

Does Dollarization Hysteresis Drive Rationality: The Case of Turkey

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Abstract:

This study investigates dollarization hysteresis and dollarization dynamics. As a secondary objective, it presents new evidence on the structural break procedure for hysteresis and the psychological foundations of hysteresis. The results of the NARDL model designed by taking structural break into account support the objectives of the study. While the existence of dollarization in the Turkish economy was detected, hysteresis deepened after the structural break. The observation of the asymmetric relationship only after the structural break provides important evidence for the effectiveness of structural break approaches on hysteresis. Moreover, contrary to the empirical literature, inflation does not cause dollarization and exchange rate shocks cause dollarization to a greater extent than the inflation itself, indicating the effect of psychological fundamentals. This is based on the fact that rational decision makers anticipate the depreciation of the domestic currency as a result of exchange rate movements. This process also explains the persistence of psychological underpinnings in the hysteresis of economic dynamics.

Keywords:

Hysteresis, Dollarization, Structural Break, NARDL Model.