried out with a “minimum distance (MD)” approach, which is simple to understand, and

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3 In order to understand what is a normal-mixture distribution, we can imagine the return of a certain stock follows a different distribution in different situations in the future, and each situation takes place in the future at given probabilities. Since we are not sure which situation will actually take place, the distribution of the return of the stock conditioned on present information will be a mixture of the normal distributions in different situations, or a “normal-mixture” distribution.

4 This problem is called “label switching” problem by Maciejowska (2010). She offers a detailed proof of it in the appendix.
easy to implement. Since I consider tripod models with thresholds in this paper, a similar MD approach can also be employed to obtain a threshold SAR (T-SAR) model from the T-SVAR estimation.

Moreover, I show that the thresholds in the threshold tripod model enable us to construct tests of many interesting hypotheses. I focus on two types of tests in this paper. First, I test whether the spatial structure contained in an economic system is identical across different regimes. Second, I test whether the difference between spatial structures in different regimes follows a certain pattern. Since spatial weights are a measure of the connectedness of the system, the two tests are actually equivalent to tests of the existence of the transition of connectedness, and the channel through which the transition of the connectedness takes place. Tests on other types of restrictions are also possible. For example, it is possible to test whether a given spatial weight matrix is misspecified or not.

C. The Network Analysis Step

In this step, we can further explore the entity interconnections revealed by the T-SAR model using some network analysis techniques. If we recall that a network is just defined as a group of entities and the connectedness among them, then the system we study can be regarded as a blend of different networks in different regimes and the transitions among the regimes can be regarded as the transitions among different networks.\footnote{This kind of network blends is also called “overlapping networks” \cite{Battiston2013} or “overlay networks” \cite{DeDomenico2013}. \cite{Kivela2014} provides a detailed review of the broader class of multilayer networks.}

However, the networks generated by the tripod model in this paper are characterized by several quite unusual traits, including non-unitary edge weights,\footnote{Usually a network is composed by “nodes” and “edges.” Each node represents an entity in the network and an edge represents a connection between the two nodes on its two ends.} directed edges, and often negatively weighted edges. Furthermore, the networks are usually complete, which means every pair of nodes in the network is to some extent connected. These traits make the application of classical network analytical techniques difficult, as many of them are actually devised to handle common incomplete networks with undirected edges with positive unitary weights. Nevertheless, I show that such unusual networks can still be handled by some novel methods that have been devised recently. First, I use the simple strength measure and the PN measure to analyze centrality\cite{Everett2014}, i.e., the importance of the role of a certain node in the networks. Second, \cite{McAssey2015} propose a novel clustering measure for complete and weighted networks, with which we can measure how close are the neighbors of a node connected mutually and to how close the whole network is interconnected. Finally, \cite{Scid2016} suggests that when we estimate the SAR model, we automatically obtain a global measure for the influence strength of the whole network, which is called the $\rho$-measure. \cite{Scid2016} also proposes many other analyses, but most
of them can only be applied to networks with only positively weighted edges. Since I try to provide some analyses that still work even when there are negative edges, I switch to a new set of analyses and only keep the $\rho$-measure in this paper.

III. SVAR and T-SVAR Models

Before introducing my model formally, I introduce the notations used throughout the remaining parts of this paper. $I_a$ is the identity matrix of order $a$. $O_a$ is the $a \times a$ matrix where all the elements are zeros. Both $AB$ and $A \times B$ are matrix products of matrices $A$ and $B$. $1_a$ is the $a$-dimensional vector of ones, and $0_a$ is the $a$-dimensional vector of zeros. $A \otimes B$ is the Kronecker product of matrices $A$ and $B$. $A \odot B$ is the Hadamard product of $A$ and $B$. Next, $\text{diag}(a_1, a_2, \ldots)$ is the diagonal matrix where diagonal elements are $a_1, a_2, \ldots$, $\text{diag}(X)$ is the diagonal matrix where diagonal elements are respectively the elements of vector $X$, and $\text{diag}(A_1, A_2, \ldots)$ is the block diagonal matrix where $A_1, A_2, \ldots$ are on the main diagonal. $\text{vec}(A)$ is the standard vectorization of matrix $A$.

A. A Review of SVAR Models

In this section, I present a brief review of the SVAR model, which is the foundation of the SVAR-spatial-network “tripod” model.

As the main advantage of an SVAR model, it allows us to capture the instantaneous responds of variables to shocks. For instance, if an SVAR system at a daily frequency is composed of two stock market indices, then the SVAR model can reveal how one market responds to a market-specific shock in the other market on the same day. This feature of the SVAR model is especially valuable for financial issues, as many financial variables such as asset prices respond to shocks promptly. Even for economic systems where variables respond more slowly, this can still be very useful, because many data can only be obtained at an even lower frequency.

In the rest part of this paper, I assume $Y_t = (y_{1t}, y_{2t}, \ldots, y_{Kt})'$ is a $K$-dimensional vector representing endogenous variables observed at time $t = 1, 2, \ldots, T$, and $X_t = (x_{1t}, x_{2t}, \ldots, x_{Mt})'$ is a vector with the $M$ dimensions representing exogenous variables observed at time $t$. Additionally, let $\{u_t\}_{t=1}^T$ be the $K$-dimensional error term, then the reduced-form model with $p$ lags studied in this paper can be defined as $Y_t = \phi(Y_{t-1}, Y_{t-2}, \ldots, Y_{t-p}, X_t, u_t)$. Correspondingly, the structural-form model can be specified as $\psi(Y_t, Y_{t-1}, Y_{t-2}, \ldots, Y_{t-p}, X_t, u_t) = 0$.

In the baseline SVAR model, let the function $\phi$ be linear and $u_t$ be a white

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7This is also known as the Schur product, or entrywise product.
8Surely, it is possible to make $Y_t$ dependent on lags of $X_t$. In this case, we can stack the lags of $X_t$ in one vector and this definition still applies.
noise. Then the reduced-form VAR model becomes

\[ Y_t = c + \sum_{i=1}^{p} A_i Y_{t-i} + A_X X_t + u_t, \]

where \( c \) is a \( K \)-dimensional constant term, \( A_1, A_2, \ldots, A_p \) are autoregressive coefficient matrices with size \( K \times K \), \( A_X \) is the exogenous coefficient matrix with size \( K \times M \), and \( u_t \sim (0, \Sigma_u) \). Obviously, this reduced-form model is equivalent to various structural form models. But most SVAR literature considers the simple case, where the function \( \psi \) is linear and additively separable, i.e.,

\[ A Y_t - A(c + \sum_{i=1}^{p} A_i Y_{t-i} + A_X X_t + u_t) = 0, \]

where \( A \) is an invertible \( K \times K \) matrix. Hereinafter, I call \( A \) the “structural matrix”. Defining \( \epsilon_t \equiv A u_t \), the model can be rearranged as

\[ (1) \quad A Y_t = A c + \sum_{i=1}^{p} A A_i Y_{t-i} + A A_X X_t + \epsilon_t. \]

It is easy to see that \( \epsilon \sim (0, A \Sigma_u A') \). If we further require \( \epsilon_t \) to be orthogonal such that its covariance matrix \( \Sigma_{\epsilon} \) is diagonal, then the model in equation (1) can be called an SVAR model. A diagonal \( \Sigma_{\epsilon} \) indicates that all pairs of components in the error term \( \epsilon_t \) have zero correlation, therefore the shocks to the economic system represented by the SVAR model are uncorrelated as well. Such shocks are called “structural shocks”. Equation (1) is in fact the “A-model” in Lütkepohl (2007) plus some exogenous variables.

In many papers and textbooks about SVAR, the structural matrix \( A \) is chosen to let \( \Sigma_{\epsilon} \) be an identity matrix \( I_K \). Under this convention, the structural shocks all have the same size, which provides empirical studies with much convenience in comparing the effects of different shocks. However, since in this paper I do not focus on comparing the effects of economic shocks, I choose another way of normalization that is more convenient for further research in the following sections. I require all the diagonal elements of \( A \) to be one, but do not restrict the scale of \( \Sigma_{\epsilon} \). It is easy to see that my normalization is equivalent to the conventional normalization: if \( A \) is a structural matrix following my rule of normalization, and \( \Sigma_{\epsilon} = \text{diag}(\sigma_{11}, \sigma_{22}, \ldots, \sigma_{KK}) \), then \( A \times \text{diag}(\sigma_{11}^{1/2}, \sigma_{22}^{1/2}, \ldots, \sigma_{KK}^{1/2}) \) is obviously a structural matrix following the conventional rule of normalization such that \( \Sigma_{\epsilon} \) is an identity matrix. The most significant advantage of my way of normalization can be shown by rearranging equation (1) as

\[ (2) \quad Y_t = G Y_t + A c + \sum_{i=1}^{p} A A_i Y_{t-i} + A A_X X_t + \epsilon_t, \]
where \( G \equiv I_K - A \). Since all diagonal elements of \( A \) have been set to one, the diagonal elements of \( G \) will be zero. This will be the most convenient form to display an SVAR model in the next section, but within this section, I still focus on the specification in the form of equation (1).

There are two groups of unknown parameters in the SVAR model in equation (1). The first group, \( \{c, A_1, A_2, \ldots, A_p, A_X, \Sigma_u\} \), is inherited from the reduced-form VAR; and the second group, \( \{A, \Sigma_c\} \), contains the additional parameters that are exclusive to the structural form model. Now let us assume that we had obtained a proper estimation of the first group of parameters\(^9\), then we would only need to find a way to get an estimation of \( A \) and \( \Sigma_c \) to fully identify the structural model.

However, the identification step is never easy. Straightforwardly, if we assume the distribution of \( u_t \) is completely decided by \( \Sigma_u \) and there is no restriction on the free elements in \( A \) and \( \Sigma_c \), then the SVAR model is not identifiable. The reason is intuitive: \( A \) and \( \Sigma_c \) are regulated by the equation

\[
\Sigma_c = A \Sigma_u A'.
\]

Since \( A \) is invertible, this equation can be rewritten as

\[
\Sigma_u = A^{-1} \Sigma_c A'^{-1}.
\]

Since \( \Sigma_u \) is a covariance matrix and therefore symmetric, it has \( K(K+1)/2 \) free elements. But in the right hand of the equation, \( A \) has \( K^2 - K \) free elements and \( \Sigma_c \) has \( K \) free elements. Putting them together, the right side of equation (3) requires \( K^2 \) free elements, whereas the left side can only offer \( K(K+1)/2 \). Hence, there will be infinite number of solutions to the equation, and the SVAR model fails to be identified. Lütkepohl (2007) also offers a formal rank condition for the identifiability of the SVAR model discussed here.

The traditional way of solving the problem is to cut the number of free parameters in the right side of equation (3) by imposing additional restrictions. As the most straightforward way to do this, we may simply set the lower- or upper-triangle of \( A \) to be zero, and thereby \( A \) and \( \Sigma_c \) can be immediately obtained by the means of a Cholesky decomposition. However, this is a very strong set of restrictions, as it assumes a recursive causal chain among the variables. In other words, it assumes we know that among the \( K \) variables, variable \( A \) is known to be instantly affected by all \( K \) structural shocks, variable \( B \) by certain \( K - 1 \) structural shock, variable \( C \) by certain \( K - 2 \) structural shocks, etc. But in practice, it is really difficult to predicate the such relationships among the variables. In fact, even making sure such recursive causal chain exists among the variables in the first place is not easy. Besides the recursive restrictions, there are other identification strategies that rely on a priori restrictions, and most of them suffer

\(^9\)The estimation methods of reduced-form VARs can be found in Lütkepohl (2007).
from similar problems in imposing the restrictions, as is echoed by Kilian (2013). Such problems are quite undesirable, as the very purpose of the tripod model is to reveal the connectedness among variables or entities without knowing much about their interrelationship a priori. Sciddá (2016) suggests a relatively more novel machine learning algorithm called “PC algorithm” to find the optimal recursive order of the variables. This algorithm does not presupposes a recursive causal chain, but it still requires that the variables of interest form a Bayesian network, where no causal cycle exists. This is a rather strong assumption, since the influence in an economic network often goes bidirectionally. In this paper, the identification problem is handled in a novel way, by exploiting the structure of $\Sigma_u$ and extracting more information from it, which enables us to obtain a unique identification without imposing strong a priori restrictions on the model. This methodology for the SVAR model is described in the following part, and in Section III.C I show that the generalized case of the SVAR model with thresholds can be also identified with it.

B. Identification of an SVAR Model with Normal-Mixture Residuals

Although the main purpose of this paper is to establish a model describing the transitions of connectedness, which is based on an SVAR model with thresholds, in order to illustrate how the identification strategy works, I first introduce how a non-threshold SVAR model with normal-mixture residuals is identified by exploiting the distribution structure of residuals. The idea is pioneered by Lanne and Lütkepohl (2010), who show normal-mixture residuals can be utilized to construct identification tests.

From the previous discussion, we have already seen that an SVAR is identified by finding a proper “structure”, which combines orthogonal structural shocks into the visible reduced-formed innovations. A mixture distribution can be regarded as a mixture of several components of simple distributions. The SVAR model is identified, if we assume that the “structure”, i.e., the way that the orthogonal shocks are combined into reduced-form innovations is the same for all the components.

Consider the reduced-form VAR model

$$Y_t = c + \sum_{i=1}^{p} A_i Y_{t-i} + A X_t + v_t,$$

where

$$v_t = \begin{cases} v_{1t} \sim N(0, \Sigma_1) & \text{with probability } \gamma, \\ v_{2t} \sim N(0, \Sigma_2) & \text{with probability } 1 - \gamma. \end{cases}$$

Now the reduced-form error term $v_t$ follows a mixture of two normal distributions with zero mean and different covariance matrices. If $\Sigma_1 = \Sigma_2$, or $\gamma = 0, 1$, then

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10 For details of the PC algorithm, see Spirtes et al. (2000, p.117–119).
the normal-mixture distribution reduces to a regular normal distribution. The covariance matrix of \( v_t \) is also the weighted combination of the covariance of its two components, \( \gamma \Sigma_1 + (1 - \gamma) \Sigma_2 \). Proposition 1 in Lanne and Lütkepohl (2010) demonstrates that given the normal-mixture distributed \( v_t \), there exists a diagonal matrix \( \tilde{\Lambda} = \text{diag}(\tilde{\lambda}_1, \tilde{\lambda}_2, \ldots, \tilde{\lambda}_K) \) with \( \tilde{\lambda}_i > 0 \) for all \( i = 1, 2, \ldots, K \) and an invertible matrix \( \tilde{\Omega} \) such that \( \Sigma_1 = \tilde{\Omega} \tilde{\Omega}' \) and \( \Sigma_2 = \tilde{\Omega} \tilde{\Lambda} \tilde{\Omega}' \). Furthermore, if every pair of diagonal elements of \( \tilde{\Lambda} \) is different, the decomposition \( \tilde{\Omega} \) is unique up to the inversion of the signs of all elements in the same column. Suppose the diagonal elements of \( \tilde{\Omega} \) are \( (\tilde{\omega}_{11}, \tilde{\omega}_{22}, \ldots, \tilde{\omega}_{KK}) \). Due to my rule of normalization, I then further rewrite the decompositions of covariances as \( \Sigma_1 = \Omega \Lambda_1 \Omega' \) and \( \Sigma_2 = \Omega \Lambda_2 \Omega' \), where \( \Omega \) has all-one diagonal elements, \( \Lambda_1 = \text{diag}(\tilde{\omega}_{11}^2, \tilde{\omega}_{22}^2, \ldots, \tilde{\omega}_{KK}^2) \) and \( \Lambda_2 = \Lambda_1 \tilde{\Lambda} \). The covariance matrix of \( v_t \) can then be written as

\[
\Sigma_v = \gamma \Omega \Lambda_1 \Omega' + (1 - \gamma) \Omega \Lambda_2 \Omega' = \Omega(\gamma \Lambda_1 + (1 - \gamma) \Lambda_2) \Omega'.
\]

Suppose that this reduced-form model is equivalent to the SVAR model specified by equation (1) so that

\[
\Sigma_v = A^{-1} \Sigma_v A'^{-1}.
\]

Comparing equation (5) with (4), we find

\[
A = \Omega^{-1}.
\]

The SVAR model is identified up to this moment. Indeed, we may still invert the column signs of \( \Omega \) arbitrarily, but this is no problem in practice, as we can always distinguish between a positive shock and a negative shock easily.

The parameters in this SVAR model can be locally estimated by maximum likelihood (ML) estimation. Denote \( \epsilon = \{\epsilon_t\}_{t=1}^T \). Collecting all the parameters in the model except the mixture weight \( \gamma \) in the vector \( \theta \), then the likelihood function is

\[
L^{\text{SVAR}}(\theta, \gamma; \epsilon) = \prod_{t=1}^T L^{\text{SVAR}}_t(\theta, \gamma; \epsilon_t) = \prod_{t=1}^T f(\epsilon_t; \theta, \gamma),
\]

11That is to say, if two decompositions \( \tilde{\Omega} \) and \( \hat{\Omega} \) both satisfy \( \Sigma_1 = \tilde{\Omega} \tilde{\Omega}' = \hat{\Omega} \hat{\Omega}' \) and \( \Sigma_2 = \tilde{\Omega} \tilde{\Lambda} \tilde{\Omega}' = \hat{\Omega} \hat{\Lambda} \hat{\Omega}' \), then there must exist a diagonal matrix \( J \), all diagonal elements of which are either 1 or -1, such that \( \hat{\Omega} = \tilde{\Omega} J \).
where the one-time density function is

\[
f(\epsilon_t; \theta, \gamma) = \gamma (2\pi)^{-K/2} \det(\Omega \Lambda_1 \Omega')^{-1/2} \exp\left(-\frac{1}{2} \epsilon'_t (\Omega \Lambda_1 \Omega')^{-1} \epsilon_t\right)
\]

\[
+ (1 - \gamma) (2\pi)^{-K/2} \det(\Omega \Lambda_2 \Omega')^{-1/2} \exp\left(-\frac{1}{2} \epsilon'_t (\Omega \Lambda_2 \Omega')^{-1} \epsilon_t\right).
\] (7)

However, it should be noticed that we can only obtain local estimation through ML. To illustrate this problem, let us assume \(\hat{\Omega}, \hat{\Lambda}_1\) and \(\hat{\Lambda}_2\) are a local ML estimation that maximizes the likelihood function in equation (6). If we permute the \(i\)-th and \(j\)-th columns of \(\hat{\Omega}\) by postmultiplying \(\hat{\Omega}\) by the elementary column-switching operator \(E_{ij}\), then \(\Omega^* = \Omega E_{ij}\), \(\Lambda_1^* = E_{ij} \hat{\Lambda}_1 E_{ij}'\) and \(\Lambda_2^* = E_{ij} \hat{\Lambda}_2 E_{ij}'\) are also a group of local ML estimation. Since \(E_{ij} E_{ij}' = I_K\), we have \(\hat{\Omega} \hat{\Lambda}_1 \hat{\Omega}' = \Omega^* \Lambda_1^* \Omega'^*\) and \(\hat{\Omega} \hat{\Lambda}_2 \hat{\Omega}' = \Omega^* \Lambda_2^* \Omega'^*\). Therefore both groups of estimations maximize the one-time density function in equation (7) for all \(t\) and thus the overall likelihood function. This is called the “label switching” problem in Maciejowska (2010). She provides a formal proof of the problem in her appendix. Since \(\Omega = A^{-1}\) represents the simultaneous effects of each structural shock, the arbitrariness of the column permutation of \(\Omega\) implies that we can only know how each structural shock affects the economic system, but do not know which structural shock identified by the SVAR model corresponds to which economic shock in reality.

Following Kohonen (2013), I solve this label switching problem by ordering information contained in some proxy variable in this paper. Kohonen (2013) argues that if we can find a proxy variable that provides information on the ordering of the diagonal elements of \(\Sigma_\epsilon\), then it becomes possible for us to pick the correct global estimation of the SVAR model among the local ML estimations. For example, if \(Y_t\) represents the returns of the stock markets in several countries, then the size of return shocks indicated by \(\Sigma_\epsilon\) can be proxied by the magnitude of news in each country. Should we find some variable showing the magnitude of news, the diagonal elements of \(\Sigma_\epsilon\) should have the same order as the magnitude of news. In this way, those local estimations where the diagonal elements of the estimated \(\hat{\Sigma}_\epsilon = \hat{\gamma} \hat{\Lambda}_1 + (1 - \hat{\gamma}) \hat{\Lambda}_2\) is ordered incorrectly will be filtered out.

So far I have shown how to identify an SVAR model with normal-mixture residuals. In following sections, I will show that an SVAR actually contains all the information I need for revealing the connectedness among the entities. However, since this paper aims to describe how the connectedness transitions in different circumstances, we need a model that internalizes the transitions. In this paper, the transitions of connectedness are modeled by a threshold SVAR (T-SVAR) model, which I present in the following section.
C. The T-SVAR Model with Normal-Mixture Residuals

In this part, I show how to construct a T-SVAR model. In the T-SVAR model, the data-generating process is partitioned by thresholds into \( N \) different regimes. Under each regime, the system is interconnected in a certain way, which is described by an SVAR model. As all the \( N \) regimes are estimated simultaneously, we obtain \( N \) different sets of interconnections of the entities or variables we are interested in, and the transitions among them are described by the threshold function. The T-SVAR model is still identified through its normal-mixture residuals.

Since in my model the threshold function is restricted to a number between zero and one, the threshold model has a probabilistic interpretation in economics. In the model without thresholds, the connectedness is fixed for all the time. After the threshold function is introduced, the connectedness is no longer certain, and we can only know that the connectedness is one among several possible states, and the probabilities for each possible state are decided by the threshold function, which is a certain reflection of the exogenous threshold variables. The dynamics of the connectedness are thus portrayed by the time-varying probability distributions decided by the threshold variables.

Assume there is an \( H \)-dimensional vector of exogenous threshold variables \( Q_t = (q_{1t}, q_{2t}, \ldots, q_{Ht})' \) for time \( t = 1, 2, \ldots, T \), and the unnormalized threshold function \( \tau^*_\delta : \mathbb{R}^H \rightarrow [0, \infty)^N \), where \( \delta \) represents the unknown parameter(s) of \( \tau^*_\delta \). I further normalize \( \tau^*_\delta \) by the sum of its value and get the normalized threshold function

\[
\tau(Q_t; \delta) \equiv \tau_\delta(Q_t) = \frac{\tau^*_\delta(Q_t)}{1_N \tau^*_\delta(Q_t)}.
\]

This means there are \( N \) regimes, and \( \tau_\delta \) can map the threshold variables to the probability of the system to be in each regime. For simplicity, in the rest of this paper, when I mention the “threshold function”, I always refer to the normalized threshold function. The components of the threshold function are denoted as \( \tau(Q_t; \delta) = (\tau_1(Q_t; \delta)', \tau_2(Q_t; \delta)', \ldots, \tau_N(Q_t; \delta)')' \).

In practice, the threshold function can take any form. For example, the translucent form with one threshold variable is

\[
\tau^\text{Tran}_b(Q_t) = \begin{cases} 
(1, 0)', & Q_t \geq b, \\
(0, 1)', & Q_t < b,
\end{cases}
\]

where \( b \) is the breakpoint. This implies that the system has probability one to be in Regime 1 if the threshold variable \( Q_t \geq b \), and in Regime 2 otherwise. We can also use the the multivariate logistic form with any number of variable(s) as the threshold function

\[
\tau^\text{Logi}_\beta(Q_t) = \left( \frac{1/(1 + e^{-\beta'Q_t})}{1 - 1/(1 + e^{-\beta'Q_t})} \right),
\]
where $\beta$ is the vector of scales of the logistic function. This threshold function allows the system to switch between two regimes smoothly, and the location and speed of the switch are decided by parameters $\beta$.

Note that according to the definition of the threshold function, the threshold variables $Q_t$ are given exogenously, but the parameters $\delta$ is unknown a priori. This means before we estimate the T-SVAR model, we only known different values of $Q_t$ correspond to different probability distributions of regimes, but do not know how they correspond. The parameter values are estimated from the data. For instance, in the transient threshold function, we only know that when $Q_t \geq b$, the system is at Regime 1, and let the data decide the value of $b$.

With these definitions, we consider the reduced-form and corresponding structural-form threshold model with $N$ regimes and $p$ lags:

$$Y_t = \Phi(Y_{t-1}, Y_{t-2}, \ldots, Y_{t-p}, X_t, r_t) \tau_\delta(Q_t),$$

and

$$\Psi(Y_t, Y_{t-1}, Y_{t-2}, \ldots, Y_{t-p}, X_t, r_t) \tau_\delta(Q_t) = 0_K,$$

where $r_t$ is still the error term, $\Phi(\cdot) = (\phi_1(\cdot), \phi_2(\cdot), \ldots, \phi_N(\cdot))$ and $\Psi(\cdot) = (\psi_1(\cdot), \psi_2(\cdot), \ldots, \psi_N(\cdot))$ are matrices of size $K \times N$ denoting the model conditioned on each regime. Notice that I do not impose restrictions on the columns of $\Phi(\cdot)$ and $\Psi(\cdot)$ here, so they can be either mutually equal, partly equal, or completely unequal. In the application part of this paper, I let all columns of them be equal. Certainly, other kinds of restrictions are possible as well.

The T-SVAR model considered in this paper can still be specified by assuming $\Psi$ is linear and additively separable. Its summation form is:

$$\sum_{n=1}^{N} A_n Y_t \tau_n(Q_t; \delta) = \sum_{n=1}^{N} \left( A_n c^{(n)} + \sum_{i=1}^{p} A_n A_i^{(n)} Y_{t-i} + A_n A_X^{(n)} X_t + \varepsilon_{nt} \right) \tau_n(Q_t; \delta),$$

where $A_n$ denotes the structural matrix conditioned on regime $n$, $\tau_n(Q_t; \delta)$ is the probability for the system to be in regime $n$, $c^{(n)}$, $A_i^{(n)}$, and $A_X^{(n)}$ are the autoregressive coefficients in regime $n$, and $\varepsilon_{nt} = A_n r_t$ are the structural shocks conditioned on regime $n$.

The key to the identification of the T-SVAR model still rests on the distributional assumption of $r_t$. In the T-SVAR model I assume the conditional distri-
bution of \( r_t \) is a time-constant normal-mixture distribution, and hence its unconditional distribution becomes a mixture of \( N \) normal-mixture distributions, i.e.

\[
\Sigma_{r,t|Q_t;\delta} = \sum_{n=1}^{N} (\gamma_n \Sigma_{1n} + (1 - \gamma_n) \Sigma_{2n}) \tau_n(Q_t;\delta).
\]

Recall the results about the covariance decompositions in Section III.B and then we know there are matrices \( \{\Omega_n\}_{n=1}^{N} \), \( \{\Lambda_1^n\}_{n=1}^{N} \), and \( \{\Lambda_2^n\}_{n=1}^{N} \) such that \( \Omega_n \Lambda_1^n \Omega_n' = \Sigma_{1n} \) and \( \Omega_n \Lambda_2^n \Omega_n' = \Sigma_{2n} \) for all \( n = 1, 2, \ldots, N \) under regular conditions. Equation (13) can thereby be rewritten as

\[
\Sigma_{r,t|Q_t;\delta} = \sum_{n=1}^{N} \Omega_n (\gamma_n \Lambda_1^n + (1 - \gamma_n) \Lambda_2^n) \Omega_n' \tau_n(Q_t;\delta).
\]

Denote

\[
\Upsilon_n = \Omega_n (\gamma_n \Lambda_1^n + (1 - \gamma_n) \Lambda_2^n)^{1/2},
\]

then equation (14) can also be written as

\[
\Sigma_{r,t|Q_t;\delta} = \sum_{n=1}^{N} \Upsilon_n \Upsilon_n' \tau_n(Q_t;\delta).
\]

Further, as assumed, for all \( n \), we have \( \epsilon_{nt} = A_n r_t \) conditioned on regime \( n \). Therefore the unconditional relationship between the reduced-form and structural-form residuals will be

\[
r_t|Q_t;\delta = \sum_{n=1}^{N} (A_n^{-1} \epsilon_{nt}) \tau_n(Q_t;\delta),
\]

and

\[
\Sigma_{r,t|Q_t;\delta} = \sum_{n=1}^{N} (A_n^{-1} \Sigma_{\epsilon}^{(n)} A_n^{-1}) \tau_n(Q_t;\delta),
\]

where \( \Sigma_{\epsilon}^{(n)} \) denotes the covariance matrix of \( \epsilon_{nt} \). Comparing equations (16) and (14), we get

\[
A_n = \Omega_n^{-1},
\]

for all \( n = 1, 2, \ldots, N \). Meanwhile, we have

\[
A_n^{-1} \Sigma_{\epsilon}^{(n)} \frac{1}{2} = \Upsilon_n I_K^{\frac{1}{2}}.
\]
This implies that $\Upsilon_n$ is actually the decomposition of the reduced-form covariance matrices if we require the covariance matrices of the structural shocks $\varepsilon_{nt}$ to be unit matrices instead. In fact, $\Upsilon_n$ is the matrix that people are usually most interested in with traditional SVAR analyses, because it represents the instantaneous response of each variable to unit-sized structural shocks.

The T-SVAR model can still be locally estimated with ML. Denote $\varepsilon_t = \{\varepsilon_{nt}\}_{t=1}^{T}$ and $\varepsilon = \{\varepsilon_{nt}\}_{t=1}^{T,n=1,2,\ldots,N}$. Stacking the mixture weights $(\gamma_1, \gamma_2, \ldots, \gamma_N)$ in vector $\Gamma$, and remaining unknown parameters in the T-SVAR model except $\delta$ in vector $\Theta$, then we get the likelihood function

\begin{equation}
L_{T-SVAR}^T(\Theta, \Gamma, \delta; \varepsilon) = \prod_{t=1}^{T} L_{T-SVAR}^T(\Theta, \Gamma, \delta; \varepsilon_t) = \prod_{t=1}^{T} \varphi(\varepsilon_t; \Theta, \Gamma, \delta),
\end{equation}

where the one-time density function is

$$
\varphi(\varepsilon_t; \Theta, \Gamma, \delta) = \sum_{n=1}^{N} \varphi_n(\varepsilon_{nt}; \Theta, \Gamma) \tau_n(Q_t; \delta),
$$

and the one-time density function conditioned on regime $n$ is

$$
\varphi_n(\varepsilon_{nt}; \Theta, \Gamma) = \gamma_n (2\pi)^{-K/2} \det(\Omega_nA_{1n}\Omega_n')^{-1/2} \exp\left(-\frac{1}{2}\varepsilon_{nt}'(\Omega_nA_{1n}\Omega_n')^{-1}\varepsilon_{nt}\right) \\
+ (1 - \gamma_n)(2\pi)^{-K/2} \det(\Omega_nA_{2n}\Omega_n')^{-1/2} \exp\left(-\frac{1}{2}\varepsilon_{nt}'(\Omega_nA_{2n}\Omega_n')^{-1}\varepsilon_{nt}\right).
$$

After we obtain local estimations of the T-SVAR model by maximizing the likelihood function, global estimation can still be achieved with the method proposed by Kohonen (2013) and described in Section III.B in this paper.

Finally, before I finish this section, I have a caveat here concerning the computational implementation of the ML estimation. Although in theory it is nothing more than finding a maximum of the log-likelihood function, in practice, direct numerical optimization algorithms work poorly for the SVAR models with normal-mixture residuals no matter whether there are thresholds or not, given the complexity of the likelihood functions. In order to achieve a high-quality optimum, I suggest using the expectation-maximization (EM) method. Maciejewskal (2010) offers an in-depth discussion about the technical issues in the ML estimation of these mixture models.

The T-SVAR model is the foundation of the tripod model in this paper. In the following section, I show how to transform a T-SVAR model to a spatial auto-regression model, which displays the connectedness in different regimes in a straightforward manner.
IV. From Structural Models to Spatial Models

An SVAR model depicts the instantaneous and lagging responses of the variables to structural shocks, and we want to further understand what interconnections the impulse-response relationship implies. Scidá (2016) demonstrates that an identified SVAR model actually contains a spatial auto-regression (SAR) process, and the spatial weight matrix in a SAR model is a good indicator of the connectedness among the entities of interest. Similarly, a T-SVAR model also contains a threshold SAR (T-SAR) process, which implies different spatial weights, and thereby different states of connectedness, in different regimes. How to transform a T-SVAR model to a T-SAR is shown in Section [IV.A]. After we obtain the T-SAR model, we may construct statistical tests of various interesting hypotheses, which is discussed in Section [IV.B].

A. The SAR Model

In this section, I start from the SAR model

\[ Y_t = \rho W Y_t + c W + \sum_{i=1}^{p} B_i Y_{t-i} + B X_t + \epsilon_t, \]

where \( \rho \) is a scalar scaling coefficient, \( W = (w_{ij})_{K \times K} \) is a spatial weight matrix, \( c W, \{B_i\}_{i=1}^{p} \) and \( B X \) are autoregressive coefficients, and \( \epsilon_t \) is still the orthogonal error term with zero mean and a diagonal covariance matrix \( \Sigma _\epsilon \). Following the convention in spatial models, I assume \( W \) is row-standardized to unitary sums and its diagonal elements are all zeros. \( W \) represents the inverse distances, or in other words, spatial connectedness among the entities in an economic system, and the “spatial connectedness” can either be a inverse measure of real geographical distances among the entities, or some figurative connection such as the amount of mutual trade among economies. Specifically, the element \( w_{ij} \) in \( W \) indicates the connection from the \( j \)-th entity to the \( i \)-th entity.\(^ {13} \) And since \( W \) is standardized by \( \rho \), \( \rho \) serves as an overall measure of the connectedness intensity of the system.

If we compare equation (18) with equation (2), it is straightforward to see how the similarity. Since the diagonal elements of \( G = I_K - A \) are zeros, equation (18) is similar to (2) with row-standardizing constraints on the sans-diagonal structural matrix \( G \). Certainly, in the SVAR model specified by equation (2), \( A \) is unknown a priori and in spatial models \( W \) is usually given. But in this paper, I estimate a special SAR model with endogenous a spatial weight, and test a given spatial weight matrix against the endogenous one implied by the data. In fact, the relationship between the SAR model with endogenous spatial weights and the SVAR model specified by equation (2) has been formally demonstrated.

\(^ {13} \)If the connections are not directional, then \( W \) will be symmetric and thus \( w_{ij} = w_{ji} \) for all \( i \neq j \). But the connections can be directional, too. In fact, the connections considered in this paper are mostly directional.
by Proposition 3.1 in Scidá (2016). Because in this paper it is very unlikely that the estimation of $G$ would have a row where all the elements are zeros due to the special SVAR identification strategy, I only present a corollary of this proposition below:

**Proposition 1.** Assume the SVAR model (2) is identified, and no row in $G$ is fully composed by zeros. Then the SAR model (18) is a constrained SVAR model (2) with $(K - 1)$ independent linear restrictions on $G$ given by

$$
RG1_K = 0_{K-1},
$$

where the $(K - 1) \times K$ matrix

$$
R = \begin{pmatrix}
-1 & 1 & 0 & \cdots & 0 \\
0 & -1 & 1 & \cdots & 0 \\
\vdots & \ddots & \ddots & \ddots & \vdots \\
0 & \cdots & 0 & -1 & 1
\end{pmatrix}.
$$

This proposition is an immediate corollary of Proposition 3.1 in Scidá (2016).

Based on the finding above, I proceed to the SAR model with thresholds. Consider the $N$-regime T-SAR model

$$
\sum_{n=1}^{N} Y_t \tau_n(Q_t; \delta) = \sum_{n=1}^{N} \left( \rho_n W_n Y_t + c_W^{(n)} + \sum_{i=1}^{p} B_i^{(n)} Y_{t-i} + B_X^{(n)} X_t + \varepsilon_{nt} \right) \tau_n(Q_t; \delta),
$$

where $\rho_n$, $W_n$, $c_W^{(n)}$, $B_i^{(n)}$, and $B_X^{(n)}$ are respectively the scaling coefficient, spatial weight matrix, and autoregressive coefficients in regime $n$. And still, $\varepsilon_{nt}$ is the structural error term.

Applying Proposition 1 to each regime in equation (12), we have for each regime $n$,

$$
\mathcal{R}(I_K - A_n)1_K = 0_{K-1}.
$$

Since $\mathcal{R}I_K1_K \equiv 0_{K-1}$, this can be rewritten as

$$
\mathcal{R}A_n1_K = 0_{K-1},
$$

for all $n = 1, 2, \ldots, N$, or equivalently in the stacking form

$$
\mathcal{R}A 1_{NK} = 0_{N(K-1)};
$$

where $\mathcal{R} = I_N \otimes \mathcal{R}$ and $A = \text{diag}(A_1, A_2, \ldots, A_N)$. This conclusion turns the
estimation of the T-SAR model into a restricted ML estimation program:

$$\max L^{T-SVAR}(\Theta, \Gamma, \delta; \varepsilon),$$

s.t. $\mathcal{R} \mathcal{A} \mathbf{1}_{NK} = \mathbf{0}_{N(K-1)}$.

However, while the constrained ML gives the parameter estimations of the T-SAR model, in practice we have to perform a very complex constrained non-linear optimization procedure; even the unconstrained non-linear optimization in the T-SVAR model is already technically challenging, let alone the restricted non-linear optimization. Therefore, in this paper, I employ the minimum distance (MD) approach suggested by Scidà (2016) to obtain the estimation constrained T-SAR model from the unconstrained T-SVAR model.

Let $\mathcal{A} = (\text{vec}(A_1)', \text{vec}(A_2)', \ldots, \text{vec}(A_N)')'$ collect all the elements of $\{A_n\}_{n=1}^N$ or $\mathcal{A}$, and

$$\mathcal{G} = \begin{pmatrix}
\text{vec}(G_1)'
\text{vec}(G_2)'
\vdots
\text{vec}(G_N)'
\end{pmatrix} = \begin{pmatrix}
\text{vec}(I_K - A_1)'
\text{vec}(I_K - A_2)'
\vdots
\text{vec}(I_K - A_N)'
\end{pmatrix}.$$

Denote a matrix where $e_{ij} = 0$ for all $i = j$ and $e_{ij} = 1$ for all $i \neq j$ as $\mathcal{E} = (e_{ij})_{K \times K}$. Let $S$ be a $(K^2 - K) \times K^2$ row-selection matrix which deletes all the all-zero rows in $\text{diag}(\text{vec}(\mathcal{E}))$ such that $S \times \text{diag}(\text{vec}(\mathcal{E}))$ does not have all-zero rows\footnote{In fact, now we have $S \times \text{diag}(\text{vec}(\mathcal{E})) = S$.}. Then we can see the matrix

$$S = I_N \otimes S$$

contains all the non-diagonal elements of $\{A_n\}_{n=1}^N$ and stacks them in the vector $\mathcal{G}$ by letting

$$\mathcal{G} = SG = S \mathcal{A}.$$ 

In fact, $\mathcal{G}$ is the parameter vector that collects all the unknown parameters in $\{A_n\}_{n=1}^N$ or $\mathcal{A}$ in the T-SVAR model as all the fixed parameters in $\mathcal{G}$ are removed. Assume we have already obtained an estimation of $\mathcal{G}$ in the unconstrained T-SVAR model denoted by $\mathcal{G}^*$, and the squared error matrix of $\mathcal{G}^*$ is $\Sigma_\mathcal{G}^*$. Now the MD estimation of $\mathcal{G}$ in the constrained T-SAR model is given by minimizing the weighted distance between the constrained $\mathcal{G}$ and the estimated unconstrained $\mathcal{G}^*$:

$$\min \limits_{\mathcal{G}} (\mathcal{G} - \mathcal{G}^*)' \Sigma_\mathcal{G}^{-1} (\mathcal{G} - \mathcal{G}^*),$$

s.t. $\mathcal{R} \mathcal{A} \mathbf{1}_{NK} = \mathbf{0}_{N(K-1)}$.

\footnote{Since $\mathcal{G}^*$ is actually obtained through the ML estimation in this paper, $\Sigma_\mathcal{G}$ can be easily calculated via estimating Fisher’s information of $\mathcal{G}^*$.}
Note that although the constraint $\mathcal{RA}1_{NK}$ is not explicitly a function of $\mathcal{G}$, it can actually be rewritten as a linear combination of $\mathcal{G}$, which I show later in this section. Now the problem has been turned into the minimization of a quadratic form with linear constraints, which actually has a closed-form solution and is thus far less burdensome in computation than the constrained ML estimator. Moreover, it has been demonstrated by Property 9 in Gourieroux and Monfort (1989) that the MD estimator is asymptotically equivalent to the constrained ML estimator, which guarantees its efficiency.

In order to find the closed-form solution of the program in (20), we first need to rewrite the constraints $\mathcal{RA}1_{NK} = 0_{N(K-1)}$ as a linear combination of the parameter vector $\mathcal{G}$. Concerning this, I show the following proposition:

**Proposition 2.** Let $\text{vec}(G_n^\Lambda 1^1), n = 1, 2, \ldots, N$ be a $K^2$-dimensional vector whose $i$-th component is 1 if the $i$-th component of $\text{vec}(G_n)$ is not zero, and 0 otherwise, and

$$
\mathcal{H}^\Lambda 1 = \begin{pmatrix}
\text{vec}(G_1^\Lambda 1^1)'K_{K-1} \\
\text{vec}(G_2^\Lambda 1^1)'K_{K-1} \\
\vdots \\
\text{vec}(G_N^\Lambda 1^1)'K_{K-1}
\end{pmatrix},
$$

The constraint in the MD program (20) can be equivalently written as:

(21) $\mathcal{RA}1_{NK} = \mathcal{H}G = 0_{N(K-1)},$

where

$$
\mathcal{H} = (I_N \otimes (1^1_K \otimes \mathcal{R})') \odot \mathcal{H}^\Lambda 1.
$$

Now that the MD program becomes a classical minimization problem of quadratic forms with linear constraints, the MD estimator is given by its solution, as is described in the following proposition with $\mathcal{U} = 0_{N(K-1)}$:

**Proposition 3.** Suppose the estimation $\hat{\mathcal{G}}$ of a certain model is given by the following MD program:

$$
\min_{\mathcal{G}} \quad (\mathcal{G} - \mathcal{G}^*)'\Sigma_{\mathcal{G}}^{-1}(\mathcal{G} - \mathcal{G}^*),
\quad \text{s.t.} \quad \mathcal{H}G = \mathcal{U},
$$

where the $d \times N(K^2-K)$ matrix $\mathcal{H}$ contains the $d$ distinctive linear constraints imposed on the parameter vector $\mathcal{G}$, and $\mathcal{U}$ is the $d$-dimensional vector indicating the values of the linear constraints, then we have

(22) $\hat{\mathcal{G}} = \mathcal{G}^* - \Sigma_{\mathcal{G}}^*\mathcal{H}'(\mathcal{H}\Sigma_{\mathcal{G}}^*\mathcal{H}')^{-1}\mathcal{H}\mathcal{G}^* + \Sigma_{\mathcal{G}}^*\mathcal{H}'(\mathcal{H}\Sigma_{\mathcal{G}}^*\mathcal{H}')^{-1}\mathcal{U}. $
Particularly, equation (22) reduces to
\[ \hat{G}^{T}\text{-SAR} = G^* - \Sigma G^* \mathcal{H}'(H\Sigma G^* \mathcal{H}')^{-1}HG^*, \]
when the model is a T-SAR model without any additional restrictions and thus \( \mathcal{H} = \mathcal{H}, \mathcal{W} = 0_{N(K-1)}. \)

Since \( \hat{G}^{T}\text{-SAR} \) contains the estimation of all the unknown parameters of \( \{G_n\}_{n=1}^N \) in equation (19), the estimations of \( \{\rho_n\}_{n=1}^N \) and \( \{W_n\}_{n=1}^N \) can be easily obtained by standardizing the rows of \( \{\rho_n\}_{n=1}^N \) by their row sums: for all \( n = 1, 2, \ldots, N, \)
\[ \hat{\rho}_n = \frac{Y^T_n \hat{G}_n 1_K}{K}, \]
and
\[ \hat{W}_n = \hat{\rho}_n^{-1} \hat{G}_n, \]
where \( \hat{\rho}_n, \hat{W}_n, \) and \( \hat{G}_n \) are respectively the estimations of \( \rho_n, W_n, \) and \( G_n \) in regime \( n. \)

The estimation \( \hat{W}_n \) portrays how the variables or entities are interconnected in Regime \( n. \) Based on these results, we may carry out a class of hypothesis tests to draw clearer conclusions about the interconnections in different regimes.

**B. Hypothesis Tests**

In this section I present how to construct a broad class of hypothesis tests of additional restrictions in the T-SAR model.

Throughout this section I denote \( G_n = \rho_n W_n \) for \( n = 1, 2, \ldots, N, \) the elements in \( \{G_n\}_{n=1}^N \) are stacked in \( G, \) and the free parameters \( \hat{G} = SG \) satisfies the restrictions of a T-VAR model so that \( HG = 0_{N(K-1)}. \)

In this paper, I focus on a special class of null hypotheses. Let \( V \) be a given \( K \times K \) matrix with the same row sums and zeros on all all diagonal elements, and \( \Xi_1, \Xi_2, \ldots, \Xi_N \) be \( N \) given subsets of \( \mathbb{R}^1. \) Then a null hypothesis considered in this paper is always such a proposition: there exists at least one group of coefficients \( (\xi_1, \xi_2, \ldots, \xi_N)' \in \Xi_1 \times \Xi_2 \times \cdots \times \Xi_N \subseteq \mathbb{R}^N \) such that

(23)
\[ \sum_{n=1}^N \xi_n G_n = V. \]

Such propositions in fact cover a broad class of interesting hypotheses. For example, assume \( N = 2. \) If we let \( V = V^{\text{Exo}} \) be a given spatial matrix, \( \Xi_1 \) be \( \mathbb{R}^1, \) and \( \Xi_2 \) be \( \{0\}, \) then the hypothesis equals
\[ H^{\text{One-Regime}}_0 : W_1 = V^{\text{Exo}}. \]
if \( V = \Omega \), \( \Xi_1 = \mathbb{R}^1 \), and \( \Xi_2 = \{-1\} \), then the hypothesis equals

\[
H^\text{Equal}_0: \quad W_1 = W_2.
\]

And if we let \( V = V^{\text{Exo}} \), \( \Xi_1 = \Xi_2 = \mathbb{R}^1 \setminus \{0\} \), then under the null hypotheses, there exist \( \xi_1^{\text{Diff}} \) and \( \xi_2^{\text{Diff}} \) such that

\[
W_2 = -\frac{\xi_1^{\text{Diff}}}{\xi_2^{\text{Diff}}} \rho_1 \rho_2 W_1 + \frac{1}{\xi_2^{\text{Diff}}} C^W \equiv \xi_1^{\text{Diff}} W_1 + \xi_2^{\text{Diff}} V^{\text{Exo}},
\]

where \( \xi_1^{\text{Diff}} = -\xi_2^{\text{Diff}} \rho_1/\xi_2^{\text{Diff}} \), and \( \xi_2^{\text{Diff}} = 1/\xi_2^{\text{Diff}} \rho_2 \). This implies \( W_2 \) is a kind of “aggregation” of \( W_1 \) and \( C^W \). I denote this null hypothesis as \( H_0^{\text{Diff}} \).

I show this type of null hypotheses can be tested with likelihood ratio (LR) tests against a less restricted model. Since \( \{G_n\}_{n=1}^N \) are estimated through the MD approach, we have to first obtain the estimations with additional restrictions under the null hypotheses and then evaluate the likelihood of the estimations under the null hypotheses.

The main problem of the estimation of the restricted model under the null hypothesis is the nonlinearity of the additional restrictions. They appear to be linear but in fact are not, as some \( \xi_n \)-s are uncertain. This being said, we may still convert it to a linear problem. First rewrite the restrictions (23) in the vectorized form. Vectorizing both sides of equation (23), we get

\[
\xi_1 \text{vec}(W_1) + \xi_2 \text{vec}(W_2) + \cdots + \xi_N \text{vec}(W_N) = \text{vec}(V).
\]

Then let \( \xi = (\xi_1, \xi_2, \ldots, \xi_N)' \). Deleting all the fixed diagonal elements and applying multiplication rules of block matrices, we obtain

\[
(\xi' \otimes I_K) \mathcal{G} = V,
\]

where \( V = S \text{vec}(V) \) is the remaining components after deleting all the diagonal elements of \( V \) from \( \text{vec}(V) \).

However, we still cannot simply put the additional restrictions in equation (26) and the basic restrictions for a T-SAR model in equation (21) together and let the restriction matrix under the null hypothesis be the simple combination of the two groups of restrictions. This is because some restrictions in equations (26) and (21) are equivalent - in equation (21) we require the row sums of each \( G_n \), \( n = 1, 2, \ldots, N \) to be the same; and when the restrictions in equation (26) are satisfied, since \( V \) has the same row sums, as long as \( (N - 1) \) in the \( N \) \( G_n \)-s have the same row sums, the remaining one must have the same row sums as well. Formally, under the null hypothesis, if \( V \) and \( G_1, G_2, \ldots, G_{N-1} \) all have the same row sums so that \( \mathcal{R} V 1_K = \mathcal{R} G_1 1_K = \mathcal{R} G_2 1_K = \cdots = \mathcal{R} G_{N-1} 1_K = 0 \), we have

\[
\mathcal{R} G_N 1_K = \mathcal{R} (V - \xi_1 G_1 - \xi_2 G_2 - \cdots - \xi_{N-1} G_{N-1}) 1_K = 0.
\]
Therefore, we need to remove these redundant restrictions in order to estimate the restricted model under the null hypothesis. Actually, the final restrictions needed for the T-SAR model under the null hypothesis are constructed in the following way:

Without loss of generality, assume that $\Xi_N$ is not restricted to $\{0\}$. Denote 

$$\tilde{H}^{\land 1} = \begin{pmatrix}
\text{vec}(G_1^{\land 1})1_{K-1}' \\
\text{vec}(G_2^{\land 1})1_{K-1}' \\
\vdots \\
\text{vec}(G_{N-1}^{\land 1})1_{K-1}'
\end{pmatrix},$$

and

$$\tilde{H} = (I_{N-1} \otimes (1_K \otimes R))' \odot \tilde{H}^{\land 1},$$

then the final restrictions of the model under the null hypothesis (23) are

$$(27) \quad \mathcal{H}_\xi G = \mathcal{V},$$

where

$$\mathcal{H}_\xi = \begin{pmatrix}
\tilde{H} \\
\xi' \otimes I_K
\end{pmatrix},$$

and

$$\mathcal{V} = \begin{pmatrix} 0_{(N-1)(K-1)} \end{pmatrix}.$$ 

It should be stressed again that the restrictions in equation (27) are not linear, because $\xi$ are unknown parameters and $\mathcal{H}_\xi$ depends on $\xi$. But we can convert them to linear restrictions. If $\xi$ is known, then we get an estimation of $G$ by applying Proposition 3:

$$\hat{G}^{H_0}_\xi = G^* - \Sigma^*_G \mathcal{H}_\xi (\mathcal{H}_\xi \Sigma^*_G \mathcal{H}_\xi)'^{-1} \mathcal{H}_\xi G^* + \Sigma^*_G \mathcal{H}_\xi (\mathcal{H}_\xi \Sigma^*_G \mathcal{H}_\xi)'^{-1} \mathcal{V},$$

and $\hat{G}^{H_0}_\xi$ is a function of $\xi$. The final estimation, $\hat{G}^{H_0}$, can be obtained by searching for a minimum of the weighted distance between $\hat{G}^{H_0}_\xi$ and $G^*$, adjusting $\xi$ within the given space $\Xi_1 \times \Xi_2 \times \ldots \times \Xi_N$. Hence, the estimation of the T-VAR model under the null hypothesis (23) is given as:

$$\hat{G}^{H_0} = \arg \min_{\hat{G}^{H_0}_\xi, \xi \in \Xi_1 \times \Xi_2 \times \ldots \times \Xi_N} (\hat{G}^{H_0}_\xi - G^*)' \Sigma^*_G (\hat{G}^{H_0}_\xi - G^*).$$

Now that we have obtained $\hat{G}^{H_0}$, we try to test the restrictions against a less restricted model under the alternative hypothesis. Suppose the estimation of $G$ under the alternative hypothesis is $\hat{G}^{H_1}$. In this paper, I assume the model under the alternative hypothesis is also a T-SAR model with less or no additional restrictions in the form of equation (23). Therefore, $\hat{G}^{H_1}$ can be obtained and
evaluated in the same way as \( \hat{G}^{H_0} \), for which reason I only discuss \( \hat{G}^{H_0} \) in the following paragraphs.

As mentioned above, I test the null hypothesis with an LR test. In order to construct the LR statistic, we must first evaluate \( \hat{G}^{H_0} \) in the likelihood function. Recalling that the T-SAR model is nothing more than a constrained T-SVAR model, we can express the likelihood function with the same form as \( L^{T\text{-SVAR}} \) and the same parameter sets \( \Theta, \Gamma, \) and \( \Delta \). Thus, the likelihood function

\[
L^{H_0}(\hat{\Theta}^{H_0}, \hat{\Gamma}^{H_0}, \hat{\delta}^{H_0}; \hat{\epsilon}^{H_0}) = L^{T\text{-SVAR}}(\hat{\Theta}^{H_0}, \hat{\Gamma}^{H_0}, \hat{\delta}^{H_0}; \hat{\epsilon}^{H_0}),
\]

where \( L^{T\text{-SVAR}} \) has been given in equation (17), \( \hat{\Theta}^{H_0}, \hat{\Gamma}^{H_0}, \) and \( \hat{\delta}^{H_0} \) are the estimations of respective parameters under the null hypothesis. The problem is, \( \hat{G}^{H_0} \) is merely a part of \( \hat{\Theta}^{H_0} \), and the remaining parameters in \( \Theta \), together with \( \Gamma \) and \( \delta \), are not obtained through the MD estimation. I try to solve this problem by returning to the ML problem

\[
L^{H_0}(\Theta^{H_0}, \Gamma^{H_0}, \delta^{H_0}; \epsilon^{H_0}) = \max_{\Theta \setminus G, \Gamma, \delta} L^{H_0},
\]

where the set difference \( \Theta \setminus G \) contains the parameters in \( \Theta \) but not in \( G \).

Given the large number of unknown parameters in the maximization problem (28), it is still a rather computationally demanding task.

Fortunately, for three of the most widely used specifications of the reduced-form model, I show that this procedure may be significantly simplified by a generalized least square (GLS) estimator of the autoregressive coefficients. In the first specification, all the autoregressive coefficients of the reduced-form model in different regimes are free to vary. In the second specification, the autoregressive coefficients of the reduced-form model are assumed to be the same across different regimes. And the third specification is a mix of the previous two.

In order to apply the GLS estimator, first let us restore the T-SAR model (19) to the reduced-form

\[
Y_t = \sum_{n=1}^{N} \left( c^{(n)} + \sum_{i=1}^{p} A_i^{(n)} Y_{t-i} + A_X^{(n)} X_t \right) \tau_n(Q_t; \delta) + r_t,
\]

where the covariance matrix of \( r_t \) has been given by equation (14). For simplicity, in the following I denote \( \Sigma_{r,t|Q_t,\delta} \) as \( \Sigma_{r,t} \). Moreover, let \( C \) collect all the unknown autoregressive coefficients \( \{c^{(n)}, A_i^{(n)}, A_X^{(n)} : n = 1, 2, \ldots, N, i = 1, 2, \ldots, p\} \), and \( \vartheta \) collect all the rest unknown parameters in \( (\Theta \setminus G) \cup \Gamma \cup \delta \). We can see that \( \vartheta = \{\Lambda_{11}, \Lambda_{12}, \ldots, \Lambda_{1N}, \Lambda_{21}, \Lambda_{22}, \ldots, \Lambda_{2N}, \gamma_1, \gamma_2, \ldots, \gamma_N, \delta\} \).

With these preparations, let us discuss the following three specifications:

**Specification A.** In this specification, all the autoregressive coefficients of the reduced-form model in different regimes are free to vary. That is to say, for any \( n_1, n_2 = 1, 2, \ldots, N \) and \( i = 1, 2, \ldots, p \), we do not require \( c^{(n_1)} = c^{(n_2)} \),

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\[ A_i^{(n_1)} = A_i^{(n_2)}, \text{ or } A_X^{(n_1)} = A_X^{(n_2)}. \]

The reduced-form \([29]\) collapses to

\[ (30) \quad Y_t = \sum_{n=1}^{N} C_n \tilde{Z}_{nt} \tau_n(Q_t; \delta) + r_t, \]

where \( C_n = (c^{(n)}, A_i^{(n)}, A_2^{(n)}, \ldots, A_p^{(n)}, A_X^{(n)}) \) is a stack of autoregressive coefficients, and \( \tilde{Z}_t = (1, Y_{t-1}, Y_{t-2}, \ldots, Y_{t-p}, X_t)'. \) Further supposing \( C_{SpecA} = (C_1, C_2, \ldots, C_n), \) and

\[ Z_t^{SpecA} = \tau(Q_t) \otimes \tilde{Z}_t = \begin{pmatrix} \tau_1(Q_t; \delta) \tilde{Z}_t \\ \tau_2(Q_t; \delta) \tilde{Z}_t \\ \vdots \\ \tau_N(Q_t; \delta) \tilde{Z}_t \end{pmatrix}, \]

equation \([30]\) can be rewritten as

\[ Y_t = C^{SpecA} Z_t^{SpecA} + r_t. \]

Vectorizing both side, we get

\[ Y_t = (Z_t^{SpecA'} \otimes I_K) \text{vec}(C^{SpecA}) + r_t. \]

This is a typical multivariate regression model with time-varying error covariances.

Assuming that \( \vartheta \) is known, we can write the GLS estimator as

\[ \text{vec} \hat{C}_{\vartheta}^{SpecA} = (\hat{\Sigma}_Z^{SpecA})^{-1} \text{vec}(\hat{\Sigma}_Y^{SpecA}), \]

where

\[ \hat{\Sigma}_Z^{SpecA} = \frac{1}{T} \sum_{t=1}^{T} (Z_t^{SpecA} Z_t^{SpecA'} \otimes \Sigma_{r,t}^{-1}), \]

and

\[ \hat{\Sigma}_Y^{SpecA} = \frac{1}{T} \sum_{t=1}^{T} \Sigma_{r,t}^{-1} Y_t Z_t^{SpecA'}. \]

**Specification B.** In this specification, all the autoregressive coefficients of the reduced-form model are the same across different regimes. Therefore, for any \( n_1, n_2 = 1, 2, \ldots, N \) and \( i = 1, 2, \ldots, p \), we require \( c^{(n_1)} = c^{(n_2)} = c, A_i^{(n_1)} = A_i^{(n_2)} = A_i, \) and \( A_X^{(n_1)} = A_X^{(n_2)} = A_X. \) Then the threshold function can be removed.
from equation (29), yielding

\[(31) \quad Y_t = c + \sum_{i=1}^{p} A_i Y_{t-i} + A_X X_t + r_t.\]

Now, let \(C^{\text{SpecB}} = (c, A_1, A_2, \ldots, A_p, A_X)\), and \(Z^{\text{SpecB}} = (1, Y_{t-1}', Y_{t-2}', \ldots, Y_{t-p}', X_t')\), then the model (31) can also be written as

\[Y_t = (Z_t^{\text{SpecB}'} \otimes I_K) \text{vec}(C^{\text{SpecB}}) + r_t.\]

The GLS estimator follows similarly to specification A:

\[\text{vec} \hat{C}_\varrho^{\text{SpecB}} = (\hat{\Sigma}_Z^{\text{SpecB}})^{-1} \text{vec}(\hat{\Sigma}_Y^{\text{SpecB}}),\]

where

\[\hat{\Sigma}_Z^{\text{SpecB}} = \frac{1}{T} \sum_{t=1}^{T} (Z_t^{\text{SpecB}} Z_t^{\text{SpecB}'} \otimes \Sigma_{r,t}^{-1}),\]

and

\[\hat{\Sigma}_Y^{\text{SpecB}} = \frac{1}{T} \sum_{t=1}^{T} \Sigma_{r,t}^{-1} Y_t Z_t^{\text{SpecB}'}.

**Specification C.** It is also easy to specify the reduced-form model (29) as a mixture of specifications A and B. There are many possible specifications in this category; as an example, consider the following case:

Assume that the intercepts \(c^{(1)}, c^{(2)}, \ldots, c^{(n)}\) can freely vary in different regimes, whereas the other autoregressive coefficients are the same across different regimes. This is a typical varying-incept threshold model that is often seen in literature. Let \(A_i^{(n_1)} = A_i^{(n_2)} = A_i\), and \(A_X^{(n_1)} = A_X^{(n_2)} = A_X\). Similar with specifications A and B, let \(C^{\text{SpecC}} = (c^{(1)}, c^{(2)}, \ldots, c^{(N)}, A_1, A_2, \ldots, A_p, A_X)\), and \(Z^{\text{SpecC}} = (\tau_1(Q_t; \delta), \tau_2(Q_t; \delta), \ldots, \tau_N(Q_t; \delta), Y_{t-1}', Y_{t-2}', \ldots, Y_{t-p}', X_t')\), then we can rewrite the model of this specification in the vectorized form again:

\[Y_t = (Z_t^{\text{SpecC}'} \otimes I_K) \text{vec}(C^{\text{SpecC}}) + r_t.\]

The GLS estimator goes as always:

\[\text{vec} \hat{C}_\varrho^{\text{SpecC}} = (\hat{\Sigma}_Z^{\text{SpecC}})^{-1} \text{vec}(\hat{\Sigma}_Y^{\text{SpecC}}),\]

where

\[\hat{\Sigma}_Z^{\text{SpecC}} = \frac{1}{T} \sum_{t=1}^{T} (Z_t^{\text{SpecC}} Z_t^{\text{SpecC}'} \otimes \Sigma_{r,t}^{-1}),\]
and
\[ \hat{\Sigma}_Y^{SpecC} = \frac{1}{T} \sum_{t=1}^{T} \Sigma_{t}^{-1} Y_t Z_t^{SpecC}. \]

Besides the three specifications discussed above, it is always possible to specify the reduced-form model \([29]\), but then we have to construct the GLS estimators for them ad hoc.

No matter what specification we use, we have now obtained the GLS estimation of \(\text{vec}(C)\), which is a function of unknown parameters \(\vartheta\). Patilea and Raïssi \([2012]\) have proven that these GLS estimators are asymptotically consistent. Recalling that \(\text{vec}(C)\) is in fact a vector composed of the autoregressive coefficients \(C\), I denote it as \(\hat{C}_{\vartheta}\). It follows that
\[
L_{H0}(\hat{\Theta}_{H0}, \hat{\Gamma}_{H0}, \hat{\delta}_{H0}; \hat{\epsilon}_{H0}) = L_{H0}(\hat{G}_{H0}, \hat{C}_{\vartheta}, \hat{\vartheta}) = \max_{\vartheta}(\hat{G}_{H0}, \hat{C}_{\vartheta}, \vartheta).
\]

As long as we obtain \(L_{H0}(\hat{\Theta}_{H0}, \hat{\Gamma}_{H0}, \hat{\delta}_{H0}; \hat{\epsilon}_{H0})\) and \(L_{H1}(\hat{\Theta}_{H1}, \hat{\Gamma}_{H1}, \hat{\delta}_{H1}; \hat{\epsilon}_{H1})\), the LR statistic is given by
\[
\text{LR} = 2(L_{H1}(\hat{\Theta}_{H1}, \hat{\Gamma}_{H1}, \hat{\delta}_{H1}; \hat{\epsilon}_{H1}) - L_{H0}(\hat{\Theta}_{H0}, \hat{\Gamma}_{H0}, \hat{\delta}_{H0}; \hat{\epsilon}_{H0})).
\]

LR can be compared with a \(\chi^2\) distribution. The degree of freedom of the \(\chi^2\) distribution can be calculated by comparing the numbers of restrictions of the null and alternative hypotheses. Taking the T-SAR model without any additional restrictions as the benchmark, the model under the null or alternative hypothesis with restrictions in equation \([27]\) has at most \(K^2 - (K - 1)\) more restrictions on \(\mathcal{G}\) than the benchmark. But there are also a certain number of free parameters \(\xi_1, \xi_2, \ldots, \xi_N\), and they must be subtracted from the total number of additional restrictions. For example, under \(H_0^{\text{Equal}}\), since \(\xi\) is a free parameter, there should be \(K^2 - (K - 1) - 1\) more restrictions on \(\mathcal{G}\) than the benchmark. Following steps of the test do not generate more restrictions; therefore the final number of additional restrictions under a hypothesis in the form of equation \([23]\) is \(K^2 - (K - 1)\) minus the number of free parameters in \(\xi_1, \xi_2, \ldots, \xi_N\). The degree of freedom of the \(\chi^2\) distribution follows.

V. Network Analyses

While the connectedness among economic entities can be described by the spatial weight matrices in the T-SAR model, there are ways to analyze the connectedness further. The large amount of literature on networks has proposed many methods to analyze the connectedness in details. In this paper, I follow Scidà \([2016]\) and build networks from the spatial weight matrices estimated in Section 27.
This completes the final part of the tripod model.

Similar to Scida (2016), I take the transposes of the spatial weight matrices \( W'_1, W'_2, \ldots, W'_N \) as the network adjacency matrices \( A_1, A_2, \ldots, A_N \). That is to say, for each regime \( n = 1, 2, \ldots, N \), I assume there is a network defined by the adjacency matrix \( A_n = W'_n \). The transpose in fact arises from the different conventions in different strands of literature: in spatial econometrics, the element \( w_{n,ij} \) on the \( i \)-th row and \( j \)-th column of the spatial weight matrix \( W_n \) usually denotes the influence of the \( j \)-th variable on the \( i \)-th variable, whereas in network studies, the element \( a_{n,ij} \) on the \( i \)-th row and \( j \)-th column of the adjacency matrix \( A_n = (a_{n,ij})_{K \times K} \) usually denotes the influence of the \( i \)-th variable on the \( j \)-th variable. The diagonal elements of \( A_n \) are set to zeros, which means that there is no “loop”, which connects a node to itself.

Adjacency matrices defined in this way have several significant features. First, they are usually asymmetric, which results in directed networks. Second, they are weighted networks, where the strength of each edge usually does not equal to one. Third, they are usually complete, which means usually every pair of nodes is somehow connected. Fourth, they often have negatively weighted edges. On the contrary, networks studied in traditional network studies typically lack these features. A large number of methods are devised for analyzing networks that are undirected, non-weighted, incomplete, and do not have negative edges. Certainly, there are also many ways to analyze networks with some of these features, but it is indeed not easy to find some method to analyze a network with all four features. In this paper, I show that it is still possible to apply several analyses to these highly featured networks built from spatial weight matrices.

First, there are centrality measures. Centrality measures are the most popular measure to assess nodes in a network. Generally speaking, they measure how well a node is connected to others. For example, the simplest centrality measure is the degree centrality, which counts the number of neighbors of each node. This measure obviously does not work for our complete network as all nodes in a complete network have the same number of neighbors. Scida (2016) also propose to use three other types of popular centrality measures, namely closeness centrality, betweenness centrality, and Bonacich power centrality. Among them the closeness centrality and the betweenness centrality do not work for our networks with negative edges, because they evaluate the shortest path between each pair of nodes, and the common definition of “shortest path” fails when there are negative edges, through which the length of the path decreases. And finally, the Bonacich power centrality works only for networks where all edges are simultaneously positive or simultaneously negative.

In this paper, I propose to use two centrality measures that can handle complete networks with both positive and negative edges. The first is the simplest and most intuitive measure by generalizing the degree centrality to weighted networks.

\[ A \] network is composed of “nodes” and “edges”. Nodes are the entities involved in the network, and edges are the connections between the nodes.
Since the networks we consider are also directed networks, we have both the “in-degrees” and the “out-degrees”, which respectively measure how much influence a node receives from other nodes, and how much influence a node exerts on other nodes. Formally, for node \( k \) in network \( n \) we have the in-degree

\[
\mathcal{c}_{nk}^{\text{d,in}} = \frac{\sum_{i=1}^{K} a_{n,ik}}{K - 1},
\]

and the out-degree

\[
\mathcal{c}_{nk}^{\text{d,out}} = \frac{\sum_{i=1}^{K} a_{n,ki}}{K - 1}.
\]

However, while the generalized degree centrality can measure how well a node is connected to its neighbors, it neglects the “quality” of the neighbors. If we believe that a node should also have high centrality when all its neighbors are well connected to other nodes, then we need a centrality measure that evaluates not only how well a node is connected, but also how well its neighbors are connected. This is exactly why the Bonacich centrality measure, Hubbell centrality measure, etc., are devised.\(^{17}\) However, since none of these measures can handle networks with both positive and negative edges, following Bonacich and Lloyd (2004), Everett and Borgatti (2014) devises the PN centrality measure. The PN centrality is basically a generalized version of the Hubbell measures that considers the positive and negative edges separately and then sums both sides together. Formally, for network \( n \), we have the in-PN measure

\[
\mathcal{c}_{n}^{\text{PN,in}} = \left( I_K - \frac{1}{4(K-1)^2} \mathcal{A}_n \mathcal{A}_n' \right)^{-1} \left( I_K + \frac{1}{2(n-1)} \mathcal{A}_n \right) 1_K,
\]

and the out-PN measure

\[
\mathcal{c}_{n}^{\text{PN,out}} = \left( I_K - \frac{1}{4(K-1)^2} \mathcal{A}_n' \mathcal{A}_n \right)^{-1} \left( I_K + \frac{1}{2(n-1)} \mathcal{A}_n' \right) 1_K,
\]

where both \( \mathcal{c}_{n}^{\text{PN,in}} \) and \( \mathcal{c}_{n}^{\text{PN,out}} \) are \( K \)-dimensional vectors containing the PN centralities for all the nodes \( 1, 2, \ldots, K \).

Furthermore, because the adjacency matrix \( \mathcal{A}_n \), \( n = 1, 2, \ldots, N \) is always column-standardized, we will always get the same in-degree and in-PN centralities for all the nodes. Therefore, in this paper, we only consider the out-degree and out-PN centrality measures.

Besides centrality measures, the clustering analysis can also reveal some important aspects of a network. Different from the centralities, clustering is both a local analysis of the position of each node in the network and a global analysis of the overall connectedness of the entire network. For each node \( i = 1, 2, \ldots, K \),

\(^{17}\) See Everett and Borgatti (2014), for a review of these measures.
we have a clustering coefficient for the node. While the centrality measures how well the node is connected to other nodes, the clustering coefficient of the node measures how well its neighbors are mutually connected. If the neighbors of a node are closely connected, then the node has a larger clustering coefficient, and vice versa. Moreover, if we take the mean of the clustering coefficients of all the nodes, we get the average clustering coefficient for the whole network, which is a good measure of the overall connectedness of the whole network.

However, traditional definitions of clustering coefficients fail for a complete network. Since all the nodes in a complete network are connected, the clustering coefficients of all the nodes will reach their maximum value, one. Therefore, the clustering coefficients for a complete network must be constructed in a different way.

In this paper, I use the clustering coefficient recently constructed by McAssey and Bijma (2015), which takes the edge weights into consideration and therefore works well for complete networks. Formally, for \( k = 1, 2, \ldots, K \) and \( n = 1, 2, \ldots, N \), the clustering coefficient of node \( i \) in network \( n \) is given as

\[
C_{nk} = \frac{(A_n + A'_n)^3_{kk}}{2((A_n + A'_n)(1_K 1'_K - I_K)(A_n + A'_n))_{kk}},
\]

where the subscript \( kk \) denotes the \( k \)-th diagonal element of the matrix. Further, the average clustering coefficient for the whole network is

\[
\bar{C} = \frac{\sum_{k=1}^{K} C_k}{K}.
\]

And finally, Scidà (2016) suggests that the estimations of the scaling parameters in the T-SAR model, \( \hat{\rho}_n \), \( n = 1, 2, \ldots, N \) are themselves natural indicators of the intensity of the interactions among the variables in regime \( n \). This is another global measure of the overall connectedness among the variables.

With these network analytical techniques, the SVAR-spatial-network “tripod” model is completed. In the following section, I show how to apply this model to study contagion during recent Eurozone crises.

VI. An Application: Financial Contagion in the Eurozone

A. Introduction

In this section, I present an application of my model, which is on contagion among the stock markets in the Eurozone.\(^{18}\)

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\(^{18}\)The application is mostly coded in R, together with a little C. I thank the authors of R and the R packages listed below: actuar, combinat, doParallel, fields, foreach, ggnetwork, ggplot2, lubridate, Matrix, matrixcalc, mixtools, mnormt, network, nloptr, plyr, profvis, reshape2, turboEM, and vars.
The Eurozone markets have been in turmoil for nearly a decade. At first, they were influenced considerably by the 2008 Financial Crisis; and not after long, the European countries found that they were in trouble again due to debt problems in a handful of countries such as Ireland and Greece. During this period, the contagion among international asset markets received much attention from both the academia and the public.

However, there is no consensus on the definition of contagion. I identify three categories of definitions. First, recent literature tend to define contagion as the intensification of shock transmissions among markets during turbulent periods. Especially, many studies model the contagion under this definition empirically by examining the structural breaks of bivariate correlations of assets, including Forbes and Rigobon (2002), Caporale et al. (2005), Chiang et al. (2007), and Caporin et al. (2013). Second, some authors anchor the definition of contagion on economic fundamentals, and define contagion as a shock transmission in excess of what can be explained by fundamentals. Dungey and Martin (2007) is an example of this category of literature. Third, some earlier literature, e.g. Edwards (1998), does not strictly differentiate contagion and spillovers. They do not assume that the shocks are transmitted in a different way during crisis periods. This is a very broad definition and rarely used in recent literature.

In this paper, I basically follow the first definition of contagion. I define contagion as the increase of connectedness among markets in the turbulent periods. However, my methodology is distinguished from most existing literature in this category, as I do not consider the statistical correlations among the markets; rather, I focus on the connectedness inferred from the contemporaneous impulse-response relationships with the threshold tripod model. My measure has several clear features. First, my model is based on contemporaneous impulse-response relationships, which show a clear causal map of the propagation of shocks. It is widely known that correlation is different from causality; so when we observe a correlation between two markets, we cannot know what causes the correlation. But in my model, it is easy to observe how the markets are connected by mutual shocks and responses. Related to this, while correlation analyses suffer from problems due to heteroskedasticity and must be corrected (see Forbes and Rigobon 2001), my model accommodates the heteroskedasticity easily. Second, network analysis techniques can efficiently summarize the interrelationship among the markets as well as the unique roles played by each market in both tranquil and turbulent periods. Moreover, it is easy to see how the market interrelationship changes in different periods from a network angle, which provides us with clues for the channels of contagion. Third, my model allows the data to decide the crisis and non-crisis states of the market interrelationship. I also use a smooth threshold function, which does not draw a clear-cut separation between crisis and

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19In fact, the correlation can be a measure of connectedness as well. For example, the weighted gene co-expression network analysis (WGCNA), which has been widely applied in bioinformatics, builds networks on correlations. It might be interesting to investigate market correlations from the network angle, too.
non-crisis periods. Therefore, I do not need to define the beginnings and ends of crises manually, thus making my measure of contagion more flexible and less arbitrary.

Following Kohonen (2013), I select five representative countries to study the contagion in Eurozone stock markets, namely Greece (GR), Germany (DE), Italy (IT), Spain (ES), and Ireland (IE). And I let the data determine the contagion and non-contagion regimes according to the iTraxx Europe, a European credit default swap (CDS) index.\footnote{Higher iTraxx suggests higher CDS spreads for European financial assets, and therefore higher default risk in European markets.} With the threshold tripod model, I confirm the existence of contagion among the stock markets in these countries in recent years, and reject the hypothesis that the contagion is solely conducted by the cross-border interbank channel. Further analyses reveal the distinctive roles played by the five countries in both the contagion and the non-contagion regimes clearly.

**B. Data and Model Setup**

I study stock market logarithm returns in the five representative countries. The market indices are respectively the Athex Composite, the DAX 30, the FTSE MIB, the IBEX 35, and the Ireland SE Overall, all of which are obtained from Datastream. The observation period ranges from January 2nd, 2006 to May 26th, 2016, therefore there are 2,714 observations in total. For computational reasons, I multiply all the log returns by 100.

Figure B1 shows the trends of the data in the observed years. Note that all the data have been rescaled by their initial values. It is easy to notice that these markets are to a large extent interrelated. Especially, all the countries saw a large simultaneous downturn during the 2008 crisis, and a relatively less significant one during the recent European debt crisis. Moreover, the German market and the Greek market show extremely different trends, which hint the different roles played by the two countries.

[Insert Figure B1 here.]

I assume there are two different regimes, and the regime with generally higher market connectedness is called “Regime 2”, and the other “Regime 1.” Contagion can be thus viewed as the difference of the market connectedness between the two regimes. I then choose the iTraxx Europe index as the threshold variable, which is retrieved from Datastream. It measures the overall default risk in Europe. In fact, default risk is the most common crisis indicator used in contagion literature, e.g., Kalbaska and Gątkowski (2012), Manasse and Zavalloni (2013), among others. It is also used by De Bruyckere et al. (2013) in their study of the Eurozone contagion. Their historical trends are plotted in Figure B2. For the threshold function, I use the multivariate logistic function described in equation (10)

\[
\tau_{1}^{\text{Logi}}(\text{iTraxx}_t; \beta) = \frac{1}{1 + e^{-\beta_0 - \beta_1 \text{iTraxx}_t}},
\]
and

\[ \tau_2^{\text{Logi}}(\text{iTraxx}_t; \beta) = 1 - \tau_2(\text{iTraxx}_t; \beta), \]

which allows the system to transition between each other smoothly. The location and speed of the transition are decided by the coefficients of the multivariate logistic function \( \beta_0 \) and \( \beta_1 \). Keeping other parameters constant, the larger the absolute value of \( \beta_1 \) is, the faster the system switches between the regimes.

[Insert Figure B2 here.]

All the autoregressive coefficients in the reduced-form VAR are assumed to be constant. This means the relationship between different markets are the same across different regimes barring the different instantaneous effects in the same day when shocks take place. This assumption can be supported by the so-called “non-crisis-contingent”\(^{21}\) category of contagion theories in Forbes and Rigobon (2001), who argue that “any large cross-market correlations after a shock are a continuation of linkages that existed before the crisis,” such as trade. In fact, in this application part I test whether the Eurozone contagion relies on cross-border interbank market linkages. The lag order is set to one to rule out potential autocorrelation effects.

It should be noted that I do not include any factor that predicts the returns in this application. The tripod model framework definitely allows me to do so, as I always allow exogenous variables in the model description in previous sections.

C. The Local Identification

I first estimate the two-regime T-SVAR model of market log returns with constant reduced-form autoregressive coefficients, a multivariate logistic threshold function, and one lag. Without any additional information, I can achieve the local identifications. But due to the “label-switching” problem, these local identifications of \( \Omega_1 \) and \( \Omega_2 \) do not make economic sense at this moment, because we can always arbitrarily permute the columns of the local estimations of them.\(^{22}\) Nevertheless, since we do not need the global identification to obtain the estimations of the parameters in the threshold functions and the mixture weights, we can still know now that the estimations of the mixture weights under Regimes 1 and 2 are respectively \( \hat{\gamma}_1 = 0.310 \) and \( \hat{\gamma}_1 = 0.118 \), and the estimations of the threshold function parameters in equation (32) are respectively \( \hat{\beta}_0 = 2.703 \), and \( \hat{\beta}_1 = -0.037 \), where the variable with hats are the estimations of respective parameters without hats. We can see that the coefficient for iTraxx, \( \beta_1 \) is negative. This implies that an increase in iTraxx will lead to a higher probability for the system to be in Regime 2, where the markets have closer interconnections as I show in the following sections. The trend of the threshold function can be viewed more clearly in Figure B3. This figure reveals two major clusters of high-interconnection

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\(^{21}\)This is the name given by Forbes and Rigobon (2001) to a class of economic theories. There is no relationship between this name and the title of this paper at all, as they refer to different things.

\(^{22}\)For the meaning of the parameters, see Section III.C.
periods: the 2008 crisis, the following Eurozone crisis. Interestingly, during the period starting from late 2015, there is likely to be a recurrence of the Eurozone crisis, though not as significant as the previous two crises.

[Insert Figure B3 here.]

D. From Local Identification to Global Identification

Now that we have obtained local identification, we may proceed to the global identification of the T-SVAR model.

Based on the theoretical model of King and Wadhwani (1990), Kohonen (2013) suggests to use the magnitude of news in each market, which is extracted from Google Trends Indices (GTIs), as the proxy variable to attain the correct permutation of the columns of covariance matrix decompositions $\hat{\Omega}_1$ and $\hat{\Omega}_2$. The idea is simple: the GTI of a certain term indicates the relative volumes of weekly queries of the term on Google. Therefore, a more volatile GTI of a market-related term will imply stronger news in this period, and stronger news will lead to stronger innovations in asset returns, as are described by the diagonal elements of $\Sigma^{(1)}_e = \gamma_1 \Lambda_{11} + (1 - \gamma_1) \Lambda_{21}$ and $\Sigma^{(2)}_e = \gamma_1 \Lambda_{12} + (1 - \gamma_1) \Lambda_{22}$. Once the correct $\hat{\Lambda}_{11}$, $\hat{\Lambda}_{21}$, $\hat{\Lambda}_{12}$ and $\hat{\Lambda}_{22}$ are pinned down, the column permutations of $\hat{\Omega}_1$ and $\hat{\Omega}_2$ must follow, and vice versa. In fact, Google Trends has already been widely employed to proxy news magnitude and predict asset volatilities (e.g. Vlastakis and Markellos, 2012, Dimpfl and Jank, 2016). In this paper, the global identification is achieved with the help of GTI, too. The search terms are also the same as Kohonen (2013), which can be found in Table B1. The trends of the GTIs for these search terms can be found in Figure B4. Obviously, this plot shows the all the markets in this study receive extreme attention during the Eurozone crisis period.

[Insert Figure B4 here.]

In order to apply the Google Trends data to the T-SVAR model, we have to first extract the information on news magnitude from the raw data series, and then use it to pin down the correct permutations of the columns of $\hat{\Omega}_1$ and $\hat{\Omega}_2$.

Considering that the increases of GTI are likely to be caused by news, whereas the decreases of GTI are usually results of no news, I define the news magnitude for a market as the mean of the positive logarithm changes of respective GTI. Moreover, as I consider two different regimes in my model, the news magnitude under each regime is actually measured by the weighted mean of the positive logarithm changes of GTI, where the weights are the probability for the system to be in respective regime at each time. Specifically, the news magnitude for

See equation (14).
market $i$ in Regime $n$ is given by

$$\text{NewsMagnitude}_{in} = \frac{\sum_{t=1}^{T} \tau_n \log(i\text{Traxx}_t; \hat{\beta}) \max\{\Delta \ln \text{GTI}_{it}, 0\}}{\sum_{t=1}^{T} \tau_n \log(i\text{Traxx}_t; \hat{\beta})}.$$ 

Since the GTI data are at a weekly frequency, there is a possibility that some news may have long-tail influence in the following week. Therefore I also try to replace $\Delta \ln \text{GTI}_{it}$ with the residuals of the AR(1) processes formed by them, and the results turn out to be the same. I report the results in Table B2.

Now that we have the orders of the news magnitude for each market in under the two regimes, we need to find correct permutations of the columns of $\hat{\Omega}_1$ and $\hat{\Omega}_2$ such that the diagonal elements of $\hat{\Sigma}_\varepsilon^{(1)}$ and $\hat{\Sigma}_\varepsilon^{(2)}$ are in the same order as the news magnitude orders in Table B2. Since there are $5! = 120$ possible column permutations either for $\hat{\Omega}_1$ or $\hat{\Omega}_2$, what we need to do now is to calculate the corresponding $\hat{\Sigma}_\varepsilon^{(1)}$ and $\hat{\Sigma}_\varepsilon^{(2)}$ of all the 120 possible permutations. After that, we can pick out the permutations which correspond to $\hat{\Sigma}_\varepsilon^{(1)}$ and $\hat{\Sigma}_\varepsilon^{(2)}$ with correct ordering of diagonal elements. Luckily, in this example, for both Regimes 1 and 2, there are unique correct permutations of $\hat{\Omega}_1$ and $\hat{\Omega}_2$. The unique global identification of the T-SVAR model is thus achieved.

Once we achieve the global identification, we can calculate the estimations of $\Upsilon_1$ and $\Upsilon_2$ in equation (15), which immediately gives us the instantaneous response of each variable to unit-sized structural shocks. The estimation results are reported in Table B3. The upper half of the table corresponds to $\hat{\Upsilon}_1$ and the lower half to $\hat{\Upsilon}_2$. For each half, the element in $i$-th row and $j$-th column indicates the instantaneous response of the $i$-th market to the unit-sized structural shock originating from Market $j$. For example, the element in the 1st row and 2nd column in the upper half of the table is -0.319, then it means in Regime 1, when a unit-sized structural shock takes place in the German market, the Greek instantly has a response that has a size of -0.319. The off-diagonal elements actually capture the cross-market spillover effects under each regime. It is interesting to note that for both regimes the response of the Greek market to positive German news and the response of Irish market to Spanish news is negative. This may reflect the roles played by the two countries in the observation periods as the likely places where contagion can originate.

Now that we have obtained the estimations of the T-SVAR model, we can proceed to the T-SAR model implied by the T-SVAR by applying Propositions 2 and 3. The MD estimations of $W_1$ and $W_2$, the spatial weight matrix under Regimes 1 and 2 can be found in Table B4.

E. The Spatial Model

Now that we have obtained the estimations of the T-SVAR model, we can proceed to the T-SAR model implied by the T-SVAR by applying Propositions 2 and 3. The MD estimations of $W_1$ and $W_2$, the spatial weight matrix under Regimes 1 and 2 can be found in Table B4.
It is much easier to interpret the spatial weights than $\Upsilon_1$ and $\Upsilon_2$. Notice that the rows in $W_1$ and $W_2$ indicate how strong the influences from other countries can affect a certain country, and the columns indicate how strong the influences from the corresponding country to other countries. Now compare $\hat{W}_1$ and $\hat{W}_2$ in Table B4 column by column, and it is not difficult to find some interesting facts.

First, in Regime 1 the Greek market has quite small influences on every other market, as none of the weights of Greece to other markets exceeds 0.1. However, in Regime 2, the influences of the Greek market surge to more than 0.2. This finding confirms the common impression that Greece plays a very important role in exporting contagion during the recent crises. At the same time, many would also have the impression that Germany is the main supporter of the countries in crises, and this is confirmed by the second column in $\hat{W}_2$, too, as the weights of Germany to all other markets except Italy are quite large. Especially, it is Ireland, rather than Greece, receives the largest influence from Germany, and the weight 0.71 is surprisingly high, which hints a very close Germany-Ireland financial bond. However, the significant role played by Germany seems to only exist in Regime 2, and in Regime 1, German influences are much smaller. In other words, Germany is more like the firefighter for the Eurozone who only appears when there is fire. As are shown by the third and fourth column, the influences of the Italian and the Spanish markets generally decay from Regime 1 to Regime 2, which reflects that the crises in both countries are relatively weaker. Under Regime 2, although the closeness from Ireland to Greece and Italy increases, the closeness from Ireland to both Germany and Spain decreases, and in general, the role of the Irish market does not seem to change too much across different regimes. A panoramic portrayal of the interconnections among the five countries revealed by the spatial weigh matrices is displayed in Figure B5. We can easily perceive from this figure that the lines in the right sub-plot representing Regime 2 are darker than the left sub-plot, which indicates generally closer connections among variables in Regime 2.

I then try to test whether the interconnections among the markets are statistically different in different regimes. The null hypothesis is thus set as

$$H_0^{Equal} : W_1 = W_2,$$

versus the alternative hypothesis $H_1$: the T-SAR model without any additional restriction on $W_1$ and $W_2$. This hypothesis is exactly the example shown in equation (24) in Section IV.B. Since the reduced-form autoregressive coefficients are assumed to be constant across regimes in this application, we can use the results of specification B in Section IV.B. For the test of this null hypothesis, we have $LR = 3.133 \times 10^5$. Compared with a $\chi$-square distribution with 20 degrees of freedom, the null hypothesis $H_0^{Equal}$ is rejected with the $p$-value less than $1 \times 10^{-3}$. 
Next, I present a test for a more informative null hypothesis: the contagion, defined as the difference between the connectedness of the markets under Regimes 1 and 2, is spread through the cross-border interbank market network. If we regard Regime 1 as the regime without contagion, and Regime 2 as the regime with contagion, then this hypothesis can be tested with the T-SAR model. Specifically, in Regime 1, shocks are spread through the network described by $W_1$, therefore $W_1$ represents natural non-contagion-contingent interconnections among the markets even when there is no contagion. Under Regime 2, the non-contagion-contingent interconnections represented by $W_1$ are still there. However, now there is the contagion. Besides the existing interconnections $W_1$, shocks can now be spread through a new contagion-contingent network, which is denoted as $V_{\text{Interbank}}$. As a result of the co-existence of the non-contagion-contingent network $W_1$ and the contagion-contingent network $V_{\text{Interbank}}$ in Regime 2, interconnections among the markets now become $W_2$. Therefore, if we assume the contagion is spread through network $V$, then we should be able to express $W_2$ as a linear combination of $W_1$ and $V_{\text{Interbank}}$. Formally, we can write the null hypothesis as \( H_{\text{Diff}}^0 \): there exists at least one $\zeta_{\text{Diff}}^1 \in \mathbb{R}^1$ and one $\zeta_{\text{Diff}}^2 \in \mathbb{R}^1$ such that 

$$W_2 = \zeta_{\text{Diff}}^1 W_1 + \zeta_{\text{Diff}}^2 V_{\text{Interbank}}.$$  

We can see that this null hypothesis is also exactly the example shown in equation (25) in Section IV.B. As long as $V_{\text{Interbank}}$ is given, this null hypothesis can be tested against $H_1$: there is not any additional restriction on $W_1$ and $W_2$ in the T-SAR model.

In this paper, I construct $V_{\text{Interbank}}$ from the cross-border interbank claim data reported by Bank for International Settlements in the same way as Tonzer (2015). Suppose the element in the $i$-th row and $j$-th column of $V_{\text{Interbank}}$ is $v_{ij}^{\text{Interbank}}$. Then

$$v_{ij}^{\text{Interbank}} = \frac{\sum_{t=1}^{T} \text{ForeignClaim}_{ijt}}{\sum_{t=1}^{T} \sum_{j \neq i} \text{ForeignClaim}_{ijt}},$$

where $\text{ForeignClaim}_{ijt}$ is the interbank positions of country $i$’s banking system towards banks in country $j$ at time $t$. The actual value of $V_{\text{Interbank}}$ is reported in Table B5. Not unexpectedly, all the countries have large claim proportions in Germany and small claim proportions in Greece.

Now, with the help of results of Specification B in Section IV.B we obtain the LR statistic for the test of $H_{\text{Diff}}^0$. LR $= 2.979 \times 10^6$. Compared with a $\chi^2$-square distribution with 21 degrees of freedom, the null hypothesis $H_{\text{Equal}}^0$ is rejected with the $p$-value less than $1 \times 10^{-3}$. Note that even after the adjustment due to the difference in degrees of freedom between $H_{\text{Equal}}^0$ and $H_{\text{Diff}}^0$, the LR statistic for $H_{\text{Diff}}^0$ is still far larger than $H_{\text{Equal}}^0$. This implies that it is even farther from the
fact to assume the contagion is *purely* spread through the cross-border interbank network than to assume there is no contagion at all.

However, it should be noticed that by this test I *do not* argue that the Eurozone contagion is not spread through the cross-border interbank network. I only argue that $V_{\text{Interbank}}$ cannot *solely* explain the channel of the Eurozone contagion. A better portrayal of the contagion channels may be obtained by compounding $V_{\text{Interbank}}$ with some other networks.

**F. Network Analyses**

In this part I present the results of the network analyses. All the measures mentioned in this section are out-measures.

Centrality measures are shown in Table B6. This table can be regarded as a formal summary of the analyses of the spatial weight matrices in the previous section. Those findings are all reconfirmed here. First, the centrality of Greece grows tremendously from Regime 1 to 2, and the centrality of Germany also sees a large increase. These are consistent with the impression about the important roles played by Greece and Germany in the recent Eurozone crisis. The centralities of Italy and Spain drop significantly from Regime 1 to 2, and Ireland maintains highly central in the network in both regimes. All these findings are in full accordance with the analyses of spatial weight matrices in Section VI.E. Additionally, in Regime 2, the two most central countries are Greece and Ireland. We can say Greece and Ireland are the two most important origins of contagion among the selected five countries. These finding hold no matter whether we use the simple degree centrality measure or the PN centrality measure, which does not only measure how much influence a country has on its neighbors, but also how much influence the country’s neighbors have on neighbors’ neighbors.

[Insert Table B6 here.]

Then I present the results of clustering analyses in Table B7. First look at the average clustering coefficients of the whole network. The result here is not surprising at all. Since average clustering coefficients measure the overall connectedness of the entire network, it is no wonder that the markets in the five countries become more interconnected in Regime 2, which is associated with crises. However, when we look at the clustering coefficients of each individual country, we will notice more interesting facts that cannot be revealed by centrality analyses. In Regime 1, the country with the highest clustering coefficient is Greece. Recall that a clustering coefficient indicates how the neighbors of a node are interconnected, the high clustering coefficient of Greece actually suggests that it plays a rather peripheral role in Regime 1 as other countries are closely interconnected even without Greece. In contrast, Italy has the smallest clustering coefficient in Regime 1, which may be a result of its strong centrality under the regime. However, when the system enters Regime 2, the clustering coefficients of these countries change drastically. Italy has become the most peripheral country with the highest clustering coefficient; and now it is Germany that has the smallest
clustering coefficient and contributes the most in conglutinating other countries together. Moreover, although the centrality of Ireland increases from Regime 1 to 2, its clustering coefficient increases, too. This hints that the importance of Ireland may not necessarily increase from Regime 1 to 2.

Insert Table B7 here.

And finally, the estimations of $\rho_1$ and $\rho_2$ measure the interconnection intensity among the markets as well. For Regime 1, the estimation $\hat{\rho}_1 = 0.876$, and for Regime 2, $\hat{\rho}_1 = 1.044$. For another time, we find the markets in Regime 2 are more closely interconnected than in Regime 1.

VII. Conclusions

A broad class of economic and financial models involves the investigation of connectedness of economic variables or entities. Historically, different strands of literature, such as vector auto-regressions, spatial models, and network models are all related to the connectedness in different ways. In recent years, there have been a few pioneering attempts to integrate these different strands of literature in one unified framework. And this paper attempts to bridge the structural vector auto-regression, spatial auto-regression, and network models together.

However, sometimes we care about not only static interconnections, but also transitions cross different regimes of connectedness in different circumstances. A typical example is the empirical modeling of financial contagions, which are usually defined as the difference between the interconnections among entities under in different financial environments, rather than the interconnections as such. Catering to such problems, I try to upgrade the SVAR-spatial-network “tripod” model with a transition mechanism by introducing thresholds in the model, which provide considerable convenience for studying the dynamics of connectedness of a system.

The SVAR-spatial-network “tripod” model in this paper can be broken down to three major parts, namely the SVAR model, the spatial model, and the network analyses. For the SVAR part, first I show how to identify SVAR model without strong prior assumptions on the causal structure by assuming normal mixture distributions of error terms. This establishes the groundwork for the whole model. Second, I introduce dynamics to the SVAR model by upgrading the SVAR to a threshold SVAR (T-SVAR) model. The threshold function relies on some exogenous variables and can take various convenient forms. For the part of spatial modeling, I demonstrate that a threshold spatial auto-regression (T-SAR) is equivalent to the T-SVAR model with certain linear restrictions. This allows us to estimate the spatial weight matrices from the T-SVAR model even without any prior knowledge of the spatial weights. Spatial weights are good measures of the connectedness. I then show how to use the T-SAR model to construct likelihood-ratio tests of a broad class of hypotheses. Finally, regarding network analyses, based on the intrinsic similarity between spatial models and networks,
I show that we can use some newly devised techniques for network analyses to reveal additional information of the model.

I then present an application of the model to the analysis of contagion during recent crises in the Eurozone. I pick the stock markets in five countries, namely Greece, Germany, Italy, Spain, and Ireland as representative markets. In the SVAR part, I establish a crisis indicator based on a European CDS index, which decides the probability for an observation to be in crisis according to different interconnection patterns of the five markets. Also, with the help of the normal mixture assumption of error terms, I make a clear record of the spillover effects among the markets in each regime. In the spatial part, I obtain the estimations of spatial weight matrices in the T-SAR model in different regimes. The spatial weight matrices are good measures of the connectedness among the five markets. Furthermore, I construct two formal statistical tests. Defining the contagion as the difference between the connectedness of the five-country system under the two regimes, the first test rejects the hypothesis that contagions do not exist; and the second test rejects the hypothesis that the contagion channel can be solely explained by a cross-border interbank network in Europe. In the end, I carry out centrality, clustering, and ρ-analyses of the networks revealed by the T-SAR model. Network average clustering coefficients and ρ-s in different regimes further confirm that the markets are interconnected differently in different regimes; and centrality measures and individual clustering coefficients show the distinctive roles played by the selected five markets in different regimes.

Certainly, the application to study the contagions in the Eurozone is still far from the depletion of the potential of my model. In this paper I always try to describe the model in its most general form so as to make it applicable to as many situations as possible. This being said, there is still considerable room for the improvement of the model in the future. For example, the spatial autoregression model considered in this paper has a very simple form compared with many other spatial-time series models, and viewing from the angle of the network literature, the network considered in this paper is also quite simple among the immense world of multilayer networks. There is much left for future research.

Mathematical Proofs

A1. Proof of Proposition 2

Let \( \mathcal{H}_{nn} = (1'_{K} \otimes R)' \odot \text{vec}(G')1'_{K-1} \), then we have

\[
\mathcal{H} = \text{diag}(\mathcal{H}_{11}, \mathcal{H}_{22}, \ldots, \mathcal{H}_{NN}).
\]
Further let $\mathcal{G}_n$ be the $((n - 1)(K^2 - K) + 1)$-th to the $n(K^2 - K)$-th components of $\mathcal{G}$, then

$$
\mathcal{H} \mathcal{G} = \begin{pmatrix}
\mathcal{H}_{11} \mathcal{G}_1 \\
\mathcal{H}_{22} \mathcal{G}_2 \\
\vdots \\
\mathcal{H}_{NN} \mathcal{G}_N
\end{pmatrix}.
$$

By Theorem 3.1 in Scidá (2016), we know that for $n = 1, 2, \ldots, N$, $\mathcal{H}_{nn} \mathcal{G}_n = 0_{K-1}$ is equivalent to $\mathcal{R} \mathcal{A}_n \mathbf{1}_K = 0_{K-1}$, then $\mathcal{H} \mathcal{G} = 0_{N(K-1)}$ is equivalent to

$$
\mathcal{R} \mathcal{A} \mathbf{1}_{NK} = \begin{pmatrix}
\mathcal{R} \mathcal{A}_1 \mathbf{1}_K \\
\mathcal{R} \mathcal{A}_2 \mathbf{1}_K \\
\vdots \\
\mathcal{R} \mathcal{A}_N \mathbf{1}_K
\end{pmatrix} = 0_{N(K-1)}.
$$

\[ \square \]

A2. Proof of Proposition

The optimization of the MD program can be solved by the Lagrangian method. Suppose that $\mathcal{U}$ has $U$ components. Consider the Lagrangian function

$$
\mathcal{L} = (\hat{\mathcal{G}} - \mathcal{G}^*)' \Sigma_{\mathcal{G}}^{-1} (\hat{\mathcal{G}} - \mathcal{G}^*) - \ell'(\mathcal{H} \hat{\mathcal{G}} - \mathcal{U}),
$$

where $\ell$ is the Lagrangian multiplier. First-order conditions follow:

(A1) \hspace{1cm} \frac{\partial \mathcal{L}}{\partial \hat{\mathcal{G}}'} = 2 \Sigma_{\mathcal{G}}^{-1} (\hat{\mathcal{G}} - \mathcal{G}^*) - \mathcal{H}' \ell = 0_{N(K^2-K)},

and

(A2) \hspace{1cm} \frac{\partial \mathcal{L}}{\partial \ell} = \mathcal{H} \hat{\mathcal{G}} - \mathcal{U} = 0_U.

Premultiplying equation (A1) by $\mathcal{H} \Sigma_{\mathcal{G}}$, we get

$$
2 \mathcal{H} (\hat{\mathcal{G}} - \mathcal{G}^*) - \mathcal{H} \Sigma_{\mathcal{G}} \mathcal{H}' \ell = 0_U.
$$

Using equation (A2), it follows that

$$
\ell = 2 (\mathcal{H} \Sigma_{\mathcal{G}} \mathcal{H}')^{-1} \mathcal{H} \hat{\mathcal{G}} - 2 (\mathcal{H} \Sigma_{\mathcal{G}} \mathcal{H}')^{-1} \mathcal{U}.
$$

Substituting it back to equation (A1), we have

(A3) \hspace{1cm} \hat{\mathcal{G}} = \mathcal{G}^* - \Sigma_{\mathcal{G}} \mathcal{H}' (\mathcal{H} \Sigma_{\mathcal{G}} \mathcal{H}')^{-1} \mathcal{H} \mathcal{G}^* + \Sigma_{\mathcal{G}} \mathcal{H}' (\mathcal{H} \Sigma_{\mathcal{G}} \mathcal{H}')^{-1} \mathcal{U}.

41
Following equation (A3), it is obvious that

$$\hat{G}^{T-SAR} = G^* - \Sigma^* H' (H \Sigma^* H')^{-1} HG^*,$$

when $\mathcal{H} = \mathcal{H}$, and $\mathcal{U} = 0_{N(K-1)}$. \qed
REFERENCES


Figure B1. Stock Market Indices

This figure reports daily closing values from January 2nd, 2006 to May 26th, 2015 of the representative stock market indices in five Eurozone countries. All the data are rescaled by their initial values.
Figure B2. : iTraxx Europe Values

This figure reports daily closing values of iTraxx Europe from January 2nd, 2006 to May 26th, 2015.

Figure B3. : Values of the Threshold Function

This figure shows the probability for the system to be in Regime 1, which has generally closer market interconnections from January 2nd, 2006 to May 26th, 2015.
This figure shows the Google Trends Indices for the search terms listed in Table B1 from January 2nd, 2006 to May 26th, 2015. All series keep their original scales.
Figure B5. : An Overview of the Connectedness among the Five-Country System

This figure is an overview of the five-country system studied in this paper. The lines represent the closeness among the countries revealed by the T-SAR model. Dashed lines indicate negative values. A darker line indicates a closer connection between the countries connected by the line. And the sizes of the balls where country names are printed show the PN-centralities of each country.
Table B1—: Search Terms for the Google Trends Indices

<table>
<thead>
<tr>
<th>Country</th>
<th>Term</th>
</tr>
</thead>
<tbody>
<tr>
<td>Greece</td>
<td>Greece economy OR Greece debt OR Greece stock market</td>
</tr>
<tr>
<td>Germany</td>
<td>Germany economy OR Germany debt OR Germany stock market</td>
</tr>
<tr>
<td>Italy</td>
<td>Italy economy OR Italy debt OR Italy stock market</td>
</tr>
<tr>
<td>Spain</td>
<td>Spain economy OR Spain debt OR Spain stock market</td>
</tr>
<tr>
<td>Ireland</td>
<td>Ireland economy OR Ireland debt OR Ireland stock market</td>
</tr>
</tbody>
</table>

This table shows the search terms for Google Trends Indices for each country.

Table B2—: News Magnitude

<table>
<thead>
<tr>
<th>Regime</th>
<th>Country</th>
<th>Log Change Measure</th>
<th>AR(1) Residual Measure</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>News Magnitude</td>
<td>Rank</td>
</tr>
<tr>
<td>1</td>
<td>Greece</td>
<td>0.1361</td>
<td>5</td>
</tr>
<tr>
<td></td>
<td>Germany</td>
<td>0.0973</td>
<td>3</td>
</tr>
<tr>
<td></td>
<td>Italy</td>
<td>0.0941</td>
<td>4</td>
</tr>
<tr>
<td></td>
<td>Spain</td>
<td>0.0971</td>
<td>2</td>
</tr>
<tr>
<td></td>
<td>Ireland</td>
<td>0.0826</td>
<td>1</td>
</tr>
<tr>
<td>2</td>
<td>Greece</td>
<td>0.1123</td>
<td>5</td>
</tr>
<tr>
<td></td>
<td>Germany</td>
<td>0.0808</td>
<td>2</td>
</tr>
<tr>
<td></td>
<td>Italy</td>
<td>0.1013</td>
<td>4</td>
</tr>
<tr>
<td></td>
<td>Spain</td>
<td>0.0984</td>
<td>3</td>
</tr>
<tr>
<td></td>
<td>Ireland</td>
<td>0.0744</td>
<td>1</td>
</tr>
</tbody>
</table>

This table shows the news magnitude for each country in Regimes 1 and 2 estimated from logarithm changes of Google Trends Indices and the AR(1) residuals thereof. Then they are ranked from the smallest to the largest.
Table B3—: Instantaneous Responses to Unit-Sized Structural Shocks

<table>
<thead>
<tr>
<th>Matrix</th>
<th>Responding Variable</th>
<th>Structural Shock Label</th>
<th>GR</th>
<th>DE</th>
<th>IT</th>
<th>ES</th>
<th>IE</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>GR</td>
<td>3.355</td>
<td>-0.319</td>
<td>0.803</td>
<td>0.141</td>
<td>0.602</td>
<td></td>
</tr>
<tr>
<td></td>
<td>DE</td>
<td>1.268</td>
<td>1.543</td>
<td>1.186</td>
<td>0.977</td>
<td>0.809</td>
<td></td>
</tr>
<tr>
<td></td>
<td>IT</td>
<td>1.270</td>
<td>1.000</td>
<td>1.018</td>
<td>0.531</td>
<td>2.088</td>
<td></td>
</tr>
<tr>
<td></td>
<td>ES</td>
<td>1.141</td>
<td>0.350</td>
<td>1.392</td>
<td>1.344</td>
<td>1.819</td>
<td></td>
</tr>
<tr>
<td></td>
<td>IE</td>
<td>0.978</td>
<td>0.384</td>
<td>2.774</td>
<td>-0.382</td>
<td>0.915</td>
<td></td>
</tr>
<tr>
<td></td>
<td>$\hat{\Upsilon}_1$</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>GR</td>
<td>3.642</td>
<td>-0.259</td>
<td>1.117</td>
<td>0.133</td>
<td>0.340</td>
<td></td>
</tr>
<tr>
<td></td>
<td>DE</td>
<td>1.376</td>
<td>1.251</td>
<td>1.648</td>
<td>0.926</td>
<td>0.458</td>
<td></td>
</tr>
<tr>
<td></td>
<td>IT</td>
<td>1.378</td>
<td>0.810</td>
<td>1.415</td>
<td>0.503</td>
<td>1.181</td>
<td></td>
</tr>
<tr>
<td></td>
<td>ES</td>
<td>1.239</td>
<td>0.284</td>
<td>1.934</td>
<td>1.274</td>
<td>1.029</td>
<td></td>
</tr>
<tr>
<td></td>
<td>IE</td>
<td>1.061</td>
<td>0.312</td>
<td>3.855</td>
<td>-0.362</td>
<td>0.518</td>
<td></td>
</tr>
<tr>
<td></td>
<td>$\hat{\Upsilon}_2$</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

This table shows estimations of $\Upsilon_1$ and $\Upsilon_2$, which stand for the instantaneous responses of each market return to unit-sized structural shocks. The upper half of the table corresponds to $\hat{\Upsilon}_1$ and the lower half to $\hat{\Upsilon}_2$. For each half, the element in i-th row and j-th column indicates the instantaneous response of the i-th market to the unit-sized structural shock originating from Market j. For example, the element in the 1st row and 2nd column in the upper half of the table is -0.319, then it means in Regime 1, when a unit-sized structural shock takes place in the German market, the Greek instantly has a response that has a size of -0.319.

Table B4—: Estimations of Spatial Weight Matrices

<table>
<thead>
<tr>
<th>Matrix</th>
<th>Spatial Weight, To</th>
<th>Spatial Weight, From</th>
<th>GR</th>
<th>DE</th>
<th>IT</th>
<th>ES</th>
<th>IE</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>GR</td>
<td>0</td>
<td>0.144</td>
<td>0.309</td>
<td>0.204</td>
<td>0.343</td>
<td></td>
</tr>
<tr>
<td></td>
<td>DE</td>
<td>0.037</td>
<td>0</td>
<td>0.407</td>
<td>0.290</td>
<td>0.266</td>
<td></td>
</tr>
<tr>
<td></td>
<td>IT</td>
<td>0.054</td>
<td>0.238</td>
<td>0</td>
<td>0.200</td>
<td>0.509</td>
<td></td>
</tr>
<tr>
<td></td>
<td>ES</td>
<td>0.040</td>
<td>0.092</td>
<td>0.435</td>
<td>0</td>
<td>0.432</td>
<td></td>
</tr>
<tr>
<td></td>
<td>IE</td>
<td>0.059</td>
<td>0.081</td>
<td>0.859</td>
<td>0.002</td>
<td>0</td>
<td></td>
</tr>
<tr>
<td>$\hat{W}_1$</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>GR</td>
<td>0</td>
<td>0.360</td>
<td>0.038</td>
<td>0.034</td>
<td>0.568</td>
<td></td>
</tr>
<tr>
<td></td>
<td>DE</td>
<td>0.278</td>
<td>0</td>
<td>0.330</td>
<td>0.312</td>
<td>0.079</td>
<td></td>
</tr>
<tr>
<td></td>
<td>IT</td>
<td>0.482</td>
<td>-0.041</td>
<td>0</td>
<td>-0.014</td>
<td>0.573</td>
<td></td>
</tr>
<tr>
<td></td>
<td>ES</td>
<td>0.435</td>
<td>0.281</td>
<td>0.050</td>
<td>0</td>
<td>0.233</td>
<td></td>
</tr>
<tr>
<td></td>
<td>IE</td>
<td>0.241</td>
<td>0.707</td>
<td>0.216</td>
<td>-0.164</td>
<td>0</td>
<td></td>
</tr>
<tr>
<td>$\hat{W}_2$</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

This table shows estimations of the spatial matrices $W_1$ and $W_2$. The upper half of the table corresponds to $W_1$ and the lower half to $W_2$. Since these matrices are asymmetric, I differentiate the weights from a country to the weights to a country.
Table B5—: Value of $V^{\text{Interbank}}$

<table>
<thead>
<tr>
<th>Country</th>
<th>GR</th>
<th>DE</th>
<th>IT</th>
<th>ES</th>
<th>IE</th>
</tr>
</thead>
<tbody>
<tr>
<td>GR</td>
<td>0</td>
<td>0.690</td>
<td>0.136</td>
<td>0.060</td>
<td>0.114</td>
</tr>
<tr>
<td>DE</td>
<td>0.028</td>
<td>0</td>
<td>0.350</td>
<td>0.377</td>
<td>0.245</td>
</tr>
<tr>
<td>IT</td>
<td>0.052</td>
<td>0.841</td>
<td>0</td>
<td>0.119</td>
<td>0.033</td>
</tr>
<tr>
<td>ES</td>
<td>0.008</td>
<td>0.506</td>
<td>0.372</td>
<td>0</td>
<td>0.113</td>
</tr>
<tr>
<td>IE</td>
<td>0.070</td>
<td>0.431</td>
<td>0.287</td>
<td>0.211</td>
<td>0</td>
</tr>
</tbody>
</table>

This table reports the value of $V^{\text{Interbank}}$ used in this paper. For the meaning of the elements, see equation (33).

Table B6—: Centrality Measures

<table>
<thead>
<tr>
<th>Country</th>
<th>Degree Measure</th>
<th>PN Measure</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Regime 1</td>
<td>Regime 2</td>
</tr>
<tr>
<td>GR</td>
<td>0.111</td>
<td>1.071</td>
</tr>
<tr>
<td>DE</td>
<td>0.326</td>
<td>0.975</td>
</tr>
<tr>
<td>IT</td>
<td>1.182</td>
<td>0.473</td>
</tr>
<tr>
<td>ES</td>
<td>0.409</td>
<td>0.126</td>
</tr>
<tr>
<td>IE</td>
<td>0.911</td>
<td>1.084</td>
</tr>
</tbody>
</table>

This table reports the degree and PN centralities for each market in different regimes.

Table B7—: Clustering Coefficients

<table>
<thead>
<tr>
<th>Country</th>
<th>Regime 1</th>
<th>Regime 2</th>
</tr>
</thead>
<tbody>
<tr>
<td>GR</td>
<td>1.092</td>
<td>0.891</td>
</tr>
<tr>
<td>DE</td>
<td>1.043</td>
<td>0.867</td>
</tr>
<tr>
<td>IT</td>
<td>0.535</td>
<td>1.373</td>
</tr>
<tr>
<td>ES</td>
<td>1.000</td>
<td>1.203</td>
</tr>
<tr>
<td>IE</td>
<td>0.711</td>
<td>0.885</td>
</tr>
<tr>
<td>Network Average</td>
<td>0.876</td>
<td>1.043</td>
</tr>
</tbody>
</table>

This table displays the clustering coefficient for each country as well as the network average clustering coefficient in different regimes.