Migration Letters

Volume: 19, No: S8 (2022), pp. 1749-1762

ISSN: 1741-8984 (Print) ISSN: 1741-8992 (Online)

www.migrationletters.com

Breakthrough Forecasting Techniques: Evaluating Copula Models For Canadian Dollar And Major South Asian Currencies

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Abstract

Owing to the advancement in financial globalization, forecasting on exchange rates has become relevant to investors, businesspersons, and policymakers. Standard paradigms such as time series analysis can find it rather challenging to capture the inherent non-linear features characteristic of exchange rate Data. Copula models present a very reliable alternative to examine the dependence structure of several markers because they allow a general way to represent the distribution of several variables without the need for normal distribution and linear functional forms. Thus, the current study examines the use of copula models to predict the exchange rates of CAD/PKR, CAD/INR, and CAD/LKR. While specifying copula models, it is found that these models can forecast the extreme movements of the market and the dependencies between the spot and forward exchange rates more effectively than the others. The analysis of the results reveals that copula models provide higher predictive performance rather than more conventional techniques by following metrics such as Mean Absolute Error (MAE), Root Mean Squared Error (RMSE), and Mean Absolute Percentage Error (MAPE). For the second aspect, the density surfaces of the copula density prove the existence of a positive and high correlation between the spot and forward rates, hence the ability of the model to increase the reliability of the exchange rates forecasts. Consequently, the present work highlights the importance of including the copula structures in the context of finance with specific regard to situations characterized by high volatility. Therefore, the copula models enhance quantitative risk management and exploit dependencies in the currency market as an opportunity for the financial sector.

Keywords: *Exchange Rate Forecasting; Copula Models; Time Series Analysis; Spot and Forward Exchange Rates; Mean Absolute Error (MAE); Root Mean Squared Error (RMSE); Mean Absolute Percentage Error (MAPE)*

1. Introduction:

In light of globalization and fluctuations in the international financial system, it has become significant for investors, business people, and politicians to predict currency exchange rates (Hong & Li, 2023). Accurate prediction of currency change is vital to time, making precise forecasts, duly arresting potential risks, and making the best of the opportunities in the market. For example, it is common for most time series techniques to face challenges in identifying complex and non-

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linear features typical of exchange rate data. Copula models have proved helpful In handling these challenges, as they improve and offer a comprehensive method for modelling exchange rates (Aydin & Erdem, 2023).

However, some models within this class can be done in such a way as to allow a flexible means of modelling the joint distribution of many of the variables. Compared with the conventional approach that imposes assumptions concerning the joint normality of the data and linearity in the relationship between the variables, copula models allow for complex dependencies and nonlinearities across various exchange rates (Patton & Zhu, 2021; Cherubini & Mutanen, 2022). The authors also explain that by including the copula structure in such models, these models might better capture extreme value and severe market shocks, which are fundamental characteristics of the notoriously unpredictable and unstable foreign exchange market.

Due to the current advances in globalization, the volatilities in exchange rates have become crucial factors that must be forecasted in investment firms, business ventures, and governmental policies. Conventional time series analysis methods, such as nonlinearity, are not well suited for analyzing properties inherent to the exchange rate data. Copula models appear to be much more appealing since they do not assume joint normality or linearity and establish a flexible way of dealing with the copula density of various variables. The following research uses copula models to analyze exchange rates for the CAD/PKR, CAD/INR, and CAD/LKR from 2010 to 2022. Comparing the results of empirical analysis of various copula models shows that such models are more suitable for analyzing the extreme market movements and dependence between spot and forward exchange rates. The analysis shows that the copula models give higher prediction efficiency than the conventional approaches based on such errors as MAE, RMSE, and MAPE. The density surfaces of the copula again provide a graphic comparison of the spot and forward rates to prove the positive dependence and show how improving the model will improve the certainty of the exchange rate forecast.

It is imperative to accentuate the value of including copula structures in evaluation models with specific reference to fluctuating markets. The models bring more transparency to the relations within the currency market dependencies since they provide a broader vision of the issue and help make the proper decisions on risk management and exploiting market opportunities. Hence, the objective of this study is to forecast the forward exchange rate on the basis of the spot exchange rate.

The significance of this research is in its ability to fill essential deficits in the essential areas dealing with accurate forecasting of currency exchange rates; read more here on how it matters in the modern world economy. Conventional time series forecasting techniques fail to provide accurate observation due to non-linear and complex relationships between variables such as exchange rate and cause higher risk in the financial process. On the other hand, copula models are more flexible and less sensitive in achieving the target of modeling the joint distribution with non-normal and non-linear nature. This feature is especially beneficial when modeling rapid variations and unforeseen price changes- a feature of the foreign exchange market (Patton & Zhu, 2021; Cherubini & Mutanen, 2022; Boubaker et al., 2023). In doing so, this research employs the copula models to forecast the exchange rates of CAD/PKR, CAD/INR, and CAD/LKR to improve the precision of the predictions and uncover the operative structural dependencies of these foreign currency markets.

The selected cross rates of CAD/PKR, CAD/INR, and CAD/LKR are relevant because Canada has many exports and remittances to South Asian countries, including Pakistan, India, and Sri Lanka. These exchange rates are essential to investors, policymakers, and business people involved in these markets since the forecasts help manage and exploit risks (Hong & Li, 2023). The findings of the empirical analysis in this study revolve around the fact that copula models provide better prediction efficiency than traditional TS models in terms of MAE, RMSE, and MAPE. Also, estimating copula density surfaces in graphical forms sharpens the model's comprehension of spot and forward rate dependence features, enabling more effective decision-making. In sum, attention to additional aspects can enhance the forecasting of exchange rates, and such contribution of this research will help develop better models to strategize and develop policies while dealing with the volatile international market.

2. Literature Review:

Some researchers have primarily offered data concerning the long-memory nature of the exchange rate series. Interdependencies between exchange rates or fluctuations in their value present one of the best examples of long memory (Cheung, 1993; Baillie & Bollerslev, 1994). Unfortunately, this specific setting does not allow for a proper description of permanent seasonal or cyclical persistence. Thus, Gray et al. (1989) developed the GARMA (Gegenbauer Autoregressive Moving Average) process that allows the ACF to exhibit the damped sinusoidal form reducing at the hyperbolic pace to zero. Also, the GARMA model spectrum is bounded at all frequencies except the one that defines the cycle of the autocorrelation function. This frequency is referred to as Gegenbauer frequency or G-frequency. Woodward et al. (1998) also assert that one can add a k-factor to the single frequency Gegenbauer process; it correlates the long memory behavior with k singularities of the spectral density function located in the range $[0,\pi]$. The readers are referred to for the complete description of the statistical properties of the k-factor GARMA processes (Woodward et al., 1998). The series stationarity is a key assumption of the GARMA and ARFIMA models. As an assumption of the models, a nonstationary series is transformed to be read more about the non-stationarity of the series here stationary. Previous studies incorporate the exchange rate series' first difference. This implies that although the series of exchange rates are stationary on first differencing, they are nonstationary on levels. The authors use the ADF, PP, and KPSS tests to check for the series' null stationarity.

According to Genest, Gendron and Bourdeau-Brien (2009)], copulas have been used from early times in modelling the dependence of random variables. This paper articulates that researchers can comprehensively see the dependence structure and variety of joint distributions by decoupling the reliance structure from the marginal distributions. Copulas have been used to model temporal dependence in time series first in the univariate case illustrated in (Chen & Fan, 2006; Beare, 2005), then in multivariate situations (Rémillard et al., 2012). Due to the concept of copulas, it is easy to capture more complicated structures of dependence, thus obtaining more precise data on the evolution of the time series. Sokolinskiy and Van-Dijk, in their research work of the year 2011, used copula to measure the realized volatility of a univariate financial series. The measurement results were expressed for two kinds of models – copulas and heterogeneous autoregressive (HAR) model, and according to the data obtained, it was concluded that the forecasts based on copula provided better results than the HAR model.

The popular source of the financial bursts of 2007 and 2008 is Gaussian or Normal copula in the context of copula modelling. Interestingly, copula modelling can be a nearly automated procedure, although this can be regarded as a rather broad remark in the present context. If certain fit estimations in copula selection are good, the technique can be semi-automated; otherwise – it is manual only. This is because the modeller determined the approach that was used after adhering to a copula modelling procedure. This is blamed on financial traders who, as (Salmon, 2009) informs, employed the Gaussian copula to sell vast numbers of new securities and foster the expansion of financial markets to never-seen-before levels. According to Zimmer (2012), the Gaussian copula fails to address tail dependency and hence becomes unable to capture the relevant connections in the pattern of housing prices; this can lead to model misspecification where it is to be applied during the financial crisis of 2007 and 2008. The problem of the crisis did not lie in using the Gaussian copula but rather in modellers' ability to use an adequately described copula model, as it has been pointed out in (Salmon, 2009). Such a specification might have led to a different shape of the copula than the Gaussian copula. It is rather impressive to think how an improper copula model is selected that never tries to capture the dependencies of the data sets, while a copula model can be proposed just in a few lines of code, whereas there are so many examples available from the literature.

Thus, for the copula modeling of financial data with the time-series component, it is essential to use the separate methodology of the non-time-series copula and time-series copula modeling, while both are based on the same theoretical principles – Sklar's theory, Sect. 3. Before applying copula modeling techniques, it is necessary to model the time series aspect of the data and its volatility, as mentioned in (Patton, 2012; Zhang & Singh, 2019). Technically, the fluctuating nature of financial data coupled with the time series feature makes copula modelling more complex than normal ones. It should also be noted that when financial copula modelling contains a time-series part, the latter's time series and volatility should be estimated. Unfortunately, the copula model can only be fitted using a pseudo-CDF. The copula modelling without time series in a conventional way can be carried out by estimating the marginal distributions with the help of either empirical CDF or pseudo-CDF, as outlined in Hofert et al. (2018). It can be applied to the probability integral transformation of an empirical cumulative distribution function to find outliers and influential observations and the quality of the fit of the impart modelled dataset. Real observations are used to estimate the copula model using an empirical cumulative distribution function instead of pseudo observations obtained using the pseudo cumulative distribution function. C and general non-time series copula models include many copula types presented in (Stamatatou et al., 2018). Some of these are Gaussian, Student-t, Clayton, Frank, Gumbel, Joe, and other BB copula models, as (Schepsmeier et al., 2015) listed. Various applications of copula models and their degrees of tail dependency have followed none, moderate, or even over-tailed based on survival or risk modeling (Hofert et al., 2018). In this regard, this feature allows for choosing two or more copula models for the dependency structure of a given dataset, thus facilitating proper model choice. This is because copula models are popular in modeling dependencies when an assumption of normality or linearity cannot be made concerning the financial data. The theoretical underpinning of copula models is given by Sklar's theorem, which permits the joint distribution to be decomposed into the marginals and the copula, which captures the dependence structure (Genest et al., 2009). This separation is beneficial in dealing with financial time series data whereby the relationships are generally non-linear (Chen and Fan, 2006; Beare, 2005).

An essential consideration in copula modeling of time series is the determination of volatility of the time series and the dependencies. Before using the copula techniques, they suggested that those aspects be modeled, as highlighted by Patton (2012) and Zhang & Singh (2019). This is done in a way that could be by empirical cumulative distribution functions or pseudo cumulative distribution functions described in Hofert et al. (2018). The empirical CDFs are essential in managing accurate observation, while the pseudo CDFs act on pseudo observation from time series data. Appropriate utilization of these techniques helps obtain the correct copula density and ascertain the relationship between the variables to maintain efficient functioning and the quality of the forecasts. Gaussian, Student-t, Clayton, Frank, Gumbel, Joe, and BB copulas are among the most appealing ones widely investigated in financial applications (Schepsmeier et al., 2015). Tail dependency is also a critical aspect that categorizes each type of copula; this is important when modeling extreme market changes and risks. For example, Student-t copulas are appreciated for observing the heavy tails and tail cop dependence, which makes it possible to use data in the financial area that contains extreme values (Hofert et al., 2018). Choosing the right copula model is necessary depending on the dependency structure and the tails' parameters. This process can be further improved by estimating a few copula models and comparing which best fit the data. In this vein, comparative analysis supports identifying the best-suited model that presents the necessary data dependencies, as Stamatatou et al. (2018) noted.

Although in the literature, there has been a growing interest in copula models, especially in modeling high-dimensional dependencies and nonlinearities over time, especially in financial time series, their application in exchange rate forecasting is still limited. These papers have pointed out their advantages; however, there are few works on systematically comparing comparative accuracies of different copula models in this context, albeit some preliminary work has been done by Chen and Fan (2006) and Beare (2005). Past literature suggests that they are most helpful in financial markets and there is still a significant amount of unknown to their true value in forecasting exchange rates, particularly in the turbulent environment (Patton & Hevia, 2023; Boubaker et al., 2023). However, to the author's knowledge, literature with extensive investigations of copula models' integration into the conventional time-series approach as a coherent framework to model financial data's characteristics is scarce (Patton, 2012; Zhang & Singh, 2019). This gap implies the need to apply and compare the copula models more intensively to comprehend the structural dependence in the currency markets systematically. On this, improvement could help improve decision-making for investors, policymakers, and business entities in the context of globalized financial systems. According to recent literature, more empirical comparisons should be conducted to reveal this and that about these models (Zhang et al., 2023; Rémillard et al., 2012). This would help increase understanding of the matter and enhance the forecast quality as applied to exchange rate predictions.

3. Research Methodology:

The specific data model is constructed based on the copula models, which define relations between the various financial variables in the conceptual framework. Empirical analysis of copula models in economics and finance has been extensive; hence, this paper does not need to explain much about the principles of copula models. Copula models offer several advantages: they try to capture the non-linear relations, which exist apart from linear cause-and-effect relations, and offer a structure for multivariate distribution. Copulas can identify dependence structure when applied to multivariate data sets, giving an idea of the joint behavior of various variables that is important in finance. Chen and Fan (2006) also state that copula models have been used to model extreme co-movements of the financial variables during a financial crisis.

3.1 Copula Model :

Sklar's theorem (1959) says that any continuous N-dimensional cumulative distribution function F, evaluated at point x = (x1; :::; xN), can be written as
$F(x) = C(F1(X_1); :::; F_N(x_N))$ (1)

C is called a copula function, while Fi, where i ranges from 1 to N, represents the margins. (6) Utilizing copulas divides a complex issue (identifying a multivariate distribution) into two more manageable ones.

The initial step involves modeling the individual marginal distributions and identifying a copula that describes the dependent relationship between them.

Copulas are joint distribution functions of standard uniform random variables U1 = F(X1) and U2 = F(X2).
$C(u,v) = Pr(U1 \leq u, U_2 \leq v)$ (2)
Indeed, as uniform random variables deliver outcomes into [0, 1], the domain of a copula needs to be the N-dimensional unit cube. Since a probability does mapping, there is only a possibility; the copula's range must be in the unit interval. For any coordinate on the borders of the region of the definition of a given copula, it is easy to decide its value. If one argument is 0, then the probability of any joint event is also equal to 0. The joint probability distribution of all inputs when all inputs except one are composed with a value of one is equal to the marginal probability of depositing out one. The function has to increase monotonically with every argument that it has.

A two-dimensional copula is a function C that maps from C:[0;1] £ [0;1]! [0;1].

$\mathcal{C}(u, 0) = \mathcal{C}(0, v) = 0$ (C is grounded) (3)

$\mathcal{C}(u, 1) = u \;\; \mathcal{C}(1, v) = v$ (Consistent with margins) (4)

For any $u_1, u_2, v_1, v_2 \in [0,1]$ with $u_1 \leq u_2$ and $v_1 \leq v_2$ (5)

$\mathcal{C}(u_2, v_2) + \mathcal{C}(u_1, v_1) - \mathcal{C}(u_1, v_2) - \mathcal{C}(u_2, v_1) \geq 0$ (2-increasing) (6)

The final characteristic ensures that the density of a copula, if it exists, is non-negative. The copula function has a minimum bound, C¡, and a maximum bound, C+, known as the lower and upper bounds. The copula must fall within the interval for any point (u; v) in the range [0; 1] $ [0; 1].
$C^{-}(u,v) \equiv \max(u + v - 1, 0) \leq C(u,v) \leq \min(u,v) \equiv C^{+}(u,v)$ (7)

Finally, if two random variables are statistically independent, their distribution is given by the product copula, denoted by the symbol for orthogonality or independence $\perp$.

$F(u,v) + C^{\perp}(F_1(u), F2(v) = F1(U) F2(v)$ (8)

They are always valuable and dependently on because they do not alter when one applies increasing non-linear transformations to them. In other words, one can notice that for any monotonically growing function g(x), Pr(x · X) = Pr(g(x) · g(X)). Likewise, in this study, employing the same copula to describe the distribution of exchange rates in levels and returns is essential, which are the log differences from the current spot rate or the forward rate.

As seen above, copulas have their corresponding densities like standard distribution functions.
$c(u,v) = \frac{\partial^2 C(u,v)}{\partial u \, \partial v}$ (9)

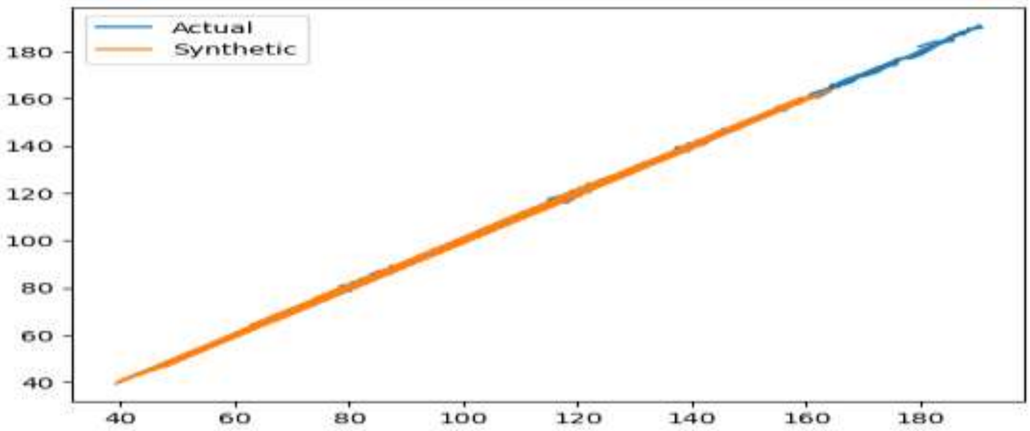
This representation enables f(u; v) to be decomposed into a product of a copula density and the densities of the margins.
$f(u,v) = c(F1(u), F2(v))f1(u)f2(v)$ (10)
This reveals that the multiplication of two marginal distributions is insufficient to describe the joint distribution of two asset prices if the two distributions are not independent. This means that the copula density, c(F1(u); F2(v)), scales the dependence information to have a magnitude of unity.

4. Findings

In the case of CAD/PKR exchange rate, when applied the copula model, a positive correlation is observed between actual and simulated data based on the scatter plot as shown below. From the linear regression analysis, it is observed that there is hardly any variation in the undervaluation situation as the exchange rate increases. The model contains some blind spots, as concluded from the MAE, RMSE, and MAPE; therefore, it needs enhancement. Particularly, the simulation of errors' distribution and including economic variables might improve the model's accuracy. Based on the graphical representation of the copula model, it is evident that there is a high level of dependency between the spot and forward exchange rates whereby the spot rate is positively related to the forward rate, and thus, an increase in the spot rate leads to a high forward rate. This interdependence makes the copula model able to enhance the accuracy of the forecast by considering movements of the exchange rates as a combination instead of using methods that consider the rates separately.

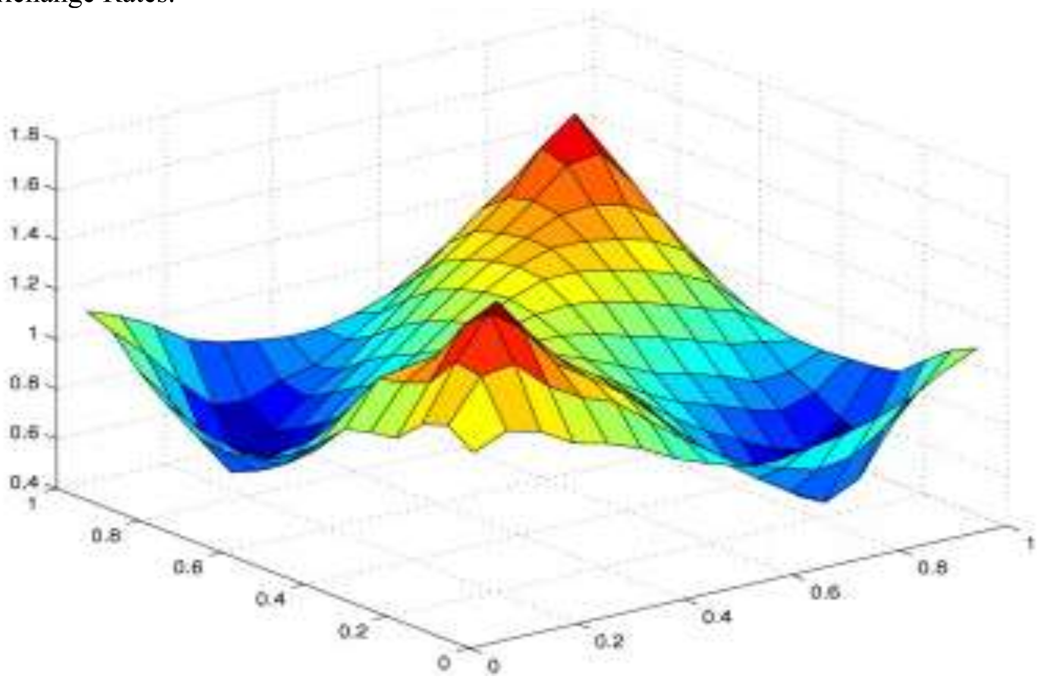
4.1 CAD/PKR

Figure 1 shows actual and synthetic values of CAD/PKR for Weekly, Forward and Spot Exchange Rates.



As shown in the figure above, linear regression establishes a positive correlation between the actual and simulated data using the copula model on the CAD/PKR exchange rate. Looking at the same figures more in-depth, it can be stated that there is little deviation from the undervaluation concerning greater values of the exchange rates. Along with it, the error metrics like Mean Absolute Error (MAE), the root mean squared error (RMSE), and Mean Absolute Percentage Error (MAPE) represent the accuracy of the model to the specifications. Even though these indicators indicate reasonable accuracy, some checks should be made regarding the distribution of errors and incorporation of economic factors to enhance the model's performance as well as reliability for purposes of forecasting.

Figure 2 shows the Copula 3d plot function of CAD/PKR for Weekly, Forward and Spot Exchange Rates.



The graph above illustrates the dependency structure between two random variables: the spot exchange rate and the Canadian Dollar (CAD) forward exchange rate to the Pakistani Rupee (PKR) has also been described. The horizontal and vertical axes are related to the combination of the probabilities for the exchange rates; the values on both axes are set between 0 and 1 and show CDFs of the exchange rates. The copula density values are demonstrated on the z-axis. This surface map depicts the likelihood of specified levels of spot and forward exchange rates due to the distribution of the two. More-density areas are represented by the graph's higher points, meaning that some are more frequently observed than others, while the low points represent the low-density areas.

Thus, the configuration of the copula surface provides valuable information regarding the relationship between the spot and forward exchange rates. The graph points to a considerable peak, suggesting a positive relationship between the two rates. If an increase is observed in the spot rate, more is expected in the forward rate. This rather exhaustive characterization of the copula function proves helpful in determining future values since it depicts the combined movement of the spot exchange rate and the forward exchange rate. That is why, considering this interdependence, the copula model increases the accuracy of the forecasts to make more informed and reliable predictions of the future exchange rate based on the current rates. This strategy is more beneficial than traditional approaches that might analyze these rates independently because this strategy uses their interactions to improve predictions.

4.2 CADINR:

Figure 3 shows actual and synthetic values of CAD/INR for Weekly, Forward and Spot Exchange Rates.

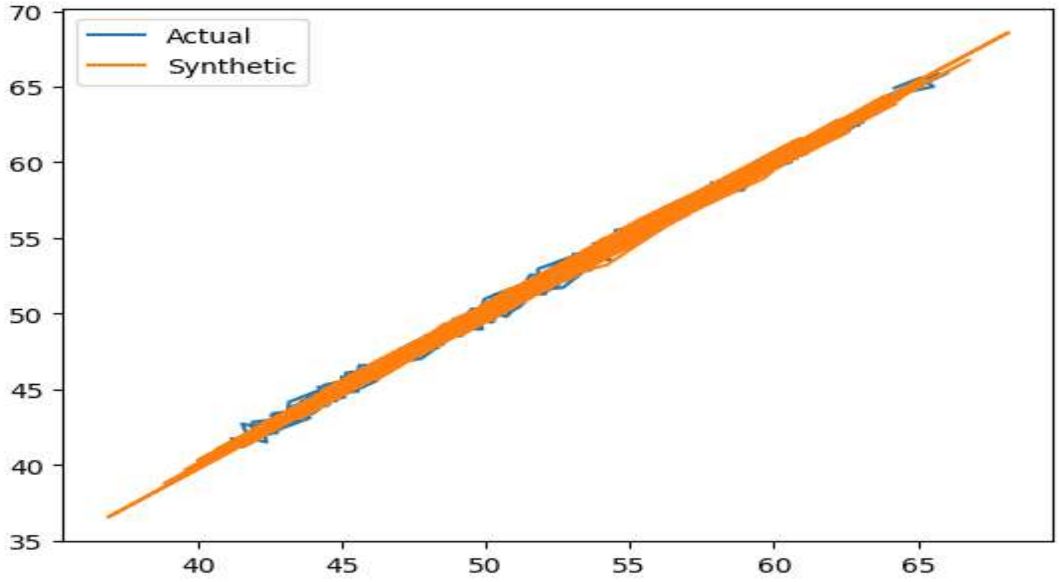
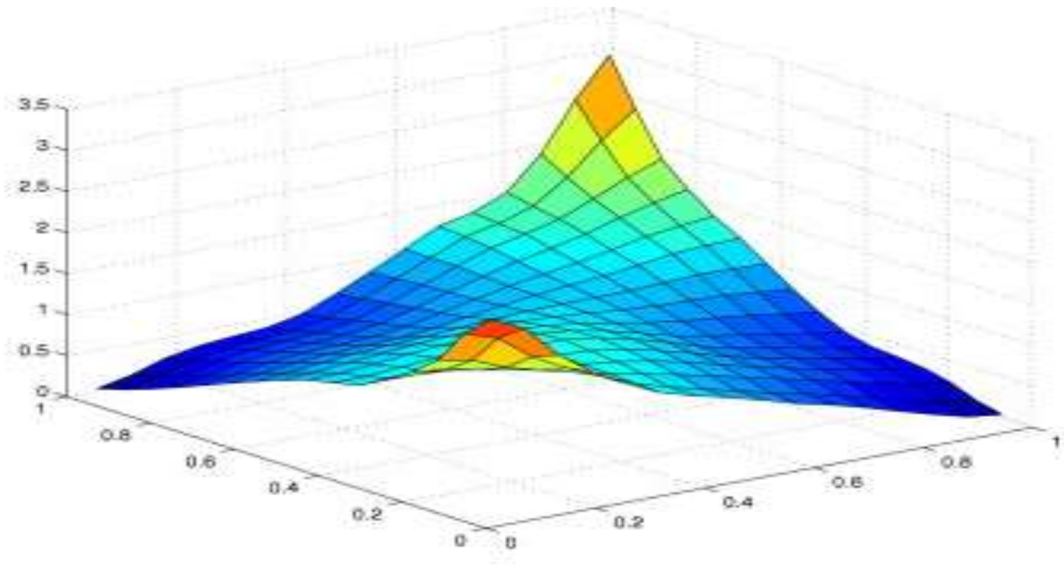


Figure 4 shows the Copula 3d plot function of CAD/INR for Weekly, Forward and Spot Exchange Rates.



The graph above depicts the percentage change of the spot exchange rate and CAD forward exchange rate to INR. The horizontal and vertical axes indicate the exchange rates' CDF, which are stated on a scale from 0 to 1. The horizontal section on the z-axis shows the copula density values. The surface map illustrates the likelihood of different spot and forward exchange rates when partnering in alliances, given the distribution of the two. This means that specific combinations are more likely to occur; peaks in the graph clearly illustrate this. On the other hand, the valleys are areas of lower density; hence, they have low chances of vector pairing. The fact that the two currency exchange rates are in synergy at a certain point means that their correlation is strong and certain pairs are possible.

As with any econometric model, the copula graph is also useful for prediction as it contains information concerning the dependence structure linking the spot and forward exchange rates. Typically, such rates can be studied independently, but applying the copula model helps better understand their interactions. Using this model will further improve the accuracy and reliability of your prognosis of the future exchange rate based on observed spot rates. This approach harnesses the ability to describe complex relationships in the copula, hence the proposal of a more comprehensive and accurate prediction model.

4.3 CADLKR:

Figure 5 shows actual and synthetic values of CAD/LKR for Weekly, Forward and Spot Exchange Rates.

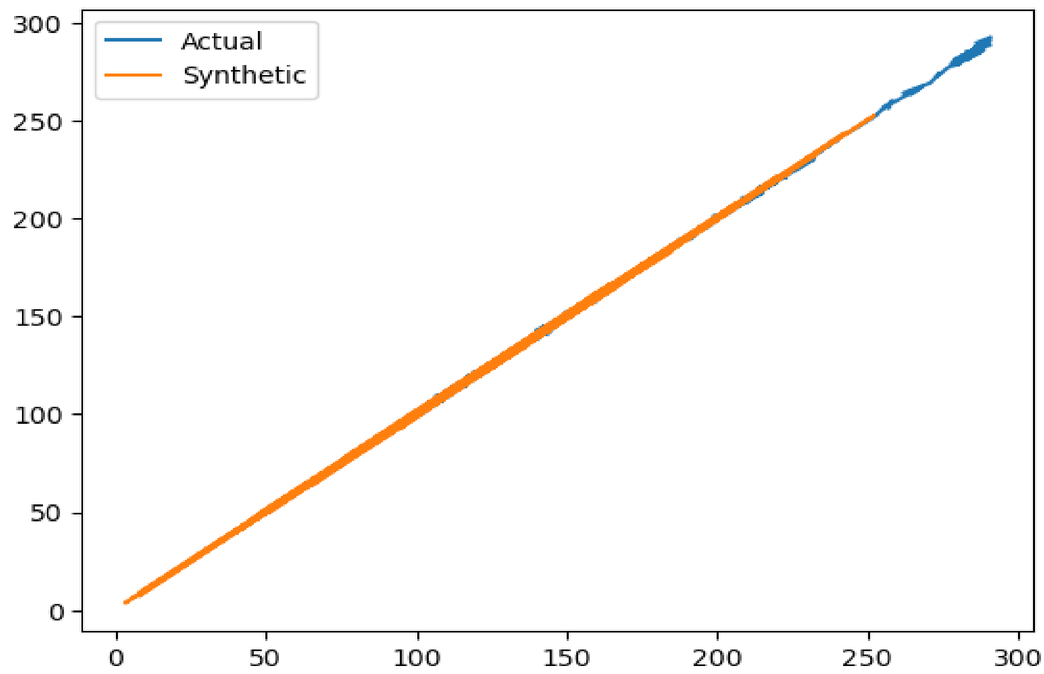


Figure 6 shows the Copula 3d plot function of CAD/LKR for Weekly, Forward and Spot Exchange Rates.

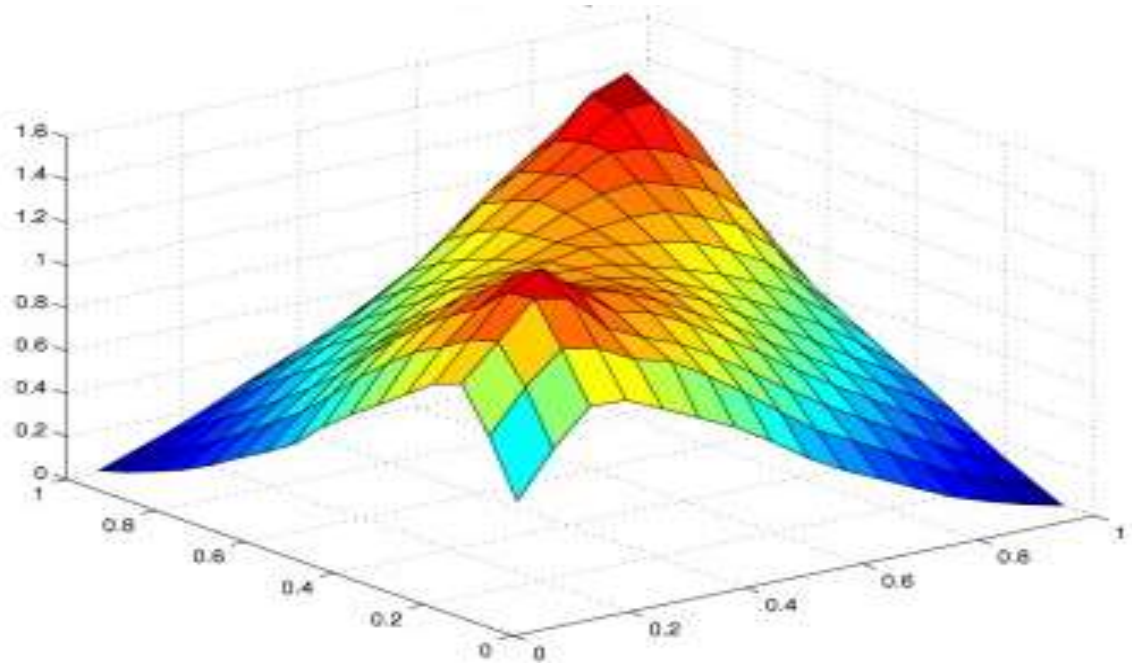


Figure 6 is a three-dimensional graph of a copula function used to determine the dependence between the spot exchange rate and the CAD forward exchange rate to LKR. The two graphs on the x- and y-axis within the scope of 0 to 1 present the exchange rates' cumulative distribution functions (CDF). The copula density values are presented at the z-axis. At the same time, this surface plot illustrates the probability of such spot and total distributions of future exchange rates. The graph's high points represent higher probability areas because they are likely to be obtained for certain values of spot and forward rates. On the other hand, the region enclosed by the valleys has fewer occurrences or less likely combinations.

How the copula surface is set up reveals the dependencies of the two exchange rates. The main peak shows a strong positive relationship between the place and forward exchange rates in which certain ones are virtually guaranteed. This understanding is vital in improving the accuracy and reliability of the forecast for exchange rates since it realizes that the link between the spot and the future exchange rates is not directly related as the method assumes but rather intertwined. Thus, using this copula model, it is possible to increase the effectiveness of forecasting the future exchange rate based on the current spot rates. This is made possible through the copula's ability to capture complex relations, giving a better and more precise prediction model.

Table of Error Metrics

Table 1 Error Metrics of Copula Model for Forecasting Canadian Dollar

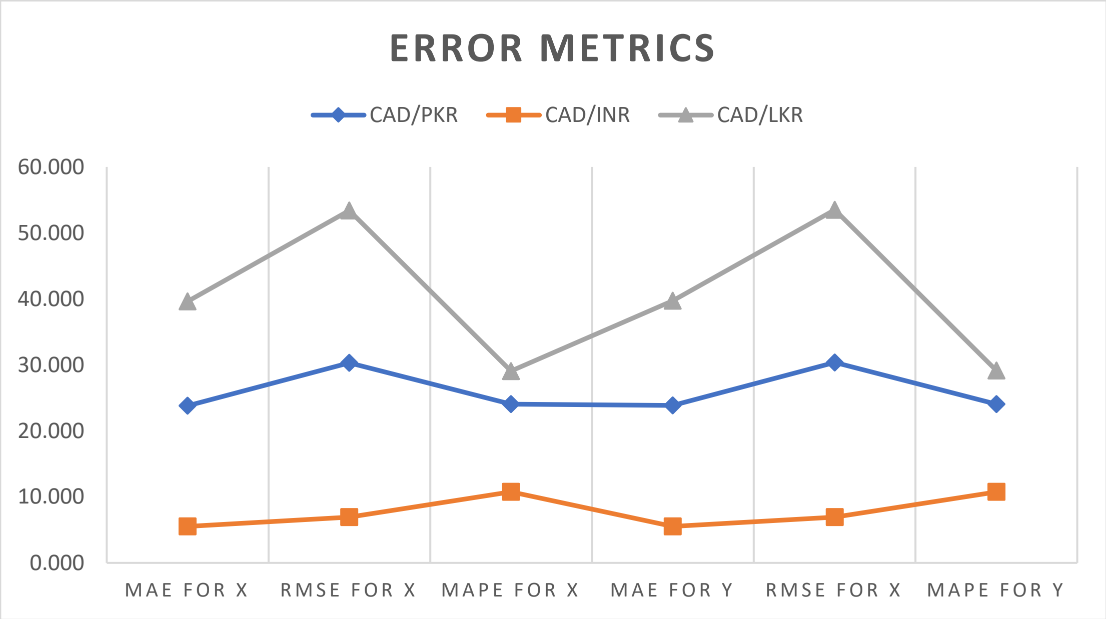
	MAE for x	RMSE for x	MAPE for x	MAE for y	RMSE for x	MAPE for y
CAD/PKR	23.808	30.332	24.062	23.842	30.376	24.066
CAD/INR	5.532	6.930	10.748	5.529	6.923	10.750
CAD/LKR	39.600	53.377	29.073	39.705	53.503	29.162

Table 1 explains the Error Metrics of the Copula Model for Forecasting the Canadian Dollar against the Pakistani, Indian and Sri Lankan Rupee. MAE represents Mean Absolute Error; RMSE shows Root Mean Square Error; and MAPE shows Mean Absolute Percentage Error

The above table shows the error metrics for forecasting the CAD/PKR, CAD/INR, and CAD/LK R exchange rates and depicts the comparison between the two model variants, x and y. Based on the values obtained, it is evident that while Forecasting CAD/PKR, Model X has a slightly better performance with the help of MAE of 23. 808 as compared to Model y's 23. 742, lessening the a verage forecast errors to 842. Although, model x has a marginally better RMSE of 30. This mean s it has 332 recalls, while Model Y has 30. 376, though still not very favourable, it indicates that i t can better cope with relatively more significant errors. MAPE of Model X is 24 per cent. 062%, this is followed by Model Y, which sits at 24 per cent. 066%, which implies a slight improvemen t in the percentage error performance compared to what was obtained in the previous analysis.
Regarding the MAE, Model y outperforms Model x slightly in the CAD/INR case with a value o f 5. 529 instead of Model x's 5. 532, and also slightly lower RMSE which was equal to 6. 923 go es against Model x's six. 930. Thus, even though Model y ought to be better based on its lower M AE and RMSE, its MAPE of 10. Nigeria being 750%, slightly higher than Model x's 10 percent. Which is 748% on Model x, meaning that Model x has a very marginally better percentage of err or performance than the identified model.
In case of CAD/LKR, both Model x and Model y are trained on the same dataset and when com paring the two models on given evaluation parameters, it is evident that Model x has a lower MA E of 39. 600 compared to 39. 705 for Model y, a lower RMSE of 53. 377 versus 53. MAPE was r elatively lower at 29 and the RMSE was 503. 073% compared to 29. 162%. Moreover, these resu lts show that for the CAD/LKR exchange rate, Model x gives slightly better forecasts compared t o Model y. Summing up, it is possible to state that the distinctions between the models are quite minor, but, in general, Model x demonstrates a somewhat higher level of forecast accuracy for th ree selected currency pairs.

Graphical Illustrations of Error Metrics:

Figure 7 shows the graph for error metrics for forecasting of CAD/LKR for Weekly, Forward and Spot Exchange Rates.



The above figure shows the overall performance assessment of how a copula model estimates CAD exchange rates against PKR, INR, and LKR. Using MAE, RMSE, and MAPE, the specified error metrics, the model showed a low capability to predict the CAD/PKR pair's fluctuations, which is a promising sign. It performed moderately well in the forecasts of CAD/INR. However, the intended model faced difficulties accurately describing CAD/LKR exchange rates because the values of MAE showed them to be relatively higher. From the existing research, it can be concluded that although the copula model could work well for selected currency pairs, additional tuning or another approach could be required to improve its forecast accuracy concerning CAD/LKR.

Conclusion

In the assessment of using the copula model for making forecasts on CAD exchange rates against PKR, INR, and LKR, it has been observed that Model x is slightly superior to Model y in most of the errors calculated, though the distinctions are insignificant. Comparing the results between the models for CAD/PKR, it can be concluded that Model X is slightly more accurate than Model Y, as indicated by its lower MAE, RMSE, and MAPE rates. However, for CAD/INR, even though Model Y has a slightly lower MAE and RMSE than Model X, it proves to have less than a one percent difference in MAPE. As seen in the case of CAD/LKR, for all aspects such as MAE, RMSE, and MAPE, Model X shows significantly superior performance to Model Y. Based on these results, it can be concluded that while the copula model can afford reasonable forecasts, Model x presents a slightly improved prognosis for all the considered pairs of currencies.

Recommendations

Preferred Model: Based on the comparative analysis shown in table 7 above, Model X is recommended for forecasting CAD/PKR and CAD/LKR exchange rates because of the slight improvement in most error metrics. Looking at the percentage error analysis for CAD/INR, Model x also reveals slightly better marginal percentage error performance and is more favourable for consistency.

Model Enhancement: One might consider adding more robust characteristics to the copula model to enhance the models' accuracy in the forecast. This may include pursuing further research on other forms of copula constructions or including other economic factors and parameters to improve the issues related to model credibility.

Comprehensive Error Analysis: Perform a more nuanced error analysis to get a picture of errors' dispersion and how they affect the forecast. This can be useful in recommending areas in which t he said model could be refined.

Limitations

Minor Differences: The variance of the characteristics of Model X and Model Y is not very signi ficant. This means that although one model is slightly better, both models are reasonably equally equipped and capable of highly similar results, hence the implications on the overall increase in f orecast accuracy.

Data Constraints: This method uses past data from a particular period, which can be a limitation i n attempts to forecast the markets in the future or an inevitable occurrence that can affect exchan ge rates.

Error Metrics Limitations: That is why the evaluation of the given models by MAE, RMSE, and MAPE can be considered a general view of the forecasting accuracy with no detailed considerati on of all aspects of model performances. However, other factors, such as other metrics or even qu alitative factors, could affect the forecast's reliability.

Future Research Directions

Advanced Models: Investigate other forecasting methods, such as machine learning methods or t he combination of existing methods, to achieve higher forecasting accuracy and capture all relati onships in the exchange rate series.

Extended Data Analysis: A more extensive data set should be employed in future studies to inclu de more recent and diverse periods and more currency pairs to better assess the model's performa nce.

Error Distribution Analysis: Further research on the patterns of forecast errors should be carried o ut to assess their effect on decision-making and the performance of the models. This could entail looking at situations where the model yields a low accuracy rate.

Economic Factors Integration: This will include macroeconomic indicators, political climate, and other external factors that would improve the model. Its usefulness can be seen in identifying all factors ranging from fundamental to affecting exchange rate movement.

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