

The Effects of World Financial Integration on Financing Current Account Deficits: The Case for Turkey

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DOI Link: <http://dx.doi.org/10.6007/IJARBSS/v4-i10/1214>

Published Date: 11 October 2014

Abstract

The world financial markets are integrated more than ever. Together with countries opening their economies to the world, we see the dynamics of capital movements changing together with how countries respond to their domestic capital needs. Today, foreign capital is financing most of Turkey's current account deficit. With this paper, we show that the main reason why Turkey is borrowing so much money from international markets and its current account deficit is substantial, is global liquidity rather than domestic conditions. We spend more, either for consumption or investment, due to the availability of cheap money. The availability of cheap credit prevents the economy to self-adjust through movements in exchange rates which would narrow the current account deficit.

We find that U.S. interest rates, Turkish current account balance and Turkish real GDP are non-stationary and cointegrated which prevented us from using an ordinary least square estimation. Instead, we use a vector error correction model to estimate the relationship between these variables. We find that there is a long-run causal relationship from U.S. interest rates to Turkish current account balance. We further confirm our results with Granger causality tests and support the view that global liquidity is fueling growth across the world, including Turkey.

Keywords: Current Account Balance, Interest Rates, Global Excess Liquidity, World Financial Integration, Co integration, Vector Error Correction Model

JEL Classification: F32, F62

1. Introduction

The ever integrated world financial markets have changed the rules of the game for countries' economic development. Advancements in technology, especially in computerization and transmission of data, allowed easier transfer of capital across continents with much more security. With these innovations, capital movements are conducted real-time, day or night and billions of dollars are transferred in seconds (Went, 2000). Capital mobility altered the world economic map profoundly.

These changes brought opportunities as well challenges for countries across the world. Having access to international financing allowed developing countries to borrow funds to stimulate their development. On the other hand, in some cases, short-term capital caused abrupt capital movements that eventually derailed domestic economies. The most prominent challenge of financial integration is sudden movements of short-term capital which causes crises, notable in the 90's and 2000's. Typically, developed countries have excess capital and expensive labor; developing countries are short in capital and have relatively cheaper labor. Since capital looks for highest returns and usually this is in developing countries, it already has an incentive to follow a path to a developing country.

The developments in the United States' economy after the 2001 crisis have profound effects in the economic development of many countries. The U.S. central bank, the Federal Reserve or FED, administered a policy of low interest rates for a considerable amount of time under the leadership of Alan Greenspan. This propelled not only the markets in the U.S., but also the markets of the developing world with ample funds to invest, consume and enjoy. Notably, Turkish economy has grown steadily in this era, but, together with other developing countries. In fact, its ranking in world economies did not improve much¹. It is no coincidence that Turkey and its economic matches, Brazil, Russia, India, South Africa and more, have grown together. This is mainly due to the shared global financial conditions, lower interest rates in the U.S. that spilled over to the rest of the world, which fueled economic growth.

Low global interest rates together with a global saving glut (Bernanke, 2005), have given Turkey the opportunity to finance its current account deficit, which persisted to be a part of its economy ever since it set off to be an open economy. Offering better returns than the developed world with a politically stable environment in the 2000's, Turkey had no problem in attracting the capital of the world. In this period, Turkish Lira appreciated which additionally boosted returns on investments made in Turkey and reduced the cost of borrowing money in U.S. dollars for Turkish firms.

In the other case where there had been less global liquidity, we would expect Turkish Lira to appreciate to remove the pressure off the current account balance. But availability of cheaper funds allowed Turkey to keep spending more, both on investment and consumption goods, without experiencing higher interest rates. This is the reason why we expected to observe a co-movement of Turkish current account balance with the interest rate prevailing in the world, the U.S. interest rate.

Unlike Spiro, (1997), we analyze the effects of interest rates on current account balance where he looked at the other direction, from current account deficit to interest rate differential between Canada and United States. A current account deficit will create a pressure on domestic interest rates, the crowding out effect. Since there will be less amount of funds in markets, the equilibrium level of interest rates has to rise, or the central bank has

¹ In 2013, Turkey stands at 17th place in the world where it was 18th in 2003 in terms of the size of the economy. Source: CIA World Factbook

to increase interest rates to attract foreign capital. Although the same argument is valid for Turkey, Turkey is in more need of borrowing capital than Canada. The demand for capital will be the driving force for Turkey that will consequently affect the other variables, like the current account balance. Though, we end up with a similar conclusion that lower foreign borrowing leads to lower domestic interest rates.

Monetary Policy and Current Account Balance

Monetary policy is essential in establishing and maintaining the financial stability of a country. In an open economy though, there are more dynamics to evaluate before choosing the optimal monetary policy. After opening to the world, external factors like an interest rate change in a foreign country might have a major role in the domestic economy, where a simple interest rate change, a monetary policy, could have been sufficient for economic stabilization before. Especially, a small and open economy should never be so proud of its own interest rate policies. No matter how hard it tries, it is almost impossible to avoid influences of the bigger players of the world. This is why markets in small and open economies react to policy changes, announcements or forecasts of bigger economies, mainly the U.S. economy. Therefore, analyzing the monetary policy or the current account deficit without considering world markets are questionable practices for such economies.

In this paper, we empirically find that Turkish financial markets are indeed integrated to the world financial markets. Turkish economy, or the financing of Turkish economy, crucially depends on the low interest rates of the U.S. economy. These low rates allowed Turkey to finance its current account deficit without increasing its own interest rates, or experiencing an appreciation of the Turkish Lira.

2. Financial Integration of Turkey

In early 1980's², Turkey started to open its economy to the world with successive developments until full financial liberalization. First, the steps are taken towards a flexible exchange rate regime from a fixed exchange regime. Following that, a partial permission is given to domestic banks to buy and sell foreign currency without government intervention in 1983. In 1985, banks were allowed to set their exchange rates on their own, and in 1989 restrictions on capital transfers from the country are removed.

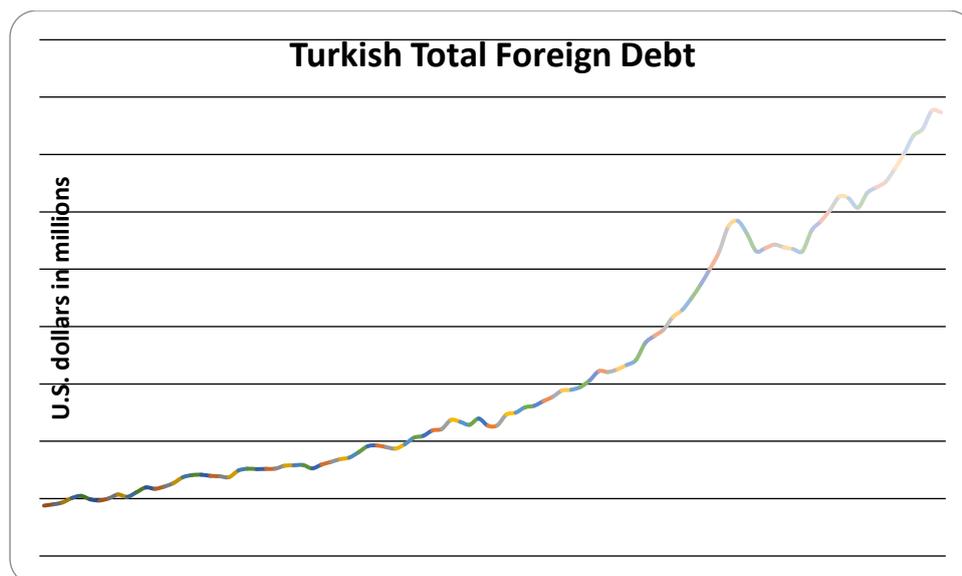
With financial market liberalization, Turkey's exposure to world developments has increased in its domestic and foreign affairs. As soon as Turkey chose to be an open economy to finance its economic development under the leadership of its new Prime Minister Turgut Ozal, its current account balance turned negative and the financing of this current account deficit became dependent on foreign debt and short-term capital. Although this meant being dependent on foreign financing, Turkey used this capital to purchase capital goods and to invest in its long-term development. Turkey was transformed from a closed economy to an export-led open economy where this period became a major phase in its advancement.

A consequence of this financial openness is the beginning of nonfinancial firms borrowing money from world markets. As seen in Figure 1, the total amount of foreign debt in Turkey has steadily risen³.

Figure 1, Foreign Debt

² On January 24, 1980, there was a famous set of rulings known as *January 24th rulings* which is initiated by the prime minister of the time Suleyman Demirel and prepared by a future prime minister Turgut Ozal.

³ Data is taken from the database of the Central Bank of the Republic of Turkey.



Enlargement of the foreign debt stock also contributes to the current account deficit. Interest payments on foreign debt are included in current account balance accounts. The percentage of interest payments on foreign debt in the budget varies between 7%, in 2011, and 52%, in 2009, right after the 2008 global crisis, (Göçer, Mercan, Peker, & Şahin Bulut, 2013).

Together with the increase in total foreign debt, the percentage of this debt belonging to the private sector has also increased. In 1989, the share of the privately owned foreign debt in Turkey was 15% where it went up to almost 70% in 2014. Figure 2 shows the progress of privately owned foreign debt of Turkey.

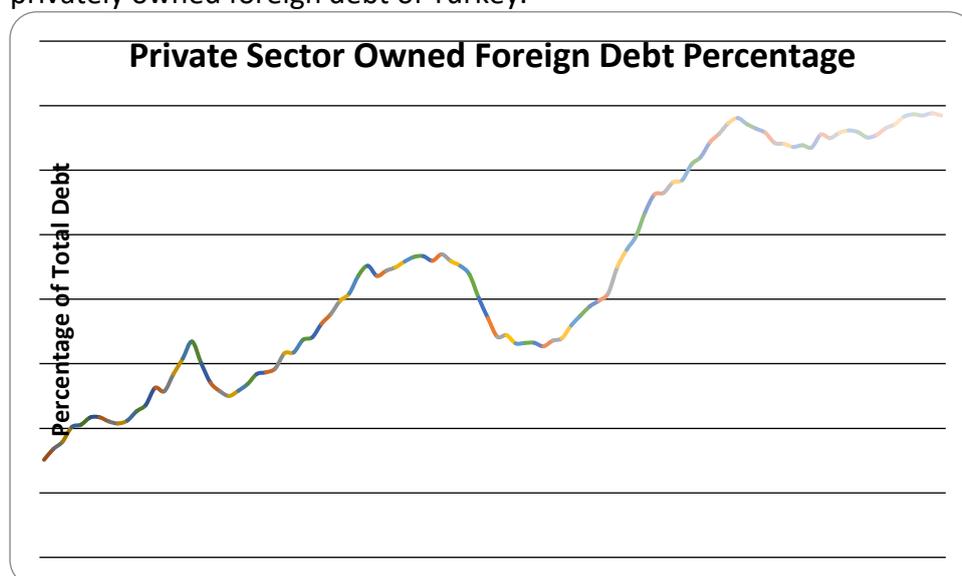


Figure 2, Private sector foreign debt ratio

There are some number of reasons for this upwards trend in privately owned debt. The first one is the availability of capital with low returns in the developed world, or global liquidity; and the second one is the appreciation of Turkish Lira. Furthermore, substantial drops in Turkish savings rate in 2000's played an additional role in private sector giving its attention to external sources rather than internal sources. With the appreciation of Turkish Lira, imports get cheaper, exports more expensive and consequently, the current account deficit increases. Our main proposition with this paper is that the major determinant of Turkey's current account deficit is the availability of cheap capital in world markets rather than internal causes.

There are some number of factors that are used to explain the current account deficit: trade imbalance, GDP, overvalued domestic currency, stock market performance or exchange rate policy, as in (KARABULUT & DANIŞOĞLU, 2006), (Uygur, 2004), (Sahbaz, 2011), (Özmen, 2004), (Kasman, Turgutlu, & KONYALI, 2005) or (Peker & Hotunluoğlu, 2009). Although these factors may have effects at varying degrees, people changing their behavior due to the availability of cheap money is more likely to explain the movements in these other factors. In economics, we say people respond to incentives and try to explain many outcomes with this principle. We believe similar dynamics are playing a role here.

3. The Analysis

We used data from 2003 to 2014 to test our hypothesis. In 2001 Turkey had a financial crisis and in 2002 the political party changed where that party is in power to this day. In the period analyzed, Turkey enjoyed a fairly stable environment. Detailed information about data is given below.

3.1 Data

Average monthly cost of borrowing money, domestic interest rates, is taken from Turkish Treasury's Electronic Data Delivery System. Turkish gross domestic product (GDP), current account balance and inflation rates are taken from the database of the Central Bank of the Republic of Turkey. U.S. inflation rate and interest rates data are taken from FRED, Federal Reserve Economic Data, a service provided by the Federal Reserve Bank of St. Louis. All data is seasonally adjusted, if not already adjusted, using U.S. Census Bureau's X-13 ARIMA-SEATS seasonal adjustment program.

We used data from the first quarter of 2003 to the first quarter of 2014. Monthly data is converted into quarterly data if necessary. We used the statistical software package Stata® for computations.

3.2 Cointegration in Variables

3.2.1 Unit Root Tests

Current account balance to GDP ratio, U.S. interest rates and Turkish real GDP all have unit roots at the first level, $I(1)$. The results are given in Table 1 below where it can be seen that Z-statistics are higher than the critical values for these variables. The null hypothesis of nonstationarity is not rejected with these results.

Table 1, Dickey-Fuller test for unit root

	Z test statistics	1% Critical Value	5% Critical Value	10% Critical Value
Current Acc. to GDP	-1.704	-3.628	-2.95	-2.608
U.S. Treasury rates	-0.411	-3.621	-2.947	-2.607
TR real GDP	-0.759	-3.621	-2.947	-2.607

An interesting result here is that the internal borrowing cost of the Turkish treasury is stationary. This is a sign of different dynamics for Turkish internal borrowing costs. Turkish treasury has tried different strategies for its internal borrowing. For example, long term debt papers are recirculated to avoid short-term borrowing.

3.2.1 Cointegration Tests

It would be tempting to use the first differences in a regular ordinary least squares (OLS) regression but valuable information will be lost with taking the first differences, (Kennedy, 2003). This is a reason why error correction models are developed for such data. To avoid a spurious regression, variables have to be cointegrated, which is analyzed next.

First, we would like to determine the number of lags to be used for our cointegration variables. Using methods introduced by Nielsen (2001) we chose four lags for the cointegration tests. Based on Johansen (1995) maximum likelihood estimators, we determine the number of cointegrated variables. The results for two variables, current account balance to GDP ratio (CAR) and U.S. interest rates (US_int), are given in Table 2. We add Turkish real GDP (TR_GDP) as an explanatory variable and present the results in Table 3.

Table 2, Johansen test for cointegration, CAR and U.S. interest rates

Trend: constant				Number of obs = 40	
Sample: 5 - 44				Lags = 4	
			5%		
maximum				trace	critical
rank	parms	LL	eigenvalue	statistic	value
0	14	-67.955122	.	17.5807	15.41
1	17	-59.982504	0.32876	1.6355*	3.76
2	18	-59.164758	0.04006		

Table 3, Johansen test for cointegration, CAR, U.S. interest rates and Turkish real GDP

Trend: constant				Number of obs = 40	
Sample: 5 - 44				Lags = 4	
			5%		
maximum				trace	critical
rank	parms	LL	eigenvalue	statistic	value
0	30	-639.85827	.	33.8539	29.68
1	35	-631.02551	0.35702	16.1884	15.41
2	38	-622.95193	0.33214	0.0412*	3.76
3	39	-622.93134	0.00103		

The test statistics are reported for a model with a constant trend and four lags. Looking at the results we find that there is cointegration in between current account balance to GDP ratio and U.S. interest rates, the bivariate case; and that there are two cointegrating relationships in between current account balance to GDP ratio, U.S. interest rate and Turkish real GDP, the multivariate case. In table 2, the trace statistics is less than the 5% critical value when the rank is 1: a single cointegration equation and in table 3, the trace statistics is less than the 5% critical value when the rank is 2: two cointegration equations.

According to the test results, Turkish current account balance to GDP ratio and U.S. interest rates are cointegrated which means that they have a long-run relationship. This is an important result that proves the relationship between two countries geographically far away from each other. In a global and financially integrated world, this is not a surprising result though.

3.3 Vector Error Correction Model

Since the variables, CAR and US_int are cointegrated, we use a vector error correction model for our data. First, we analyze the bivariate case and later in the multivariate case we add an explanatory variable, Turkish real GDP, to the model.

3.3.1 Bivariate Case

Results for the bivariate case are given in Table 4.

Table 4, Vector error correction model for bivariate case

Vector error-correction model

Sample: 5 - 44 No. of obs = 40
 Log likelihood = -59.9825 AIC = 3.849125
 Det(Sigma_ml) = .0687947 HQIC = 4.10865
 SBIC = 4.566899

Equation	Parms	RMSE	R-sq	chi2	P>chi2
D_CAR	8	1.17144	0.2175	8.893252	0.3514
D_US_int	8	.280714	0.5838	44.87841	0.0000

	Coef.	Std. Err.	z	P>|z|	[95% Conf. Interval]	
D_CAR						
_cel						
L1.	-.1758144	.0786309	-2.24	0.025	-.3299282	-.0217006
CAR						
LD.	.1855365	.1594148	1.16	0.244	-.1269108	.4979838
L2D.	.1884352	.165152	1.14	0.254	-.1352567	.5121272
L3D.	-.0409531	.1722052	-0.24	0.812	-.3784691	.2965629
US_int						
LD.	-.0646185	.5985626	-0.11	0.914	-1.23778	1.108543
L2D.	.2702404	.6522129	0.41	0.679	-1.008073	1.548554
L3D.	-.9735148	.6101804	-1.60	0.111	-2.169446	.2224168
_cons	-.0115946	.1944916	-0.06	0.952	-.3927911	.369602
D_US_int						
_cel						
L1.	.0581278	.0188425	3.08	0.002	.0211972	.0950583
CAR						
LD.	-.0268339	.0382009	-0.70	0.482	-.1017062	.0480385
L2D.	.0069587	.0395757	0.18	0.860	-.0706082	.0845256
L3D.	-.0515084	.0412659	-1.25	0.212	-.1323881	.0293712
US_int						
LD.	.3883403	.1434347	2.71	0.007	.1072134	.6694672
L2D.	-.0254664	.156291	-0.16	0.871	-.3317912	.2808584
L3D.	.503828	.1462187	3.45	0.001	.2172445	.7904114
_cons	-.0350691	.0466064	-0.75	0.452	-.126416	.0562777

Cointegrating equations

Equation	Parms	chi2	P>chi2
_cel	1	9.394062	0.0022

Identification: beta is exactly identified

Johansen normalization restriction imposed

beta	Coef.	Std. Err.	z	P>|z|	[95% Conf. Interval]	
_cel						
CAR	1	.	.	.	.	.
US_int	-1.091586	.3561484	-3.06	0.002	-1.789624	-.3935474
_cons	7.954631	.	.	.	.	.

The results are interesting and parallel with our expectations.

1. The coefficient for the error correction term of CAR (-0.176) is negative and significant. This means that there is a long-run relationship between the Turkish current account deficit to GDP ratio and the U.S. interest rates. This is a long-run causal relationship from U.S. interest rates to Turkish current account balance to GDP ratio. In a global world, U.S. interest rates have an influential role in world markets. This is not only the case for Turkey, but for many other developing countries as well, (Taylor & Sarno, 1997). The interest rate movements in the U.S. are transmitted to the global economy, (Ammer, Vega, & Wongswan, 2010).
2. The absolute value of the error correction term of CAR, 0.176, represents the speed of adjustment when the two variables are decoupled from each other. In absolute

terms it is quite small as one can expect. We should not expect a rapid adjustment of these seemingly far off variables to converge to their long-run paths.

3. The coefficients of the lagged values of CAR and US_int represent short-run relationships with CAR. As it can be seen in the Table 4, all those variables are insignificant. This means that there is no short-run relationship between CAR and US_int; and their lagged values. To test this further, we used Wald test on the coefficients of the explanatory variables. The results are given in Table 5 below. With the test, we cannot reject the null hypothesis of coefficients being jointly zero. This result is also parallel with our intuition.

Table 5, Wald test on explanatory variables

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. test ([D_CAR]:LD.US_int L2D.US_int L3D.US_int)
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( 1) [D_CAR]LD.US_int = 0
( 2) [D_CAR]L2D.US_int = 0
( 3) [D_CAR]L3D.US_int = 0

      chi2( 3) =      3.01
      Prob > chi2 =    0.3894
```

Neither Lira's exchange rate, nor any other official variables are directly pegged to the U.S. interest rates. Changes in the current account balance are gradual, unless there are dramatic shifts in exchange rates. Moreover, there are contractual obligations between firms and it takes time for people and firms to change their behavior. Therefore, the finding that there are no short-run relationships between our two variables is conforming to economic theory.

4. In the cointegrating equation, the coefficient of US_int (-1.09) is negative and significant. This confirms the result that US_int is effective in CAR. When we observe an increase in U.S. interest rates, current account deficit of Turkey tends to close. When capital decides to steer its direction towards the U.S., this causes Turkish Lira to depreciate. This makes imports more expensive and exports cheaper. Such changes narrow the current account deficit, or in some cases, like during a crisis when the change in exchange rates is sudden and dramatic, may even invert the current account balance to positive values⁴.

3.3.2 Multivariate Case

We add Turkish real GDP as an explanatory variable to our model in this multivariate case. Turkish real GDP has a unit root and is cointegrated with the other two variables. The cointegration equations estimation is reported in Table 6 below.

Table 6, Vector error correction model for multivariate case, cointegration equations

⁴ In 2001 during the financial crisis of Turkey, current account balance turned positive for a short time.

Cointegrating equations

Equation	Parms	chi2	P>chi2
_ce1	2	18.12741	0.0001

Identification: beta is exactly identified

Johansen normalization restriction imposed

beta	Coef.	Std. Err.	z	P>|z|	[95% Conf. Interval]
_ce1					
CAR	1	.	.	.	.
US_int	8.835197	2.252887	3.92	0.000	4.41962 13.25077
TR_GDP	4.39e-06	1.34e-06	3.28	0.001	1.76e-06 7.01e-06
_cons	-157.8338	.	.	.	.

We find that the coefficient of TR_GDP is positive and significant ($P>|z|$ test values are smaller than critical values). This confirms the role of real economic activity on current account balance.

There are two major schools of thought, similar to many other topics in economics, on current account deficits. For some economists, the deficit hawks, the current account deficits are very dangerous. Living within your means, not only for people, but for states as well, is essential according to this group. We should be aware of the fact that even the psychological cost of a budget deficit on people is significant. People are afraid of deficits in general. Besides, this fear can be easily exploited as a political argument by politicians in their campaigns. The fact that large current account deficits precede some economic crises strengthens arguments against such deficits. In the past, some economists thought that current account deficits are the most important indicator of an economic crisis and even a hike in domestic interest rates may not be enough to reverse an outrun of capital from a country and a subsequent devaluation of the currency, (Calvo, 1994).

The other view, the view of the current account deficit doves, points that borrowing, and consequently a deficit, is essential for growth. In this view, a capital flow into a country is a sign of investor confidence and it is essential for the development of a capital strapped country. Besides that, administration of a flexible exchange rate policy is a reason for not worrying too much about a deficit, since free markets are expected to stabilize any imbalances of the economy through changes in exchange rates. Sometimes, current account deficits are due to government budget deficits, the twin deficits hypothesis. In this case, if the budget deficit is a consequence of politicians' irresponsible decisions, it can be seen as a problem. But if the private sector, rather than the public sector, is the reason for the current account deficit, which is the case for Turkey, it can even be a good sign for the economy.

In Turkey's case, its GDP is growing with its current account deficit which supports the second view of the economists. With very low savings rates, Turkey has to borrow money to sustain its development and it has no other choice. We believe that a flexible exchange rate is the most important safety net for its current account deficit.

4. The Direction of the Precedence, Granger Causality Test

Current account deficits and interest rates are closely related two variables. There are economic theories supporting a causal relationship in both directions. A larger current account deficit may reduce available funds, the crowding out effect, in the capital markets to increase domestic interest rates. On the other hand, an increase in interest rates may attract foreign capital which will cause domestic currency to appreciate, eventually increasing the current account deficit. Therefore, it is important to know the direction of this relationship but we should keep in mind that we are talking about the interest rates of the U.S. and the current account deficit of Turkey, two different countries. Granger causality test (Granger,

1969) is developed to tell if past values of one variable, U.S. interest rates in our case, can be used to predict another variable, Turkish current account balance. We used this test to double check our findings with our vector error correction model.

One requirement of the Granger causality test is using stationary variables. We have shown that U.S. interest rates and Turkish current account balance are non-stationary variables. Therefore we will be using the first differences of these variables in our analysis. To determine the number of lags we use a sequence of likelihood ratio (LR) tests which is explained in (Lütkepohl, 2007) and determine it as nine for our model. After running the Granger causality test, we report the results in Table 7.

Table 7, Granger causality test results

Granger causality Wald tests

Equation	Excluded	F	df	df_r	Prob > F
D_CAR	D.US_int	4.3722	9	15	0.0059
D_CAR	ALL	4.3722	9	15	0.0059
D_US_int	D.CAR	1.0919	9	15	0.4226
D_US_int	ALL	1.0919	9	15	0.4226

Looking at the results given in the table above, we reject the null hypothesis of U.S. interest rates not preceding Turkish current account balance and accept the null hypothesis of Turkish current account balance not preceding U.S. interest rates. This means that U.S. interest rates Granger cause Turkish current account balance where the opposite is not true. This is the same result we got with using a vector error correction model. Therefore, our proposition is robust to Granger causality test.

5 Conclusion

In a global world where financial markets are very much integrated, small and open countries have a disadvantage with their economic independence. Under such circumstances, the current account deficits are directly linked to the state of the world and they cannot be controlled with some domestic policies alone. Many people, and researchers, fail to incorporate international factors in explaining the current account deficits. This also leads to wrong policy recommendations.

On the other hand, there can be deliberate attempts to ignore international linkages to mask policy mistakes or give credit to domestic policies by politicians. Although these types of efforts are rare, a sound analysis is a must to understand current account balances and dynamics of the global world.

Sustainability

The Turkish economy enjoyed the cheap credit of the world for a long time but the important question is if the current dynamics of the economy are sustainable or not. Will a laissez faire economics be enough to maintain economic growth? The biggest challenge is a potential crisis, a sudden deterioration of the economy, instead of gradual adjustments where agents can alter their behavior to economy's new conditions. Although a sudden hike in U.S. interest rates looks unlikely, even if it rises in the medium to long run, the Turkish economy can adjust, through exchange rate or interest rate adjustments, to the new circumstances.

Current account balance depends on many different variables. Savings rates, exchange rates, domestic and international interest rates, investor or public confidence, competitiveness in international markets, marginal product of capital, public budget deficit, monetary policy, global liquidity and many more variables take roles in the current account balance. Therefore,

it is not possible to come up with a rule of thumb to determine the sustainability of current account deficits. A case by case analysis should be used for every country, every time.

Bubbles

A precursor to a crisis is usually a bubble economy and the most expected type of a bubble is a debt bubble in current global conditions. As shown in the Figure 1 above, the level of Turkish private sector's debt stock is rising. As long as this debt is invested as productive capital, it may not be a big problem to worry about. Unfortunately this is hard to say for Turkey where many people are already talking about a housing bubble, (Aizenman, 2014) for example, or increased levels of household debt levels. Low interest rates boosted housing prices, which made investing in housing so profitable; it attracted many entrepreneurs into construction sector which promised at least 100% profit rates. People started buying their second or third homes in this environment where home prices are increasing twice as much or more than the inflation rate. This is a story similar to what is observed just before the 2008 housing bubble in the United States but there are no signs of a burst for Turkey yet. The latest increases in interest rates have slowed down the housing market for the moment, as of mid-2014, and it may prevent a future collapse.

The maturity of the foreign debt is another factor one needs to consider in determining the possibility of a crisis. Most of Turkey's foreign debt is private sector's long-term debt or it is in the form of foreign direct investment. This is better than portfolio investment-type of short-term capital which caused some number of crises in the world before, with sudden run of the capital from countries.

Regional Problems

Being dependent on foreign capital for financing the current account deficit brings its own risks, (AKÇAY, 2012). World systematic risks or regional developments, like wars, affect the willingness of financiers to direct their capital into such a country. Subsequently, sustainability of a current account deficit may become a major economic and political issue. International credit agencies also put a weight on current account deficits and their sustainability in their credit ratings. A downgrade in a country's rating, either by Standard & Poor's or Moody's, can influence investors to look for a different country for their capital.

Future Study and Final Thoughts

We claim that, unlike (Yorukoglu & Çufadar, 2008), the main cause of capital inflows to Turkey is global financial conditions rather than country specific conditions. We should emphasize that we do not rule out the favorable domestic conditions of Turkey but without global excess liquidity, there would not be much capital flowing into Turkey no matter what the domestic conditions are. Furthermore, this is not the case for Turkey only, but the case for many other developing countries.

A future area of research would be to empirically test if Turkish markets respond more to changes in global markets or to changes in domestic markets. Looking at news articles, we observe that markets do respond to announcements, like interest rate announcements, made in the U.S. or Turkey; but it would be valuable to test to which one markets respond more with an empirical study.

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