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ARE THE NEW CRYPTO-CURRENCIES QUALIFIED TO BE INCLUDED IN THE STOCK OF HIGH QUALITY LIQUID ASSETS? A CASE STUDY OF BITCOIN CURRENCY

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Abstract

As crypto-currencies hold dual nature of a medium of exchange (currency) and an investment asset, some questions may arise about the potentiality of including crypto-currencies as liquid investment asset in financial institutions particularly in the banking sector to enhance their liquidity risk management and improve their portfolio diversification investment strategy. The objective of this study therefore is to examine the characteristics of Bitcoin currency based on the requirements of High-Quality Liquid Assets (HQLA) standards of Basel III and compare its volatility structure with other traditional asset classes that are already recommended by Basle III as HQLA. The study utilizes both descriptive and quantitative analysis using the GARCH family models to examine the volatility structures of these assets. The findings show that Bitcoin currency holds the same characteristics of HQLA, however; the risk of legality and recognition is still under consideration by legal authorities around the world and this risk will be eradicated in the future as crypto-currencies derive their legality from their real intrinsic value, multi-economic usefulness and not by law as in the case of fiat money currency. Furthermore, the symmetric volatility structure analysis shows the continuing persistence of volatility and predictability behavior in return series of Bitcoin currency and other- traditional asset classes in the U.S. market. However, Bitcoin's stability has gradually improved over time. With regard to the asymmetric informative response, Bitcoin returns respond more to negative shock but it has no statistical significance, thus suggesting the lack of leveraging effect in Bitcoin market but this effect was found to be statistically persistent in other traditional asset class markets. In addition, Bitcoin returns show very low correlation with other traditional asset classes. All these imply that Bitcoin is a potential candidate as a hedge and asset diversifier, which is recommended to be included in the HQLA. This study provides some support to recent theoretical work on crypto asset return behaviour and liquidity risk management. The findings provide appropriate information about Bitcoin asset behaviour compared to other traditional asset classes which will enable them to make the right investment decision with regard to hedging, diversification and liquidity risk management. The findings of this study may assist in evaluating the suitability of including crypto assets into HQLA to improve the liquidity requirement standards and ensure that banks have an adequate amount of HQLA specifically during times of financial turmoil.

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