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Inflationary Impacts Since the Global Pandemic Crisis: The Potential of Forecasting Techniques and Technologies

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Introduction

There were, as is still the case, currently, calls for possible consideration of further accommodative and expansive monetary policies which include macro prudential tools. Interest rate adjustments in other jurisdictions; as well as fears of retaliatory responses – as previously highlighted - which include the use of currency devaluations, also all added to the heightened and increased levels of uncertainty, which not only impacted central bank policy instruments of other jurisdictions, but also global stock markets. The effects of lower interest rates on the central bank's inflation targeting policies – as well as consumer expectations, constituted a subject of contentious debates. Whilst lower interest rates are needed to stimulate economic activity – even where it appears that reasons for doing so are not immediately apparent, there were also concerns that such actions may impact consumer expectations by delaying spending in the hopes of lower rates or even worse, trigger fears and concerns amongst investors.

Main Issues to be addressed

Global stable coins (GSCs) are considered to present "significant adverse effects" domestically and internationally in terms of monetary policy - as well as financial stability. "Further, their challenges to cross jurisdictional efforts to combat money laundering and terrorist financing presents further issues for international monetary systems- with implications for monetary sovereignty.

In accentuating the potential effects and impacts of stable coins, the following have been observed (Brainard, 2019:8): 1) Widespread adoption of stable coins could have implications for the role of central banks and monetary policy. 2) The central bank's approach to implementing monetary policy may be complicated to the extent that bank's participation in short term funding markets is affected. Reference is made to open economies and their susceptibility to a payments system impacted by digital currencies that are controlled by private actors - in which case it is highlighted that Sweden, along with

countries like Australia, New Zealand, Canada and Norway, fall within a category of countries - a group of small open economies with floating exchange rates and inflation targets which experience relatively similar challenges and problems (Ingves, 2019: 2). It is further added: - Through free capital movement, low real interest rates have been imported, and a downward pressure on inflation, generated through processes such as globalization.

Questions that have been brought to light, center round whether central banks considering the issue of digital currencies should also assign interest rates to such currencies - as well as conditions and factors which would impact such currencies. Would those rates be more flexible and volatile than the previous floating exchange and inflation targeting rates? Why should governments back stable coins which have the potential to trigger risks of systemic nature, relevance and importance where there were options to support their central banks with much needed stability? Why should governments back private actors engaged in crypto assets and global stable coins' issue where regulatory, legal uncertainty, sound governance and public policy issues - amongst several other challenges still needed to be resolved? Why not render support to, and consolidate on the measures, mechanisms and existing mechanisms available to central banks? Governments can be criticized for engaging in purely politically motivated and political interests where regulatory safeguards appear to be overlooked as a means of endorsing certain actors which may ultimately benefit their political interests. Certain actors, by virtue of their national values, as well as their significance, relevance, and impact on stock markets, may be accorded preferential treatment - a kind of "too big to fail institution ". However, providing assistance and support to prevent a systemic failure does not necessarily infer that license is permitted to carry on with unregulated activities. This is precisely why moral hazard issues arise - sometimes politically motivated interests may end up undermining central bank stability mandates.

Which is why the engagement of accommodative unconventional and conventional monetary policies does not necessarily undermine central bank independence. Sometimes asset backed government programs do not compromise independence - rather it is the support of governments for unregulated untested ventures which have potentially devastating systemic consequences that poses serious matters of concern. It is welcomed that the Financial Stability Board is currently engaged in initiatives aimed at considering the regulatory issues of stable coins. In accentuating what sets Libra apart from other stable coins, Brainard (2019: 5) states that "the issuance of a private digital currency opaquely tied to a basket of sovereign currencies, through an active user network representing more than

a third of the global population " necessitated the responsibility of addressing fundamental sets of legal and regulatory challenges before initial payment could be facilitated.

As a means of addressing public policy challenges, Beau (2019: 4) proposes the following responses: 1) Ignoring crypto assets - however this in his view, is not recommended on the basis of risks presented- more so in the case of stable coins 2) Banning crypto assets; 3) Promoting innovations with the potential to change the payment services market, namely establishing appropriate regulations that make it possible to reconcile the following two fundamentals: reconciling i) Risks already highlighted. ii) Preserving the potential for technological innovation offered by crypto assets.

Hence financial stability concerns constitute just one aspect to crypto assets.

The innovative possibilities - as well as those of distributed ledger technologies constitute benefits which can be harnessed to enhance digital possibilities of the Fourth Industrial Revolution.

Such benefits are as follows (Beau, 2019: 2,3)

- Block chain technology and more broadly, the distributed ledger technologies (DLT), could help address the market's needs and demands - particularly demand for quick and safe cross border payment solutions which are available 24-7
- DLT (distributed ledger technologies) could help remedy the current limits of the existing wholesale market infrastructures
- Crypto assets undergoing technical and economical trials bring about not only opportunities to improve payment systems, but also material risks which on the contrary, might weaken them, if not addressed.

Forecasting Techniques as a Means of Mitigating Uncertainties: Artificial Intelligence and Block chain Technologies

The use of machine learning techniques as a means of predicting bank distress in the United Kingdom, is highlighted by Treitel, H.and Suss .J., (2019, in their paper "Predicting Bank Distress in the UK with Machine Learning."¹

¹ Treitel.,H. and Suss .J, (2019). "Predicting Bank Distress in the UK with Machine Learning" Bank of England Staff Working Paper No 831

In their analysis, they compare and contrast classic linear regression techniques with modern machine learning approaches that are able to “capture complex non-linearities and interactions.” They find that the random forest algorithm “significantly and substantively outperforms other models” when utilizing the AUC and Brier Score as performance metrics (Treitel and Suss, 2019).

Other findings are as follows (2019:3,4):

- In justifying their argument that conventional approaches, such as logistic regression models, are unable to account for complex interactions and non-linearities, thereby tending to perform worse than their more flexible machine learning counterparts, they compare pooled logistic regression with a linear random effects model, the k nearest neighbours (KNN) algorithm, two classification tree ensembles (random forest and boosting), and a support vector machine (SVM).
- In order to measure performance, they estimate out-of-sample predicted probabilities using a unique cross validation design that accounts for various potential sources of bias - repeating the entire cross validation exercise ten times to account for the variability that arises due to the specific initial random split performed.
- Even though they find that the random forest algorithm significantly outperforms the other approaches examined in terms of the area under the ROC curve (AUC) and Brier score, the cost benefit analysis of implementation is also highlighted in the sense that “the performance advantage of the random forest algorithm comes with a transparency cost relative to the pooled logit model which, depending on the requirements of regulators, could outweigh the benefits.”

They further, conclude that that lagged macroeconomic variables are very important for predicting distress and that for the random forest, a measure of average real UK earnings constitutes the single most important variable – the average earnings, in contrast, not being as important.²

Conclusion

Important lessons which were drawn from the most recent GFC - notably, the growing need for accommodative policies (unconventional and conventional) to facilitate appropriate responses - given limited monetary policy spaces, the emergence, rise and evolution of private actors and their implications for monetary policies and financial stability. Unregulated and without legal certainty, there are potential causes for concerns in respect of the global adoption of stable coins - even though when harnessed and regulated appropriately, these could provide much needed innovative changes and benefits. Central banks should still assume vital monetary policy setting functions - even amidst uncertainties relating to how central bank digital currencies should be issued - particularly in respect of which and whether interest rates should be attached to these. Rehn states that a key lesson of monetary policy of the last ten years is

² “relatively speaking, for the pooled logit model.”

that timely action is essential to avoid the zero lower bound - as well as an extended period of extremely low levels of inflation. The incorporation of innovative forecasting techniques with monetary policy setting may greatly mitigate current uncertainties linked to particular accommodative monetary policies. Contrasted to the policy of leaning against the wind, such techniques - along with more relevant, applicable, tried and tested techniques, and up to date indices, could generate greater confidence in the data being used - as well as expectation and inflation levels.

Incorporating Uncertainty in Forward Looking Monetary Policy Tools

“Because it takes time before monetary policy has its full impact on inflation, monetary policy is guided by forecasts for the economy and inflation. In addition, the Riksbank publishes, among other things, its own assessment of the likely future path for the repo rate and the degree of uncertainty surrounding that path. This interest rate path “is a forecast, not a promise”. In connection with every monetary policy decision, “the Executive Board makes an assessment of the repo-rate path needed for monetary policy to be well-balanced. A well-balanced monetary policy is normally a question of finding an appropriate balance between stabilizing inflation around the inflation target and stabilizing the real economy”(Goodfriend and King, 2015:21). The journey since the most recent GFC has highlighted the need for several considerations, including, namely: the need to consider pro cyclical effects – as well as business and financial cycle risks, risks attributed to the changing financial environment – in form of emerging technological risks – and particularly unregulated blockchain technologies and platforms through which crypto currency markets are currently dependent on – as well as protectionist risks.

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