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The role of Jumps and Leverage in forecasting Volatility in International Equity Markets*

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Abstract

We analyse the importance of jumps and the leverage effect on forecasts of realized volatility in a large cross-section of 18 international equity markets, using daily realized measures data from the Oxford-Man Realized Library, and two widely employed empirical models for realized volatility that allow for jumps and leverage. Our out-of-sample forecast evaluation results show that the separation of realized volatility into a continuous and a discontinuous (jump) component is important for the S&P 500, but of rather limited value for the remaining 17 international equity markets that we analyse. Only for 6 equity markets are significant and sizable forecast improvements realized at the one-step-ahead horizon, which, nevertheless, deteriorate quickly and abruptly as the prediction horizon increases. The inclusion of the leverage effect, on the other hand, has a much larger impact on all 18 international equity markets. Forecast gains are not only highly significant, but also sizeable, with gains remaining significant for forecast horizons of up to one month ahead.

Keywords: Realized Volatility, jumps, the leverage effect, HAR modelling and forecasting, international equity markets.

JEL Classification: C13, C15, C50, F30, F44.

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