

Dissertation Abstract

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My Dissertation, “Essays on Investment, Real Exchange Rate, and Central Bank in Financially Liberalized Turkey” consists of three empirical essays on the impact of global financial liberalization on macroeconomic changes and policy formation in Turkey. Together, these three essays investigate the impact of financial liberalization and inflation targeting on private investment through their impacts on real exchange rate over-valuation and volatility. Overall, the dissertation finds that liberalization and inflation targeting contribute to exchange rate over-valuation and volatility, and these, in turn, lead to a reduction in private investment in Turkey. These results run counter to those predicted by much mainstream theory and many policy proposals emanating from the Bretton Woods institutions. A brief description of each essay follows:

Essay 1: “The impact of Net Capital Inflows on Turkish Private Investment in the Presence of Real Exchange Rate Uncertainty” (Job Market Paper)

This paper investigates the impact of net capital inflows on private manufacturing investment in Turkey after the government liberalized the capital account in 1989. Capital account liberalization policies have been supported as an efficient way of reducing financial constraints on investment and growth in developing countries by providing them with additional funds. After the Asian Crisis in 1997, however, the adverse indirect impacts of capital inflows have gained attention in the literature. Such adverse effects typically include excessive real exchange rate appreciation and higher volatility of the real exchange rate. Based on time series econometrics, the results in this paper show that the net short-term capital inflows do not have a significant influence on private investment and that long-term inflows have only a marginally significant positive impact once the level and volatility of the real exchange rate are taken into consideration. Overall, this paper shows that both the appreciation of the real exchange rate, and also its volatility have depressing effects on private investment in the era of financial liberalization in Turkey.

Essay 2: “Central Bank Policy Formation under Inflation Targeting”

This essay analyze the response of the Turkish Central Bank to the changes in and the volatility of the real exchange rate during the post-capital account liberalization period in Turkey. Utilizing an extended version of the so-called "Taylor rule", it develops a time series econometric model to estimate monetary policy rule to account for changes in the Central Bank's response before and after the adoption of inflation targeting. The results show that the Central Bank's response to the real exchange rate has been reduced both in magnitude and significance under the inflation targeting regime.

Essay 3: “The Determinants of Real Exchange Rate Volatility in the post-Capital Account Liberalization Period”

In this paper, I show that real exchange rate volatility in Turkey is strongly affected by important fragility indicators such as the current account deficits and external debt accumulation by the private sector in post-capital account liberalization period in Turkey. Their negative impact is robust to the inclusion of terms of trade shocks and economic growth in the same analysis. The impact of fragility indicators on the volatility of the real

exchange rate rises when the share of short-term capital inflows in total inflows increases. These findings suggest that global financial liberalization affects volatility of the real exchange rate not only through short-run shocks but also by generating macroeconomic fragility in the long run.