

## ABSTRACT

### Liability Dollarization in Corporate Sector and Real Exchange Rate Balance Sheet Effect in Turkey

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The main sectors including corporate sector in the emerging countries cannot borrow in long maturities in their own currency and therefore tend to borrow in foreign currency. The presence of liability dollarization can make real sector firms vulnerable to global financial shocks, “sudden stops” or outflows on capital inflows and real exchange rate depreciations. During devaluation periods, liability dollarization in corporate sector increases the value of foreign currency denominated debt, weakens the balance sheet positions of firms and may adversely affect firms’ investments. Corporate sector firms’ balance sheet vulnerabilities are also a risk issue for the banking sector. In addition, liability dollarization adversely affects the effectiveness of monetary policies because of “fear of floating” and limits the central banks’ role of the lender of last resort. In this study, we investigate the microeconomic and macroeconomic variables that drive liability dollarization in corporate sector and the balance sheet effects of liability dollarization on firms’ investment. According to our results; both firm-specific (leverage ratio, tangibility, export share, size) and macroeconomic variables (inflation, real exchange rate change, volatility index, public debt balance as a percent of GDP) are significant in explaining the corporate sector liability dollarization in Turkey. Firms with higher liability dollarization are also those firms whose incomes are highly correlated with the real exchange rate. Firms with higher liability dollarization may adversely be affected from devaluations in the terms of investment if their currency composition of income and liabilities do not match.

**Key Words:** Balance sheet effect, panel data analysis, GMM estimation