DETERMINANTS OF REAL RUPEE DOLLAR EXCHANGE RATE IN PAKISTAN

SHUMAILA ISRAR
Reg #24739

A thesis presented to Bahria University, Karachi Campus in partial fulfillment of the requirements for the degree of Masters of Philosophy

MAY 2014

ABSTRACT

This research is conducted to have close view of determinants of real exchange rate in the context of Pakistan. The idea was to identify the factors which have long term and short term impact on the real exchange rate. During the research, restless, unbiased and curious effort has been made to find the determinants of real exchange rate. The study offers a blend of pure logical and analytical approach to identify the variables having statistically significant effect on the real exchange rate which might be of some help in providing guidelines for the policy implications.

The research starts with the introduction followed by the theoretical and empirical review of literature which helped in identifying the variables that are then used in different combinations to discover the significant determinants of the real exchange rate with reference to Pakistan.

To find out the presence of long run association between the variables, Johansen Co integration analysis is used. Due to limited number of observations it was difficult to perform co integration for all the variables at the same time, so the data is divided into different groups. The results of co integration decline the null hypothesis of no co integration. Error correction model is used to explain not only the long run but also the short run association among the variables. Error correction term is helping in explaining the speed of adjustment of the equilibrium.

In four different models GDP, gold prices, unemployment and workers' remittances are found to have impact on the real exchange rate in long run. Foreign direct investment, foreign reserves and political stability are found to affect real exchange rate in appreciating manner while public debt is found to have depreciating effect on RER. The error correction results are estimated for all the four models to find out the whether there exist any short run relationship? One time lag of the variables GDP$, GP$, UEMP and WR, have short run significant relationship on the real exchange rate. The models seem to be correct because of the negative coefficient of the error correction term which is statistically significant. The coefficients on most of the variables are consistent with theory and show an existence of long term and short term association.

Table of Contents