ABSTRACT

The relationship of volatility of exchange rate with inflows and outflows for a country remains one of the vital issue in economic literature and met with renewed interest in previous years mainly for those countries suffering from fluctuations of exchange rate, having hurdles in money transaction worldwide and growth constraints due to major economic indicators influenced by volatility of exchange rate. This study investigates these issues for Pakistan by employing ARDL Bound test approach to cointegration for the period of 1976 to 2014. The Bound tests examine that variables of interest are bound together in the long run when volatility of real exchange rate is regressed on exports, worker's remittances, foreign direct investment, imports, external debts, inflation and interest rate. The associated equilibrium correction made through vector error correction mechanism is also significant confirming presence of long run relationship. The results elaborate that there is no significant Granger causality is running from volatility of real exchange rate to either variable except foreign direct investment. The bi-directional causality between exports and external debts is found significant and exports are Granger cause volatility of exchange rate having impact to raise its volatility. Results explore positive and significant short and long run relation of external debts and interest rate whereas long run association of FDI with volatility of real exchange rate. Relation of exports, worker's remittances and imports are found insignificant. Empirical estimates of this study can be generalized and utilized for other developing countries experiencing same issues of volatility of exchanger rate.