

March 24, 2008

To Whom It May Concern:

I have read the entire dissertation of Mr. Poghosyan. It consists of an introduction, three chapters and a conclusion section. Below I first provide a summary of the contribution and conclusions of the individual chapters. Next, I provide my assessment of the dissertation. I conclude with some additional remarks.

The first chapter studies foreign exchange risk premium in Armenia. The Armenian banking system presents an interesting case study to analyze the effect of foreign exchange risk premium on differences in yields, as it includes parallel and highly active markets for domestic and foreign currency (USD) denominated deposits for different maturities. For example, weekly interest rates data are available on foreign and domestic currency denominated household deposits for 30, 60, 90, 180 and 360 days maturities since 1997. As an initial analysis, the deviations from the uncovered interest rate parity (UIP) in the Armenian deposit market are computed. Next, factors driving foreign exchange risk premium are studied. Finally, the dynamic pattern of time-varying risk premium is modeled using a GARCH-in-Mean model. The findings suggest that positive risk premium exists in the market and foreign exchange interventions are a significant factor explaining foreign exchange risk but for shorter horizons. On the other hand, the ratios of deposit volumes have an impact on the foreign exchange risk for longer time intervals. Another important finding is that the risk premium has a declining pattern over time, suggesting improved credibility with respect to the Armenian currency.

The second chapter provides an analysis of the role of macroeconomic factors as systemic determinants of currency risk in three new EU countries: the Czech Republic, Hungary, and Poland. It considers both real and nominal factors driving currency risk. An important contribution of the chapter is the use of a multivariate GARCH model with conditional covariances in the mean of the excess returns in the foreign exchange market. Previous studies use the univariate models, which are not capable of imposing a no-arbitrage condition in the estimations, as the multivariate models do. The empirical results suggest that monetary factors play a larger role in explaining the variability in foreign exchange returns, while real factors do not. This is an interesting finding, as the evidence from developed economies suggests just the opposite: real - not monetary - factors are important in moving foreign exchange returns. An important implication of the finding is that monetary policy exerts an important effect on exchange rates in new EU countries and is useful in pricing contingent claims. The results also suggest that there are important differences across new EU countries.

The last chapter examines dynamics of financial integration in several new EU countries with respect to "core" EU countries, proxied by Germany. Financial integration is measured using four different financial market segments, namely, T-Bill, interbank, deposit and loan rates. The new EU member states studied include the Czech Republic, Estonia, Hungary, Lithuania, Latvia, Poland, Slovenia and Slovakia. A threshold vector error correction model with a fixed rolling window is applied on interest rate series from

the four different financial market segments. The results indicate a growing degree of financial linkages in all the four market segments between new and core EU; however, the degree of financial integration varies across financial segments with money markets as the most integrated ones, followed by T-Bill and deposit markets, and loans markets having the lowest degree of integration. Policy reforms taken by the new EU members in the areas of liberalization of capital accounts and legal and institutional environment brought about a reduction of market frictions and transaction costs over time, resulting in gradual integration of financial markets

Overall, each individual chapter is of high quality and publishable in leading economics and finance journals. I believe some of the chapters are already submitted or accepted for publication. Each chapter is carefully written, applying the relevant methodology. I am quite impressed by the special care taken by the author in designing testable hypotheses and motivating the analysis in this chapter. Without any question, this work is ready for defense.

I would like to thank you for giving me the opportunity to review the entire dissertation. If I can be of any further help, please do not hesitate to contact me.

Sincerely,

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