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Testing Permanent Income and Random Walk Hypothesis for Turkey for the period 1998:1 -2012:1

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ABSTRACT

There have been ongoing researches and debates on the dynamics of developing economies with structural changes within literature of economics since 1770s. Economics investigated some basic themes during Mercantilism and Physiocracy period and, however, shaped its scientific approaches together with related techniques of philosophy/mathematics/statistics through the models of Classical, Keynesian, Neo-classical, Neo-Keynesian and Monetarist. Among these approaches, Permanent Income Hypothesis (PIH) and Random Walk Hypothesis (RWH) have been searching/analyzing the alternative consumption functions with related possible significant parameters since 1930s. This paper, first observes different income-consumption relations through decomposing them by using Autoregressive (AR) process. Thus, validity of Permanent Income Hypothesis might be viewed. At the second stage, Random Walk Hypothesis is tested, by decomposing changes in permanent income into expected and unexpected changes throughout related AR processes. In this way, paper intends to explore, if exists, excessive smoothness and/or excessive sensitivity of consumption. Within the models launched in this paper, Turkish quarterly data for consumption and income, spanning from 1998:1 to 2012:1, are employed. Outcome of this paper indicates that consumption is found sensitive to changes in unexpected income as well as changes in expected income. Findings reveal overall that Absolute Income Hypothesis is confirmed in Turkish economy.

KEYWORDS Permanent Income Hypothesis; Random Walk Hypothesis; AR process; consumption smoothness; excessive sensitivity and excessive smoothness

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