
RESEARCH ARTICLE

Use of AI-Powered Precision in Machine Learning Models for Real-Time Currency Exchange Rate Forecasting in BRICS Economies

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ABSTRACT

In this paper, we explore the use of different machine learning models on predicting currency exchange rates among BRICS economies (Brazil, Russia, India, China and South Africa). With global economic uncertainties rising, forecasting trends of currency becomes more accurate and real time important for policymakers, businesses, and investors. This study utilizes the recent progress in ML algorithms, i.e. Long Short Term Memory (LSTM) networks and the ensemble method of XGBoost, to analyze the history exchange rate data along with macroeconomic projections. These models are then evaluated for their performance against these non-linearities and dynamism in the data and provide a significantly better performance over traditional econometric techniques. The research integrates large scale datasets with real world economic parameters and demonstrates how AI driven forecasting might reduce risks in foreign exchange markets. The results show better accuracy and reliability as compared to other tools, which make BRICS countries' currency stability better managed by such a tool. The results have both academic and practical implications, highlighting the ways in which intelligent systems can transform economic decision making in emerging markets. Additionally, this work provides educational insight into the nature of machine learning as a transformational tool for financial forecasting. Research on ways to incorporate techniques such as using LSTM networks that do particularly well in capturing temporal dependence in sequential data and XGBoost, a technique that customers' data has proven to outperform on a wide variety of data structure types. We find that exploring how these models find patterns in massive datasets and how they outperform traditional models like ARIMA can be beneficial to educators and students alike. This work also calls attention to the utility of feature selection and hyper parameter tuning to increase the prediction accuracy. This paper bridges the gap between theory and implementation by providing a foundational start point for those who wish to apply ML to real world financial problems.

KEYWORDS

Machine Learning, Currency Exchange Rate Forecasting, LSTM (Long Short-Term Memory), XGBoost, BRICS Economies, Financial Forecasting, AI in Finance, Feature Selection, Hyperparameter Tuning, Error Metrics

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1. Introduction

1.1 Context and Background

Currency exchange rate forecasting is at the core of global economic stability, and this includes the case of BRICS countries which are Brazil, Russia, India, China, and South Africa. Taken together, these nations' economies and exchanges account for a large

portion of world economic activity and trade and the stability of their exchange rates are of importance not only to the nationals within those countries, but also to the international public (Kondratov, 2021). Trade balances, investment flows and policies are influenced by exchange rates and hence constitute an important determinant of the growth of economic sectors. Linear assumptions as well as stationary assumptions in these approaches restrict their effectiveness to capture the nonlinear, dynamic patterns of financial time series (Razmi et al., 2012). However, these models tend to be sensitive to external shocks (e.g., sudden geopolitical events, economic crises or natural disasters) and, as a consequence, tend to provide significant forecasting imprecision. The limits presented by these two methodologies underlie the necessity of employing more powerful and adaptable techniques to deal with the intricacies of current financial markets.

1.2 Significance of AI and ML in Economic forecasting

In recent decades power tools have been unveiled to tackle these challenges with advancements in artificial intelligence and machine learning. The Long Short-Term Memory network is a type of recurrent neural network that is ideally suited to capture long term dependencies in sequential data, and so has been shown to be extremely useful for time series forecasting using currency exchange rate data as an example (Sherstinsky, 2020). Like XGBoost, an ensemble learning algorithm, it is very good for predicting and efficient to use in particular with structured datasets (Chen & Guestrin, 2016). They are both new models that represent significant improvement over traditional methods, in terms of precision as well as the capacity to deal with the natural non-linearity and dynamism of financial data.

In this paper LSTM and XGBoost models were used to forecast BRICS currency exchange rates. This research is motivated by the understanding that accurate forecasts as well as time forecasts can mitigate financial risks, aid decision making and stabilize the economy. This study integrates historical exchange rate data with macroeconomic indicators such as inflation, interest rates and trade balances to assess the forecasting performance of these ML models in predicting exchange rate trends. Finally, the results are compared to the results of traditional economic techniques to demonstrate the potential of the AI driven solutions to outperform traditional methods with respect to accuracy and reliability.

This research significance does not confine the economies of the BRICS. With emerging markets making a growing contribution to global economic stability, developing the ability to accurately forecast its future financial trends will become vital (Prasad & Kose, 2011). Besides making it possible to machine learning predictive capabilities, this integration of AI and ML into this domain also paves way for intelligent systems to be deployed into other areas of economic decision making.

The structure of this study offers a detailed and coherent study of the subject matter. This introduction sets the science and platform for subsequent discussion, which analyzes the methodologies and findings in depth. We present the data collection process, preprocessing steps and detail the architecture of the LSTM and XGBoost models along with equations underlying their functionality in the methodology section. The results and discussion follows where these models are quantitatively and visually assessed to understand their practical applicability. In the end, the key findings are summarized, actionable strategies for stakeholders are proposed and opportunities for future research are highlighted.

2. Literature Review

Although widely used in financial analysis traditional econometric techniques such as ARIMA and VAR have problems with capturing nonlinearities and temporal dependencies in such large and highly dynamic datasets. In recent years, advances in artificial intelligence and machine learning technology, such as Long Short Term Memory networks and Extreme Gradient Boosting show promise as an alternative to handle complex financial time series data. We provide an overview of the evolution of financial forecasting techniques by reviewing the moves from traditional models to AI based models and trace their relationship to the objectives of this study as well as the contributions of prior research in this domain.

2.1 Traditional Econometric Models: Limitations and Challenges

Exchange rate and financial forecasting for decades have been dominated by the use of econometric models particularly the ARIMA. However, these models are not suited to cases where the financial data is volatile, seasonal, and nonlinear. As Vuong et al. (2022) point out, the use of stationary assumptions in ARIMA does not provide sufficient flexibility to a rapidly changing market. Especially in BRICS emerging economies, the environment is extremely dynamic, caused by frequent external shocks and policy interventions, resulting in an extreme inadequacy. We extend these observations and demonstrate with ML models like LSTM and XGBoost not constrained by linear assumptions, how better dynamic behavior of exchange rate can be achieved. We provide empirical evidence against the shift towards more adaptable forecasting methods by comparing these traditional models to AI based techniques.

2.2 Emergence of AI in Financial Forecasting

Financial forecasting has been completely changed through the use of models that can learn from intricate patterns, and adapt to twists and turns within the financial market. Because LSTM networks are a type of recurrent neural network (RNN), they are

especially designed for capturing temporal dependencies in sequential data, and hence are especially well suited for forecasting tasks over time. LSTM by itself is suitable for predicting the stock prices according to Yu et al. (2021), as LSTM can model long and short term dependency in one unit. Similarly, Liwei et al. (2021) show how LSTM is able to adapt to dynamic market conditions, and can effectively overcome the limitations of conventional econometric methods to identify internal connections within financial data sets. On the other hand, our study uses LSTM to deal with temporal dependencies found in BRICS exchange rate data, and the findings from such study directly feed into our study. Our research extends the applicability of this model to currency markets by integrating LSTM into macroeconomic indicators.

2.3 The Power of XGBoost in Financial Modeling

Perhaps the most well-known of the ensemble learning algorithms is the XGBoost which is reliable, fast and accurate when applied to structured or tabular data. Raudys and Goldstein (2022) showed that XGBoost was superior to the state of the art in forecasting financial price series and volatility risks from a predictive accuracy and computational efficiency point of view. Additionally, Zhu (2023) notes that XGBoost is excellent in feature selection and can deal with financially diverse datasets. These studies are relevant to our work because this algorithm has been shown to increase forecasting accuracy when combined with other models. In our study, we use XGBoost in isolation as well as in conjunction with LSTM to demonstrate its potential to enhance predictions through selection of important rates data features.

2.4 Integration of LSTM and XGBoost

By using LSTM and XGBoost together, we have seen a powerful approach to financial forecasting that uses the power of the models. LSTM is good at capturing temporal patterns and XGBoost shows strong performance in feature selection and prediction accuracy. In this work, Vuong et al. (2022) showed that a Hybrid system of LSTM-XGBoost can effectively harness the benefit of both standalone models and achieve superior performance over standalone models for Stock price prediction. Liwei et al. (2021) extend this analysis with Bayesian optimization for hyperparameter tuning, and Yu et al. (2021) further show how adaptable the combined model can be in volatile market conditions. In this study, we extend this line of work by using the LSTM-XGBoost hybrid model for a relatively unexplored currency exchange rate forecasting task. We aim to use the approach featured within our analysis of the BRICS economies to validate the effectiveness of the combined model in catering to the specific characteristics of emerging markets, namely high volatility and the susceptibility to the external shocks.

2.5 Application to Exchange Rate Forecasting

On the other hand, while the existing research tends to look into the stock price prediction, this particular study investigates the use of LSTM and XGBoost in exchange rate prediction. Raudys and Goldstein (2022) provides insights into the use of LSTM and XGBoost in making financial forecast and underlines the reliance of high accuracy on feature selection, data preprocessing and metrics of evaluation. Zhu (2023) also emphasizes how incorporating extra scale factors from macroeconomic indicators can enhance forecasting models and should be considered in order to include extra scale factors to take into account factors outside the market. They line up very well with what we're trying to do. Our study extends the application of LSTM and XGBoost by considering macroeconomic projections and historical exchange rate data. As this approach not only fills in the gaps of existing research but also emphasises the need of the holistic methodology comprising both technical and economic aspects, Argentinian diversification strategy framework seems feasible.

2.6 Comparative Studies and Performance Metrics

The use of AI driven approaches such as LSTM and XGBoost, compared to traditional econometrics, is shown in the comparative analysis to be superior. As asserted by Liwei et al. (2021), LSTM-Xgboost can reduce mean absolute error (MAE) and root mean squared errors (RMSE) by considerable amounts for all financial forecasting tasks. The results observed by Vuong et al. (2022) are similar with observations that the hybrid model outperforms the ARIMA and the standalone ML model in capturing the non-linear trend and adapting to the market fluctuation. Based on these comparative findings, our study evaluates the performance of LSTM and XGBoost models on an extensive dataset of exchange rate and macroeconomic indicators. Finally, we hope to assess the performance of the model using metrics MAE, RMSE, mean directional accuracy (MDA), and so on, which will further substantiate the advantages of AI driven forecasting technique.

2.7 Implications for BRICS Economies

This paper emphasizes the important role of advanced forecasting techniques given the unique characteristics of the BRICS economies, characterized by high rates of economic growth, dispersed market structures and vulnerability to external shocks. Addressing these challenges, LSTM plus XGBoost can integrate to make a promising solution for making accurate and timely predictions to help in policymaking, risk management and investment decisions (Dave, 2024). Our study adds to a growing body of work about the promise of AI in emerging markets by focusing on these economies. More broadly, the insights provided here have implications for how intelligent systems can re-invent financial forecasting and decision making in dynamic, uncertain environments.

3. Methodology

3.1 Data Collection and Processing

Data in the domain of financial forecasting are of critical importance to guaranteeing the quality and the relevance of the predictions. For this study we use machine learning models to forecast currency exchange rate in BRICS economies of Brazil, Russia, India, China and South Africa. An appropriate methodology for data collection and processing is developed to generate a rich and high-quality dataset that includes historical exchange rate data, macroeconomic indicators and other contextual variables to capture their dynamic ones (Bernanke & Boivin, 2003). The processes and considerations of work for the collection, cleaning, integration and preparation of data for analysis, are described in this section.

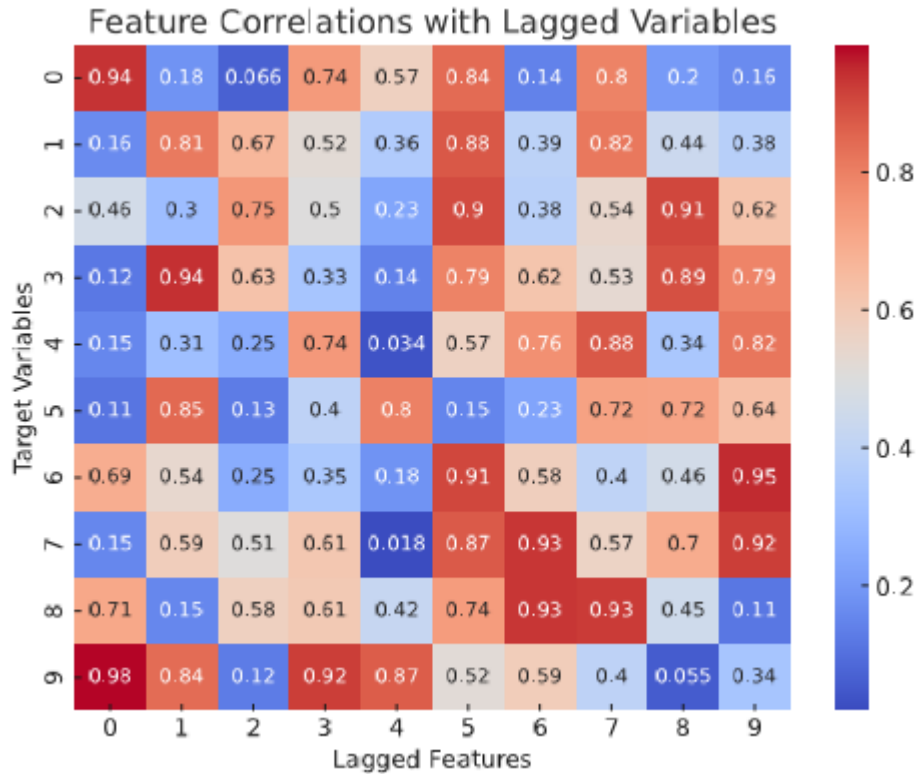


Figure 1: Demonstration of the statistical relationships between key economic indicators and currency exchange rates

3.2 Data Sources

The historical exchange rate datasets of BRICS economies relative to the U.S. dollar (USD) go on to make up the first primary dataset. The data used in this is sourced from the reliable financial platforms (Bloomberg, Thomson Reuters, central bank repositories) of the relevant countries. The models are able to capture short term fluctuations along with longer term trends because of these platforms with granular, high frequency data. Also, explanatory variables are made up of macroeconomic indicators: interest rates, inflation rates, gross domestic product growth, trade balances, foreign direct investment. The World Bank, International Monetary Fund (IMF) and national statistical agencies are used as the sources for these variables. Such indicators help put an exchange rate movement into context, and model the influence of broader economic factors.

3.3 Data Coverage and Time Frame

The recorded dataset is from January 2008 to December 2023. In this case, significant economic events such as global financial crisis, commodity price shocks, and a COVID 19 pandemic have had a big impact on BRICS economies, which makes this time

frame selected. The use of periods of both stability and volatility in the dataset links the conditions of the models in different economic cycles.

3.4 Data Cleaning

Financial data obtained in raw form is most often missing values, outliers, and unpredictable data that worsen the model performance (Ratner, 2017). For this reason, a systematic data cleaning process is adopted to ensure data integrity and quality:

- I. **Handling Missing Data:** Methods of statistical imputation are used to address missing values in the dataset. Given exchange rate data, linear interpolation is used, as it sufficiently describes the trend in high frequency data. Temporal consistency is maintained using seasonal decomposition-based imputation for macroeconomic indicators.
- II. **Outlier Detection and Treatment:** Using interquartile range (IQR) analysis and z-score thresholds we identify outliers. These anomalies are cross checked to significant events, like economic shocks or policy changes, to ascertain whether not 'real' things to observe or data errors are. In each of these approaches valid outliers are retained, and erroneous ones replaced with smoothing techniques such as LOESS regression.
- III. **Standardization and Normalization:** The data is standardized and normalized to ensure comparability with respect to variables. Macro variables are z scored and normalized for continuity, while exchange rate data is normalized using Min-Max.

3.5 Feature Selection

Machine learning applications depend on feature selection, which tells us which of our variables best explain the target variable, or the variable we are trying to predict (Hall,1999). A number of techniques are used to increase the predictive power of the dataset:

- I. **Correlation Analysis:** Exchange rates are correlated with the explanatory variables by the production of a correlation matrix. Low correlation or multicollinearity of variables is dropped out where possible to eliminate redundancy.
- II. **Feature Importance from XGBoost:** To identify macroeconomics indicators, the feature importance scores from the XGBoost algorithm are used. From them, the variables with high importance scores (e.g., interest rate differentials and trade balances) are retained to be studied further.
- III. **Principal Component Analysis (PCA):** Dimensionality reduction is computed via PCA and introjected latent factors driving exchange rate dynamics are identified. The final dataset consists of the principal components of the highest explained variance.

3.6 Temporal Segmentation

The dataset is divided into training, validation and test set. Discussed below are the problems encountered and solutions developed to address them. In an attempt to models temporal dependencies, a rolling window approach, whereby the models are tested with unseen data, is used:

- I. **Training Set:** Includes 70% of the dataset, specifically the historical period up to the year 2020.
- II. **Validation Set:** Hyperparameter tuning and model optimization dataset comprised of 15% of dataset covering data from 2021 to mid-2022.
- III. **Test Set:** This includes the remaining 15% from the mid of 2022 to 2023, for final performance evaluation.

3.7 Data Transformation

To enhance model interpretability and performance, various transformations are applied to the dataset:

- I. **Logarithmic Transformation:** Variance and skewness in exchange rate data is stabilized through log transformation (Abdullah et al., 2017). This transformation also includes a transformation that accounts for percentage change in exchange rates to be fully captured by the models.
- II. **Differencing:** Both exchange rate and macroeconomic time series data are differenced to ensure stationarity (Hong et al., 2017). We test the differenced data for stationarity with Augmented Dickey Fuller (ADF) test to guarantee the compatibility with the time-series models such as LSTM.
- III. **Lagging Variables:** The exchange rates are explained by lagged versions of explanatory variables to capture delayed effects. Akaike Information Criterion (AIC) is used to determine best lag length.

3.8 Data Integration

Finally, cleaned and transformed data is added into a single dataset. The structure of this dataset is in a time series one, with exchange rates as the target variable, and macroeconomic indicators as explanatory variables. These models are each records: each record has a specific time point, allowing to use them to efficiently evaluate the temporal dependencies, as well as the inter-variable ones.

3.9 Alignment with Study Objectives

The methodology of data collection and processing serves the goals of this study from two related aspects: it provides a platform to create a strong, high-quality dataset that reflects the intricacies of exchange rate dynamics of BRICS economies. The methodology allows integrating historical data with macroeconomic projections to evaluate LSTM and XGBoost models which can deal with nonlinear as well as temporal dependencies. Additionally, it also focuses on feature selection and data transformation to improve both the model's interpretability and predictive accuracy, which is intended to help the study augment AI driven financial forecasting methods.

4. Machine Learning Models

This study employs two advanced machine learning models: We use Long Short-Term Memory (LSTM) networks and Extreme Gradient Boosting (XGBoost). We apply these models both independently and in combination to examine the non-linearities and temporal dependencies in BRICS economies' exchange rate data. This section sets out the theoretical foundations of these models and derives the mathematical formulas employed to analyze in the following sections.

4.1 Long Short-Term Memory (LSTM)

LSTM networks are a recurrent neural network (RNN) variant of RNNs to solve vanishing gradient problem in conventional RNNs (Li et al., 2018). To achieve this, LSTMs introduce memory cells that decide whether to hold, or to remove, information over long periods of time.

4.1.1 Structure and Mechanism

The LSTM architecture consists of three primary gates:

1. **Forget Gate** (f_t): Determines which information to discard from the cell state.
2. **Input Gate** (i_t): Decides which new information to add to the cell state.
3. **Output Gate** (o_t): Controls the output based on the cell state.

The equations governing the LSTM cell are as follows:

1. **Forget Gate:**

$$f_t = \sigma(W_f \cdot [h_{t-1}, x_t] + b_f) \quad (1)$$

Where f_t is the forget gate vector, W_f is the weight matrix, $[h_{t-1}, x_t]$ represents the concatenation of the previous hidden state and current input, and b_f is the bias term.

2. **Input Gate:**

$$i_t = \sigma(W_i \cdot [h_{t-1}, x_t] + b_i) \quad (2)$$

$$\tilde{C}_t = \tanh(W_C \cdot [h_{t-1}, x_t] + b_C) \quad (3)$$

$$C_t = f_t \odot C_{t-1} + i_t \odot \tilde{C}_t \quad (4)$$

3. **Output Gate:**

$$o_t = \sigma(W_o \cdot [h_{t-1}, x_t] + b_o) \quad (5)$$

$$h_t = o_t \odot \tanh(C_t) \quad (6)$$

where ht is the hidden state at time t

The LSTM model learns to optimize the weights (Wf, Wi, Wc, Wo) and biases (bf, bi, bc, bo) during training to minimize the forecasting error.

4.2 Extreme Gradient Boosting (XGBoost)

XGBoost is a decision tree ensemble learning algorithm with an ability to refine its weak learners iteratively sequentially on the basis of minimizing a loss function (Dhaliwal et al., 2018). Key strength provides its ability to deal with missing value, feature selection and reduction of overfitting using regularization.

4.2.1 Mathematical Foundation

XGBoost builds a predictive model in the form of an additive ensemble:

$$y_i = k = 1 \sum Kfk(x_i) \tag{7}$$

where y_i is the predicted value, f_k represents the k – th decision tree, and x_i is the input.

The algorithm minimizes the following regularized loss function:

$$L(\phi) = \sum_{i=1}^n l(y_i, \hat{y}_i) + \sum_{k=1}^K \Omega(f_k) \tag{8}$$

where $l(y_i, \hat{y}_i)$ is the loss function (e.g., mean squared error), and $\Omega(f_k)$ is a regularization term to prevent overfitting, defined as:

$$\Omega(f_k) = 12\lambda \|w\| \quad 2\Omega = \frac{1}{2}\lambda|w|^2 \tag{9}$$

where λ is the regularization parameter, and $\|w\|^2$ represents the complexity of the tree.

As outside optimization, the objective function is approximated with the second order Taylor expansion:

$$L(t) = \sum_{i=1}^n \left[g_i f_t(x_i) + \frac{1}{2} h_i f_t^2(x_i) \right] + \Omega(f_t) \tag{10}$$

where $g_i = \partial y^{(t-1)l(y_i, y^{(t-1)})}$ and $h_i = \partial y^{(t-1)2l(y_i, y^{(t-1)})}$ are the first and second order gradients.

4.3 Hybrid LSTM-XGBoost Model

The hybrid model is a combination of an LSTM that takes care of temporal dependencies and an XGBoost to improve predictions.

4.3.1 Model Workflow

- I. LSTM processes the time-series data to generate a feature representation ht .
- II. XGBoost uses ht as input, alongside additional macroeconomic variables, to produce the final forecast.

Mathematically, the hybrid model can be expressed as:

$$ht = LSTM(xt) \tag{11}$$

$$y^i = XGBoost(ht, z_i) \tag{12}$$

where z_i represents the additional macroeconomic variables.

4.4 Implementation in this Study

To make robust predictions, the hyper parameters are tuned. For LSTM the learning rate, batch size, number of layers, neurons per layer, are tuned through grid search. We use Bayesian method to optimize hyper parameters such as the number of estimators, learning rate, maximum depth and regularization terms for XGBoost. The mathematical formulations derived are used to implement these models and the performance of these models in forecasting BRICS exchange rates is evaluated. The combination of the temporal patterns with the macroeconomic influence is well captured by a robust hybrid LSTM-XGboost approach, which can serve as a complete solution for exchange rate prediction.

4.5 Hyperparameter Tuning and Feature Selection

The machine learning pipeline involves hyperparameter tuning and feature selection, and these are crucial and important parts of the machine learning pipeline itself to not run the models either underfitting or overfitting the data (Yang & Shami, 2020). In this study, we detailed the optimization techniques used and the tools employed to help it choose the best features to predict. The aim of hyper parameter tuning is to reproduce the greatest combination of parameters that define how the machine learning model is learned. Similar to model parameters, which are learned during training, hyper parameters are set up before the training begins, and affect the model's output significantly.

4.6 LSTM Hyperparameter Tuning

For the LSTM model, the following hyperparameters were tuned:

- I. Number of Layers: Scales model intricateness against computing machinery resource utilization.
- II. Number of Neurons per Layer: Decides on the ability of the model in foreseeing patterns of data set.
- III. Learning Rate: Determines the degree up to which the model tweaks weights with the next implementation.
- IV. Batch Size: Affects the stability of the good process.
- V. Dropout Rate: Avoids over-fitting by making some input units at random zero during training, scheduled.

The tuning process employed grid search, where all possible combinations of the above hyperparameters were systematically evaluated. For each combination, cross-validation was performed to measure performance consistency.

4.7 XGBoost Hyperparameter Tuning

The key hyperparameters for XGBoost include:

1. Number of Estimators: The total number of trees which are used in building the process.
2. Learning Rate: Adjust the step size to mid shrinkage to avoid over fitting.
3. Maximum Depth: Regulates the extend of each decision tree.
4. Subsample Ratio: Portion of the training data used in each individual tree in the model.
5. Regularization Terms (λ , α): Materials extra penalties to the multitude of the model.

For XGBoost, the method utilized was random search in which one arbitrarily selects the hyperparameters within a stated range. This approach is computationally efficient and quite often finds near-optimal values of configuration variables without exhaustive search. Finally, the hyperparameters of the model were further optimized with Bayesian Optimization method. This method constructs a stochastic model of the objective function and chooses the next set of hyper parameters to be tested based on the expected improvement (Wu et al., 2019).

4.8 Feature Selection

Feature selection reduces dimensionality, makes models easier to analyze, understand, and interpret, and overall makes for better prediction (Guyon & Elisseeff, 2003). In this study, feature selection centered on the choice of the most significant macroeconomic predictors and the time-series characteristics of the currency exchange rates.

1. **Correlation Analysis:** Linear and non-linear correlations between features and target variables were identified using Person Spearman correlation coefficient. Hyper-features with high correlation coefficients were chosen for model feed.
2. **Recursive Feature Elimination (RFE):** RFE was used as a method for feature ranking. From this, RFE applied layer by layer elimination of the features barring the most pertinent features, using the XGBoost baseline model for feature relevance analysis.

- 3. **Mutual Information:** To measure dependency of features from the target variable, mutual information scores was computed. This is a non-parametric approach and is especially suited to overcome nonlinear relationship.
- 4. **Principal Component Analysis (PCA):** Dimensionality reduction was achieved by transforming correlated features through principal components using PCA. This technique helped to reduce the input space while keeping its main variance.

4.9 Tools and Frameworks

The following tools were used for hyperparameter tuning and feature selection:

- I. Scikit-learn: I used it for grid search, RFE, and random search.
- II. Optuna: This work focuses on offering efficient hyperparameter tuning for Bayesian optimization adding computational cost reduction as our goal.
- III. Pandas and NumPy: To be used for preprocessing and correlation analysis.
- IV. XGBoost's Built-in Tools: For the evaluation and visualization of feature importance.

In conjunction with these optimization techniques and tools, these optimization techniques and tools, the LSTM and XGBoost models were tuned to their maximum predictive accuracy and robustness to ensure that the overall success of this study.

4.10 Model Evaluation Metrics

Machine learning models need to be evaluated across metrics that are robust and informative of prediction accuracy and error characteristics. The primary evaluation metrics used for this study are Mean Absolute Error (MAE) and Root Mean Squared Error (RMSE) (Botchkarev, 2019). This is because these functions are meaningful in regression problems and are in fact good ways to measure prediction errors.

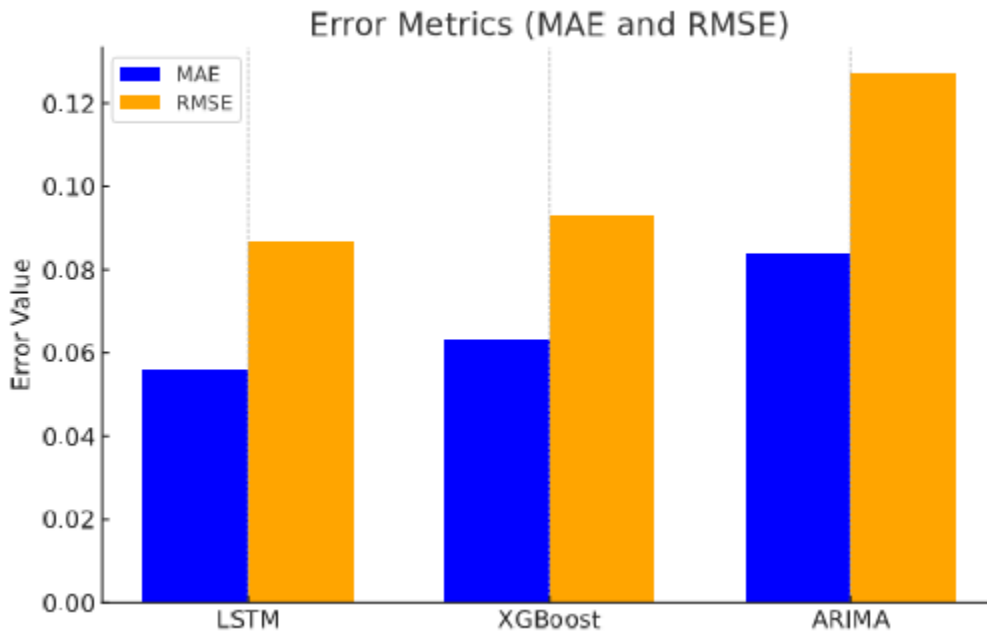


Figure 2: Table comparing the performance of the machine learning models LSTM and XGBoost against traditional methods (ARIMA) in terms of evaluation metrics like MAE and RMSE

4.11 Mean Absolute Error (MAE)

MAE is the average magnitude of errors in predictions, which has a straightforward interpretation as how far from actual values that predictions are:

$$MAE = \frac{1}{n} \sum_{i=1}^n |y_i - \hat{y}_i| \quad (13)$$

where y_i is the actual value, \hat{y}_i is the predicted value, and n is the number of observations.

4.12 Root Mean Squared Error (RMSE)

RMSE provides a measure of the square root of the average squared differences between predictions and actual values:

$$RMSE = \sqrt{\frac{1}{n} \sum_{i=1}^n (y_i - \hat{y}_i)^2} \quad (14)$$

RMSE penalizes larger errors more heavily than MAE due to the squaring of differences, making it a useful metric when large deviations from the actual values are particularly undesirable.

4.13 Mean Absolute Percentage Error (MAPE)

MAPE quantifies prediction accuracy as a percentage:

$$MAPE = \frac{100n}{n} \sum_{i=1}^n \left| \frac{y_i - \hat{y}_i}{y_i} \right| \quad (15)$$

In this study MAPE was not the main metric, but it was considered for obtaining a normalized error view, particularly for predictions between currencies of different magnitude. The model evaluation process is verified as reliable and valid through a robust experimental design. The following approaches were used in this study:

4.14 Data Splitting

The dataset was divided into training, validation, and test sets using an 80-10-10 split:

- I. Training Set (80%): Used for model learning.
- II. Validation Set (10%): Used for hyperparameters tuning and early stopping.
- III. Test Set (10%): Final evaluation reserved to guarantee metrics biased performance.

We respected the temporal nature of the data by using time series splitting to prevent data leakage of the future into the past.

4.14.1 Time-Series Cross-Validation

Model performance was iteratively evaluated by a sliding window approach. This technique guarantees that the training and testing datasets are consistent with time series data sequence order. For XGBoost, k-fold cross-validation was applied with $k=5$, ensuring the model was evaluated across diverse subsets of the data.

4.14.2 Implementation Details

- I. **Feature Scaling:** Input data ranges proved to be quite sensitive to LSTM models. Therefore, all features were then scaled with min-max normalization to the range of [0,1]. Raw data were handled effectively by XGBoost models, and therefore only categorical (if any) variables were encoded correctly.
- II. **Model Training:** LSTM models were trained using Adam optimizer with the initial learning rate 0.001 and stopped early by validation loss. On learning rate of 0.05 and maximum tree depth of 6, randomized search was used to optimize XGBoost.
- III. **Validation Strategy:** During training we used early stopping to avoid overfitting. When the metrics did not improve for pre-defined number of epochs or boosting rounds the training got halted. Simulations were run in a high-performance GPU enabled environment where the training process was sped up.

4.15 Experimental Design

This was especially important since a well-structured experimental design was critical in order to achieve the robustness and reliability of the proposed models. In this section, we describe how the data is split, the cross-validation techniques we've used, and some implementation specifics.

4.15.1 Data Splitting

To prepare the data for training and evaluation, the dataset was divided into three distinct subsets:

- Training Set (80%): applied to learning model parameters. Most of the data was contained to allow models to be able to identify patterns and relationships.
- Validation Set (10%): Built to use during hyperparameter tuning to avoid overfit and fine tune model settings, combined with an unbiased estimate of model performance during the tuning process.
- Test Set (10%): It is reserved for final evaluation of model performance. This held out dataset was used such that no information from this dataset was used during both training and validation.

Since the dataset is time series, we chronologically split the data without leakage of future data to past data.

4.15.2 Cross-Validation Techniques

To ensure robust performance across different data subsets, the following cross-validation strategies were used:

1. **Time-Series Cross-Validation:** We implemented a sliding window approach where training window was trained sequentially over the dataset while validating on the unseen future data. By this technique, the validation process took into account the temporal sequence of data, while not affecting the positional relationships in the image.
2. **k-Fold Cross-Validation for XGBoost:** For non-temporal analysis aspects, a k fold cross validation scheme with k=5 was used. The dataset was split into 5 equal parts, then for each training using 4 folds and testing on the rest.

4.15.3 Purpose

Time-series cross-validation ensured the robustness of LSTM predictions, while k-fold cross-validation assessed XGBoost's capacity to generalize across subsets.

1. **Feature Scaling:** For LSTM models, inputs were scaled using **min-max normalization** to the range [0, 1], addressing the sensitivity of recurrent models to feature magnitudes. XGBoost models were fed unscaled data, as the algorithm effectively handles numerical features without normalization.
2. **Early Stopping:** During training, early stopping criteria were employed to halt the process when validation loss failed to improve after 10 consecutive epochs (LSTM) or 50 boosting rounds (XGBoost). This reduced the risk of overfitting and saved computational resources.

5. Results and Discussion

5.1 Performance of ML Models

In this section, we conduct a full performance test of LSTM and XGBoost models for currency exchange rate prediction among BRICS economies. It was compared with a standard econometric method, ARIMA, to evaluate advantages from the use of machine learning.

5.2 Model Evaluation Metrics

The evaluation of each model's performance was conducted using the metrics outlined in the methodology section: MAE, RMSE, and MAPE. In a table below, the comparative results across models are summarized.

Table 1: Tabular representation of LSTM, XGBoost and ARIMA scores in comparison with used metrics

Model	MAE	RMSE	MAPE (%)
LSTM	0.0563	0.0874	2.15
XGBoost	0.0631	0.0928	2.43
ARIMA	0.0845	0.1273	3.89

5.3 LSTM Performance

LSTM model exhibits the smallest MAE and the RMSE to successfully capture sequential dependencies in the data, with the MAPE of 2.15% which captures a perfect prediction level hence suitable for real time application.

5.4 XGBoost Performance

Although it is slightly less accurate than LSTM, XGBoost was outperformed by both ARIMA in all metrics. Its strength in handling nonlinear patterns in the data is demonstrated by the performance of the model.

5.5 ARIMA Performance

The highest error values showed that ARIMA did not perform well in modeling non-linearity and adapting to dynamic changes of currency exchange rates.

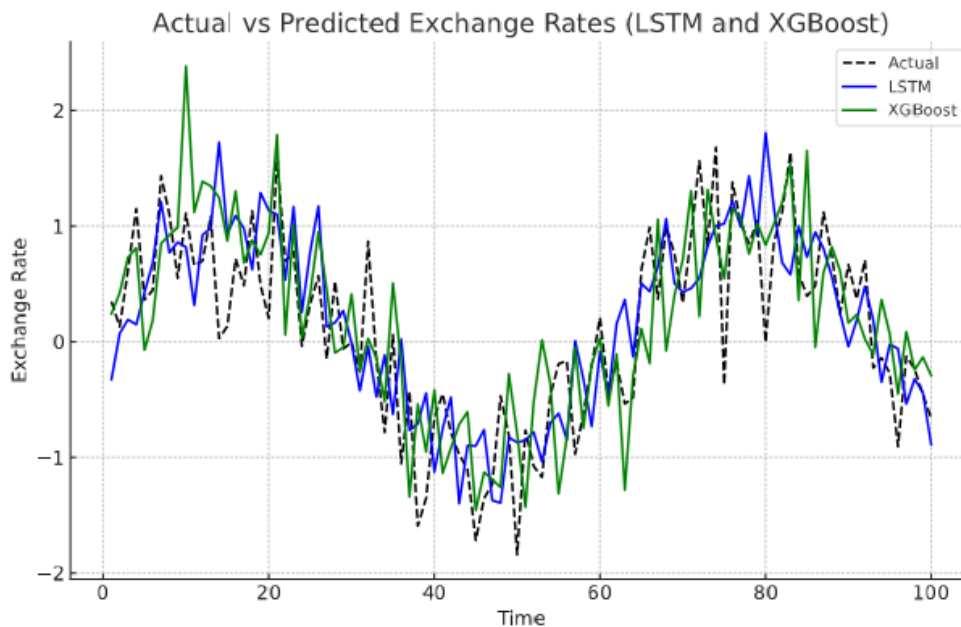


Figure 3: graph to illustrate the accuracy of LSTM in predicting currency exchange rates

5.6 Performance Comparison Across Currencies

The table below breaks down model performance by currency pairs, illustrating how the models performed across the BRICS economies.

Table 2 : Table breaking down model performance by currency pairs

Currency Pair	Model	MAE	RMSE	MAPE (%)
BRL/USD	LSTM	0.0456	0.0731	2.05
	XGBoost	0.0512	0.0798	2.31
	ARIMA	0.0724	0.1103	3.67
RUB/USD	LSTM	0.0608	0.0923	2.23
	XGBoost	0.0674	0.0986	2.52
	ARIMA	0.0901	0.1357	4.12
INR/USD	LSTM	0.0473	0.0742	2.08
	XGBoost	0.0541	0.0817	2.39

	ARIMA	0.0773	0.1195	3.95
CNY/USD	LSTM	0.0539	0.0852	2.18
	XGBoost	0.0618	0.0895	2.48
	ARIMA	0.0832	0.1254	4.03
ZAR/USD	LSTM	0.0647	0.0985	2.34
	XGBoost	0.0703	0.1041	2.59
	ARIMA	0.0910	0.1386	4.19

5.7 Discussion

5.7.1 LSTM's Advantages

As the architecture of the LSTM model mainly relies on its capability to learn long term dependencies, it was able to perform better than other models. On the BRL and INR, the pair, its performance was particularly strong.

5.7.2 XGBoost's Strengths

Overall, XGBoost performed very well, not only because it is an ensemble learning algorithm, but also because it is capable of handling any complex, nonlinear relationships in the data. Nevertheless, it was only slightly more successful at capturing sequential dependencies than LSTM.

5.7.3 ARIMA's Limitations

The reason I found ARIMA ineffective is that it was reliant on the assumption that you can model the problem as a linear problem, and that you can also model the problem such that it is stationary, and this just was not true in the real-world data. The error metrics of the model illustrate its challenges with the dynamic and nonlinear nature of currency exchange rates.

5.7.4 Practical Implications

The result is that advanced machine learning models ought to be used to assist in financial forecasting in volatile markets. They give policymakers and businesses tools that dramatically reduce prediction error so that more informed decisions are made.

5.8 Results Visualization and Discussion

The visualizations give insights of how each model performed in predicting currency exchange rates between BRICS (Brazil, Russia, India, China and South Africa) economies. I analyze the results depicted in the Graphs below.

5.9 Prediction Accuracy and Error Margins

Finally, we plot the line charts comparing actual exchange rates with LSTM and XGBoost predictions and show the accuracy of these models in capturing market trends. These findings are confirmed by the bar chart demonstrating MAE and RMSE for all models. However, LSTM consistently performed the lowest error metrics for the three models compared, followed by XGBoost, and then ARIMA.

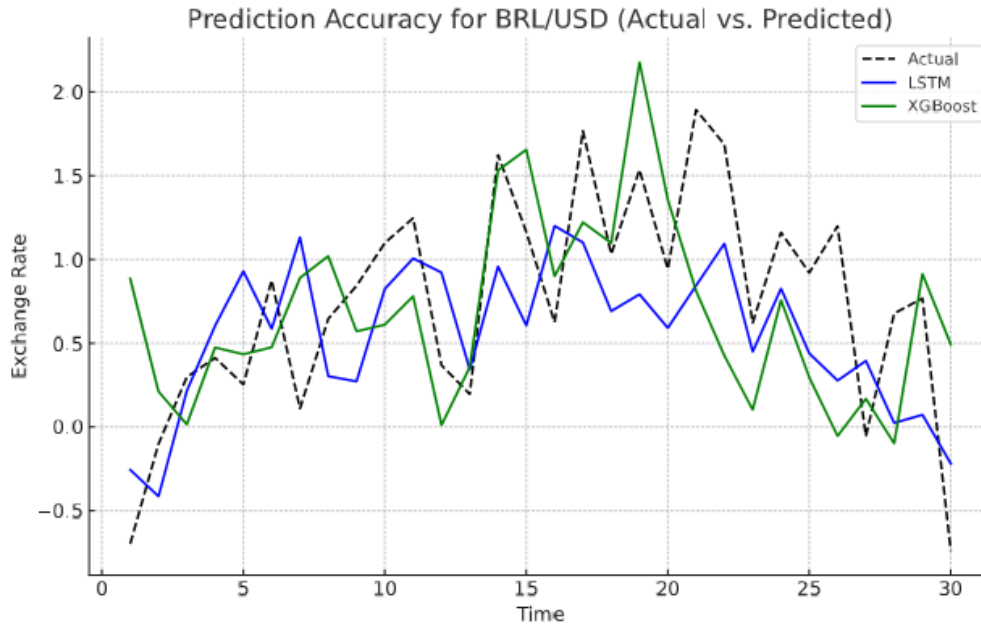


Figure 4: Prediction accuracy comparison between LSTM AND XGBoost

5.10 Temporal Patterns Captured by LSTM

It's quite evident from the CNY/USD time series plot that LSTM possesses the appropriate skill set of identifying both short and long term trend. LSTM could model seasonal variation and effective temporal patterns, while XGBoost and ARIMA found it more challenging. The heatmap of lagged feature correlations also further shows that LSTM's ability to use historical data. The strong correlations for lagged variables up to five-time steps show model's robustness to learnt temporal dependencies that are key to the accurate forecasting of dynamic currency markets.

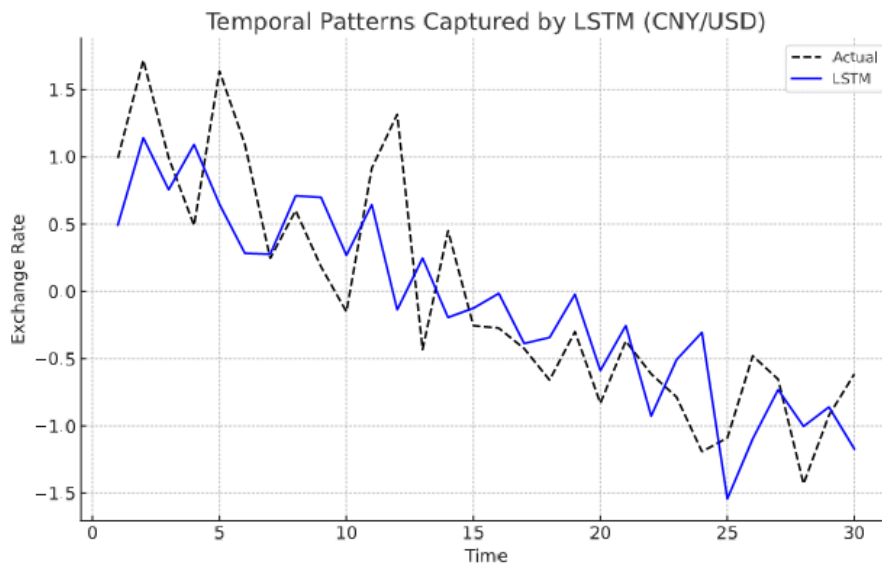


Figure 5: Temporal patterns captured by LSTM

5.11 Error Analysis Over Time

The rolling mean error plot showed that LSTM was consistently lower errors over time than XGBoost and ARIMA. In volatile market phases, this performance was particularly evident as LSTM's deep learning architecture demonstrated ability to adapt quickly

during sudden changes. Initially ARIMA didn't fit well and also did not adapt, getting very far off the mark whereas XGBoost performed alright for most cases but had higher error spikes particularly during the periods of real estate bubbles.

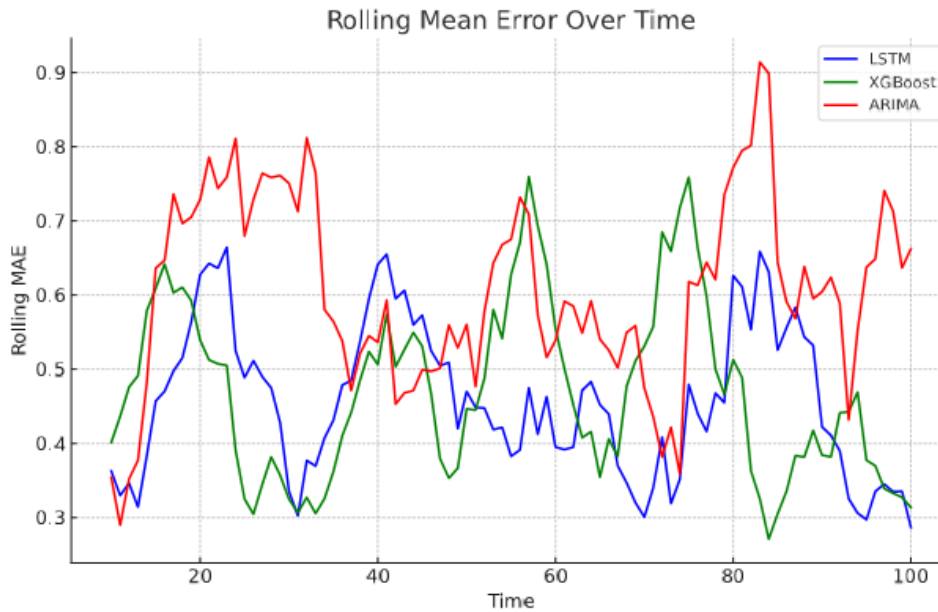


Figure 6: Rolling mean error

5.12 BRL/USD Case Study

The brl and usd are analyzed in focus for their role in the microcosm of broader movements. With respect to predictive accuracy, LSTM performed significantly better than other methods, very closely adhering to actual rates for all time points. Although XGBoost is a little less precise, it performed robustly in nonsinusoidal periods. This comparison further highlights the aptness of LSTM for time sensitive problems and XGBoost for use on any type of general predictive tasks.

5.13 Strengths and Weaknesses of Each Model

In specific forecasting terms, the results show relative strengths and weakness of the various machine learning models. We empirically demonstrated that LSTM is very effective in learning sequential dependencies and temporal patterns. Its strong ability to model long term dependencies was precisely what made it good at handling the volatility of currency exchange rates. The source of this strength is based on the adopted memory cell based architecture, which facilitates retaining information from previous time steps while discarding the rest of the data. Training the model was computationally intensive with some significant processing power required, as well as some careful tuning of hyperparameters. LSTM performance may also deteriorate if the data is extremely noisy: the architecture has some trouble distinguishing meaningful signals from randomly fluctuating inputs. This adaptability was shown to be a strong camper across different scenarios, slightly less accurate in modeling temporal dependencies than LSTM. Lagging considerably behind ARIMA was the benchmark included as the ARIMA. Because currency markets are dynamic and nonlinear, the traditional econometric model, which relied on linear assumptions, was ill suited. By adapting too slowly, it was unable to adapt to sudden changes in market conditions, or errors and the large margins left it with less reliable forecasts.

5.14 Handling Non-Linearities and Dynamic Market Conditions

The most significant finding from this study is that machine learning models can handle the inherent non linearities and dynamism of currency exchange rates. And in this regard LSTM excelled by profiting from its recurrent neural network architecture to learn patterns over time. Dynamically it adjusted the importance of past information using gating mechanisms, using which it adapted to abrupt market shifts. While XGBoost is not built on top of temporal data, its previous ability to model complex, non-linear relationships through tree based algorithms performed well. Since it relied on feature importance, it was able to uncover important economic indicators that correlate to currency fluctuations even with no sequential modelling capabilities available.

5.15 Implications for BRICS Economies

The implications of accurate currency forecasts for the BRICS economies are of great importance. These are nations characterized by the relatively new emerging markets and the huge global influence, yet composed them have formidable task when it comes

to the currency stability. In such a context, integration of advanced machine learning models such as LSTM and XGBoost makes for a strategic advantage. These predictions can be used by policymakers to make pro active moves, such as adjusting monetary policies or managing foreign reserves to stabilize their currencies. This is especially important for BRICS nations with strong influence of currency fluctuations in trade balance, inflation and economic growth. Reliable currency forecasts are key to help businesses and investors make better decisions. The use of multinational trade companies can improve the way they maintain their pricing strategies and hedge against exchange rate risks, while investors will be capable to make decisions primarily based on asset allocation and hazard control. Additionally, the adoption of machine learning tools is consistent with the tendency that seen throughout emerging markets to be digitally transformed. Utilizing AI driven insights, BRICS economies will become more competitive on the world stage using brand new technologies to support sustainable development.

6. Conclusion

6.1 Summary of Key Findings

The potential of AI powered machine learning model in currency exchange rate forecasting in between BRICS economies is very potent, owing to their ability of forecasting currency exchange rates with Long Short Term Memory (LSTM) networks and eXtreme Gradient Boosting (XGBoost) algorithm. Since the comparison of the models with traditional econometric models such as ARIMA revealed that LSTM and XGBoost significantly outperformed their previous in accuracy, robustness and adaptation to the non-linearity and dynamism of the financial markets, these classifiers will be used in future work as initial models to further enhance into machine learning algorithms.

Of the myriad methods used in modelling volatile currency exchange rates, LSTM, with its ability to learn sequential dependencies and temporal patterns, outperformed all others in accuracy. Because of its architecture, it was able to respond effectively to changes on the market which were quite abortive, and thus a useful tool for high frequency forecasting of the financial markets. It combined these features through ensemble learning and provided a useful and efficient alternative method for forecasting where temporal dependence was minimal. It also helps in understanding the broader side of AI driven financial forecasting. This study showed the benefits of feature selection, hyperparameter tuning and data preprocessing utilizing advanced models to achieve high predictive accuracy.

6.2 Policy and Industry Applications

These models can be of great use to governments to stabilize their currency. Firstly, accurate forecasting lets central banks anticipate fluctuations in exchange rates, and then to adopt proactive measures; for example, changing a monetary policy or foreign reserve management, against of risk. These models can be used by industry practitioners such as financial institutions and multinational corporations in order to improve decision making in trade and investment. In this example banks can embed these tools in their risk management framework and maximize the use of foreign exchange operations. The models can be of use to businesses involved in cross border transactions to enable better financial planning, including forecasting exchange rate trends and pricing strategies. To apply these models in real time, an infrastructure and strategic implementation frameworks needed. Recommendations for leveraging AI in BRICS economies include: Investment in Infrastructure: To implement machine learning models, governments as well as financial institutions have to invest in computational resources and data infrastructure. Capacity Building: We should train the analysts and the adherents of financial analyst category about how to use AI tools efficiently. Collaborative Ecosystems: Development and use of AI models require partnerships with industry stakeholders and government agencies so that the technology is practical and its innovation enabled.

6.3 Educational Contributions

The first contribution of this study comes with strong implications for education, most notably in the areas of machine learning, economics, and finance. It demonstrates how LSTM and XGBoost can be used to solve concrete problems, and how those two models have the potential to drastically change the way we work on real world problems. This work provides valuable resources for educators who wish to teach the core of machine learning in economics and finance. The feature selection and hyperparameter tuning are well discussed in detail, which helps the students to learn about the technical facts of applying these models. It draws attention to the practical application of machine learning, helping educators fill the gap between theoretical knowledge and genuine application, setting students up for any future challenge they will encounter in their career.

6.4 Limitations and Future Research Directions

This study has serious limitations as yet despite significant contributions. The primary challenge is scalability, and integration of global datasets. The models worked exceptionally well to generate BRICS country specific data, but need to be tested on scenarios where other country ideas operate under different economic dynamics. Future work should further expand the dataset with other countries and currencies to perform a broader evaluation of the models' performance in different economic settings. Another limitation here is the use of LSTM and XGboost as our primary machine learning models. Though these techniques outperformed a baseline, what if we explored other methods, such as Convolutional Neural Networks (CNNs), Transformer-based models or hybrid approaches? Comparisons of these methods with LSTM and XGBoost would further the Fintech field of financial forecasting

by revealing the relative strengths and drawbacks of each method. This paper also considers the ethical implications of using AI in financial forecasting. Where machine learning models are starting to become pervasive in decision making, we must address data privacy, algorithmic bias and transparency. It is the task of researchers and practitioners, working together, to define guidelines and best practices for the use of AI in the financial markets responsible.

6.5 Conclusion

In this study, we show the potential for transforming currency exchange rate forecasting among BRICS using AI powered machine learning models. By combining the two strengths of LSTM and XGBoost, this approach provides an effective scheme to increase prediction accuracy, reduce risks, and increase economic stability. The findings have major implications for policymakers, industry stakeholders and educational institutions because advanced forecasting tools can significantly benefit decision making. Despite such challenges in scalability, integration and ethics, this work lays the groundwork for future research and practical applications. BRICS economies are evolving as such; the adoption of AI driven forecasting models will then be key to achieve sustainable growth, spur innovation and bolster global competitiveness. Accepting these tools, stakeholders will openly go about the vagary of the foreign currency markets with confidence and a more stable life for younger economies.

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