Abstract

This dissertation consists of three essays that focus on the determinants and implications of exchange rate behavior in emerging markets. The first essay studies foreign exchange intervention conducted by the National Bank of Georgia. Various econometric methodologies are applied to study both the determinants and effectiveness of intervention. A unique daily data set is employed in the analysis. The major intervention motives of leaning-against-the-wind and of decreasing volatility are revealed. Intervention influences the exchange rate as intended after some lag. However, this effectiveness is achieved at the price of increased volatility of the exchange rate. In the second and third essays, the issue of currency substitution is studied. Two-currency monetary models are specified to analyze and explain currency substitution from different perspectives. These models focus on economic observables that influence a households decision to switch to a foreign currency, namely the exchange rate, interest rates of savings in foreign and domestic currencies, and domestic and foreign inflation. The second essay studies the significance and rationalizes currency substitution in Georgia. The paper finds that this issue is of first-order importance in the country. The actual dynamics of currency substitution is well explained by the model that accentuates the exchange rate, justifying Georgian policy makers focus on the exchange rate stability. The third essay is a comparative study of currency substitution in the Czech Republic, Georgia, Croatia, Kazakhstan, Kyrgyzstan, Tajikistan, and Turkey. Country-specific structural breaks are detected, rationalized, and introduced in the estimation based on theoretical monetary models. The main findings suggest that currency substitution is significant in Croatia, Georgia, Turkey, Tajikistan, and Kyrgyzstan, while it is not significant in the Czech Republic and Kazakhstan.