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The Relationship Between Financial Stability and Price Stability Through Transmission Mechanisms: The Case for Turkey

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Abstract

Financial stability is a situation in which financial system and financial institutions perform their functions correctly. The main task of financial system is to bring close together borrowers and lenders, and meet the fund need of both financial system and real economy. Price stability is a state in which prices of goods and services change very slowly in the marketplace or do not change at all. The main purpose of Central Banks is to ensure price stability. Nowadays, it is discussing whether Central Banks must take financial stability into their main objective as well. Besides, there exist a relationship between financial system and real economy. When a shock happened in financial markets, it affects real economy through transmission channels. The effect of these transmission channels over financial system and price stability is a discussion subject. Therefore, the causality relation between price stability and financial stability has been discussed in this working paper. The aim of this study is to research the direction of this relation between 1980-2013 years for Turkey. Unrestricted Vector Auto Regression (Unrestricted VAR) model is used for this analysis.

Keywords Financial Stability; Price Stability; Central Banks; Turkey; Vector Auto Regression Model (VAR)

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