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Macroeconomic Indicators, Government Quality, and Financial Markets as Determinants of Turkish FDI Inflows

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A R T I C L E I N F O

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A B S T R A C T

This study analyzes the determinants of Foreign Direct Investment (FDI) inflows in Turkey across quarterly observations. Using a quantitative approach with the Autoregressive Distributed Lag (ARDL) model, this paper investigates the dynamic impacts of interest rates, economic growth, exchange rates, government index, and stock market performance. The long-run empirical results indicate that exchange rates exert a significant negative effect, while government index and stock market development show significant positive impacts on FDI. Conversely, interest rates and gross domestic product demonstrate no statistical significance. These findings imply that foreign investors prioritize government quality and financial market depth over nominal macroeconomic indicators. Policymakers should focus on structural strengthening and currency stability to sustain capital inflows.

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INTRODUCTION

Foreign Direct Investment (FDI) acts as a critical catalyst for accelerating economic growth and creating employment opportunities in emerging market economies (Heavilin & Songur, 2020). Developing nations aggressively compete to attract international capital by optimizing capital structures and institutional frameworks. Turkey represents an intriguing and dynamic case study in this global landscape, serving as an economic bridge between Europe, Asia, and the Middle East (Aldalou & Sarsour, 2022). The country undergoes profound structural transformations, positioning itself as a prominent destination for international investors seeking expansion in an integrated market.

The phenomenological reality of the Turkish economy reveals a paradox of high economic resilience amidst intense macroeconomic volatility (Bolek et al., 2025). Substantial fluctuations in FDI net inflows often occur simultaneously with unconventional monetary policies and severe domestic currency depreciation (Karatas et al., 2025). Traditional investment theories assert that foreign capital seeks environments with stable price levels and predictable monetary frameworks. Turkey challenges conventional economic paradigms by maintaining its attractiveness for foreign commitments despite facing prolonged inflationary pressures and currency shocks (Salamat & Batayneh, 2022).

The decision of foreign investors to commit capital to Turkey connects deeply to the central bank policy rate (Dragusha et al., 2026). Monetary authority uses the One Week Repo Rate as a primary instrument to balance the dual challenges of inflation and economic output. Understanding how changes in the nominal interest rate directly influence foreign capital inflows is essential because it reflects the domestic cost of capital (Efthimiou, 2024). Drastic fluctuations alter the risk return calculations for international firms, making monetary policy a fundamental determinant of investment behaviour.

The broader macroeconomic landscape consisting of market size and exchange rate dynamics serves as the primary baseline for foreign capital evaluation (Aldalou & Sarsour, 2022). Gross Domestic Product (GDP) represents the aggregate purchasing power and market capacity of the host country, where a larger market promises higher returns. Concurrently, the exchange rate of the Turkish Lira against the US Dollar acts as a critical determinant of cost competitiveness and financial risk. While a depreciating domestic currency lowers the initial cost of acquiring assets, it simultaneously diminishes the value of repatriated profits.

International business literature emphasizes that macroeconomic indicators alone are insufficient to explain capital patterns without factoring in institutional quality and financial market depth (Thuong & My-Linh, 2025). Political stability and effective Government form the bedrock of legal certainty, safeguarding foreign assets from non-commercial risks (Heavilin & Songur, 2020). Parallel to this, the development of the domestic financial market, proxied by the performance of the BIST 100 index on the Borsa Istanbul, reflects the liquidity and corporate health of the host economy (Bolek et al., 2025). A robust financial system provides foreign firms with efficient capital allocation and reliable hedging mechanisms.

The analysis provides a significant contribution to knowledge enrichment by capturing a highly unique niche sample focusing on the Turkish economy during a period of unprecedented structural and monetary shifts. Existing literature predominantly focuses on stable emerging markets or utilizes static panel data across heterogeneous regions. A single country quarterly analysis captures how an economy navigates severe macro-financial turbulence. Evaluating the joint forces of macroeconomic indicators, Government metrics, and stock market performance fills a critical gap in international trade literature.

The analysis provides a framework to evaluate the multidimensional drivers of international investment by integrating monetary, structural, and institutional factors into a simple dynamic model. Looking at these interconnected elements allows for a deeper understanding of how political and financial market indicators function alongside traditional macroeconomic variables. Accordingly, the investigation examines whether the central bank policy rate and gross domestic product influence foreign direct investment inflows. The study also analyzes whether exchange rate dynamics, Government quality, and stock market performance determine the behaviour of foreign capital commitments

LITERATURE REVIEW

Investment Theory Marginal Efficiency of Capital

Capital allocation decisions in macroeconomic analysis rest heavily on the comparison between the expected rate of return and the prevailing cost of borrowing (Banerjee & Das, 2021). The Marginal Efficiency of Capital (MEC) represents the specific discount rate that equates the present value of expected future revenues from a capital asset with its initial supply cost. Under this framework, international investors commit foreign direct investment only when the MEC exceeds the domestic interest rate. This condition ensures that the anticipated yield from production activities surpasses the fundamental financing costs incurred during the investment phase (Banerjee & Das, 2021).

Psychological expectations and market uncertainties play a significant role in altering the valuation of prospective capital yields (Bazzana, 2024). Future return projections do not depend solely on objective statistical data but are continuously driven by subjective investor optimism, conceptualized as animal spirits (Bazzana, 2024). Shifts in the broader economic environment can severely disrupt these intuitive beliefs, causing sudden contractions in the calculated efficiency of capital. When confidence collapses due to market unpredictability, standard monetary adjustments might fail to stimulate new foreign capital commitments because the perceived risk premium becomes too high.

The functional relationship of aggregate investment behaves as a direct consequence of national output levels and borrowing costs (Bazzana, 2024). The model designates investment (I) as a function of aggregate income (Y) and the interest rate (r). Rising interest rates narrow the operational margin between the MEC and capital costs, thereby diminishing the economic incentives for foreign firms to expand operationally (Bazzana, 2024).

The structural link between interest rates and foreign direct investment inflows originates from capital costs and marginal productivity thresholds. Central bank policy rates determine the minimum profitability requirement that multinational corporations must achieve to justify cross border expansion (Hossain et al., 2024). Increasing borrowing costs narrow the operating margin between the expected efficiency of capital and actual financing expenses, thereby acting as a financial burden that depresses long term investment incentives (Banerjee & Das, 2021; Hossain et al., 2024). These volatile policy shifts disrupt investor optimism and undermine long term confidence regarding prospective capital yields.

The connection between gross domestic product and foreign direct investment inflows relies on effective demand theories and market capacity dynamics (Banerjee & Das, 2021). Aggregate national output reflects local purchasing power and available economies of scale within the host country. Consistent expansions in aggregate production signal robust market demand, which directly elevates the calculated marginal efficiency of capital for foreign firms (Banerjee & Das, 2021; Bazzana, 2024).

Eclectic Paradigm

International investment decisions rely heavily on the dynamic interaction of Ownership, Location, And Internalization advantages that shape multinational corporation strategies (Makiela & Ouattara, 2026). While ownership and internalization metrics determine internal firm efficiencies, location advantages dictate the geographical and structural attractiveness of a host country (Makiela & Ouattara, 2026). Global corporate engagement responds continuously to international economic shifts, driving firms to pursue market seeking, efficiency seeking, or resource seeking opportunities abroad (Bhaumik et al., 2025). Location acts as a highly strategic element that directly alters transaction cost calculations and corporate profitability.

Institutional frameworks and socio-political dimensions function as integral components of location advantages within the expanded analytical paradigm (McCann et al., 2026). The capacity of a host economy to attract foreign commitments depends on regulatory environments that minimize non-commercial uncertainties for multinational firms. Legal certainty, policy framework stability, and effective market regulations represent critical sociopolitical pillars that safeguard long term capital operations (McCann et al., 2026).

Currency values reflect aggregate economic health that directly alters long term transaction cost calculations and corporate profitability. Severe domestic currency depreciation compromises location advantages by increasing import costs for capital goods and escalating financial risks during profit repatriation (McCann et al., 2026). Drastic exchange rate movements alter real production cost structures and manifest underlying monetary instability (Rubaszek et al., 2025). High exchange rate volatility creates substantial currency risks that disrupt profit expectations and lower foreign investor commitments (Alshubiri, 2022).

Financial system maturity serves as a crucial differentiating factor for attracting highly mobile international corporate assets (Pariboni & Tridico, 2020).

Strong equity market performance signals the availability of advanced financial infrastructure, enabling foreign investors to execute hedging strategies, measure asset valuations, and maximize ownership advantages (McCann et al., 2026; Pariboni & Tridico, 2020). Under efficient market principles, security prices fully absorb available public information regarding economic growth prospects and macroeconomic health (Cavalli et al., 2021). Rising stock indices reflect collective investor optimism toward corporate intrinsic values, directly influencing foreign capital commitment decisions through equity market returns (Yavas & Malladi, 2020).

Building upon the established theoretical frameworks and empirical insights discussed, the study proposes the following hypotheses:
H1: Interest rates have a negative effect on FDI inflows in Turkey.
H2: Gross Domestic Product has a positive effect on FDI inflows in Turkey.
H3: Exchange rates have a negative effect on FDI inflows in Turkey.
H4: Government quality has a positive effect on FDI inflows in Turkey.
H5: Financial market performance has a positive effect on FDI inflows in Turkey.

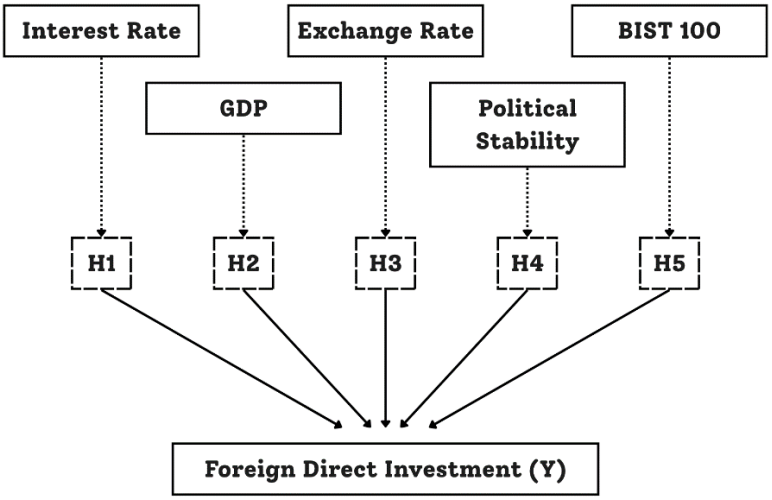

Figure 1. Conceptual Framework

METHODOLOGY

A quantitative research design serves as the foundational approach to investigate the specified population characteristics and sample parameters through structured statistical and numerical evaluations. This empirical framework relies on secondary time-series instruments that capture objective, measurable data points to analyze systemic macroeconomic and institutional shifts. Utilizing this analytical design allows for a precise description of the observed phenomena while simultaneously testing the empirical relationships and the magnitude of the formulated effects between the variables.

Research Site and Period

Turkey serves as the primary geographical object and core analytical location due to its characteristics as an emerging market with volatile macroeconomic dynamics, shifting institutional stability, and fluctuating capital market movements. Data collection relies on official online global and national

databases, including the World Bank, the Central Bank of the Republic of Turkey, and global financial networks. The temporal scope of the empirical observation utilizes high-frequency quarterly time-series data spanning from the first quarter of 2011 (2011: Q1) through the fourth quarter of 2024 (2024: Q4).

Operational Definition and Measurement of Variables

Operational definitions establish clear boundaries and specific descriptions for each observed parameter within the analytical framework. Defining these operational terms outlines the exact measurement mechanisms and data units required to eliminate empirical misinterpretations during data processing. The operational characteristics, measurement units, and respective data sources are structured systematically below:

Table 1. Definition and Measurement of Variables

Variable	Definition	Unit	Source
FDI (Y)	Net FDI inflows entering the Turkish economy.	Million USD	TurkStat & CBRT
Interest Rate (X1)	The primary policy rate set by the central bank (One-Week Repo Auction Rate).	Percentage (%)	TurkStat & CBRT
GDP (X2)	The aggregate value of final goods and services produced within Turkey (Real GDP growth rate).	Percentage (%)	TurkStat & CBRT
Exchange Rate (X3)	The relative value of the domestic currency (Turkish Lira) against the US Dollar (TRY/USD).	Thousand TRY	TurkStat & CBRT
Government Index (X4)	An institutional proxy reflecting political stability and the absence of violence in Turkey.	Index Score (1–100)	World Bank Group Government Indicators
BIST 100 (X5)	The benchmark stock market index representing the performance of the 100 largest companies on the Borsa Istanbul.	Index Points (Closing Price)	TurkStat & CBRT

Analysis Method

Quantitative data processing and systematic analysis transform the gathered time-series parameters into interpretable statistical outputs to test the formulated hypotheses. Financial and macroeconomic modeling operations are executed using the statistical software Econometric Views (EViews 13). The empirical framework utilizes the Autoregressive Distributed Lag (ARDL) technique to evaluate the dynamic impacts of interest rates, real GDP, exchange rates, Government quality, and the BIST 100 index on Turkish foreign direct investment inflows. This estimation method offers substantial structural advantages by allowing both the dependent and independent variables to possess distinct, asymmetric optimal lag lengths within a single model specification to capture long-term and short-term relationships effectively.

Following the structural framework of the analysis, the estimation process advances through a systematic sequence of econometric testing stages to ensure statistical validity. The empirical procedure initiates with the unit root test to verify the integration properties of the time-series data, followed immediately by the determination of the optimal lag length for the model architecture. Cointegration conditions are subsequently evaluated using the ARDL Bounds testing approach to confirm long-run relationships among the parameters. Prior to final interpretation, classical assumption tests are conducted to diagnose potential econometric issues, leading directly to the formal estimation of the long-term and short-term ARDL models. The final stages involve model stability testing alongside hypothesis testing to evaluate the statistical significance and magnitude of the estimated coefficients.

RESEARCH RESULT

Stationarity and Optimal Lag Selection

Verification of the integration properties represents the initial phase in evaluating the econometric validity of the collected time-series observations. Structural testing utilizes the Augmented Dickey-Fuller framework to determine whether the indicators satisfy the operational requirements for dynamic model estimation.

Table 2. Unit Root Test Results

Variable	Level		First		Lag Length
	Prob.	Result	Prob.	Result	
FDI	0.0000	Stationary	-	-	1
Interest Rate	0.8484	Non-Stationary	0.0007	Stationary	2
GDP	0.8655	Non-Stationary	0.0001	Stationary	1
Exchange Rate	0.9999	Non-Stationary	0.0000	Stationary	3
Gov. Index	0.1178	Non-Stationary	0.0131	Stationary	3
BIST 100	0.9989	Non-Stationary	0.0000	Stationary	3

Statistical findings presented in Table 2 demonstrate that Foreign Direct Investment exhibits a probability value of 0.0000, confirming its stationary condition at level I(0) since the significance falls well below the 0.05 critical threshold. Conversely, all independent indicators fail to achieve stationarity at level, but completely transition into a stationary state at the first difference I(1) execution. This mixture of integration properties across the parameters validates the specific structural conditions required to advance with the Autoregressive Distributed Lag framework.

Following the stationarity evaluation, determination of the optimal lag structure is executed automatically using the Akaike Information Criterion (AIC) to establish the final model configuration. Evaluating 12,500 model combinations identifies the top-performing specification as an ARDL (1, 2, 1, 3, 3, 3) architecture. The selected framework indicates that the dependent variable requires a single lag parameter to incorporate its past values. Independent parameters display structural variations in their lag distributions, where the

Interest Rate incorporates 2 lags and Gross Domestic Product utilizes 1 lag. The remaining indicators, comprising the Exchange Rate, Government Index, and BIST 100 Index, uniformly require a maximum distribution of 3 lags within the specification.

Cointegration Test

Cointegration testing determines whether a long-run equilibrium relationship exists among the integrated time-series parameters. The analytical procedure utilizes the ARDL Bounds testing approach to compare the computed joint F-statistic against the lower and upper critical value thresholds.

Table 3. ARDL Bound Test Result

Test Statistic	Value	Significance	I (0) Bound	I (1) Bound
F-statistic	**12.137.719**	**10%**	**2.259**	**3.264**
k	**5**	**5%**	**2.67**	**3.781**
		1%	**3.593**	**4.981**

Statistical outputs presented in Table 3 reveal a calculated F-statistic value of 12.137719. This obtained value strictly exceeds the upper bound I(1) critical values across all standard significance levels of 1%, 5%, and 10%. Specifying the 5% significance threshold where the upper bound limit stands at 3.781 confirms that the computed statistic is significantly higher, thereby demonstrating a valid long-run cointegrating relationship among the dependent and independent variables.

Diagnostic Tests

Diagnostic evaluations are performed to ensure that the estimated ARDL specification satisfies the statistical requirements of classical linear regression. Testing covers residual normality, serial correlation, and heteroskedasticity properties to confirm that the parameters are efficient and unbiased. Statistical metrics summarized in Table 4 confirm that the model passes all primary diagnostic criteria at the standard 5% significance level.

Table 4. Model Diagnostics Test Result

Diagnostic Test	Method / Statistic	Statistical Value	Probability	Result / Status
Normality	Jarque-Bera	1.919629	0.382964	Normally Distributed
Serial Correlation	Breusch-Godfrey LM Test (Obs×R2)	5.19897	0.0743	No Autocorrelation
Heteroskedasticity	Breusch-Pagan-Godfrey (Obs×R2)	19.33903	0.3712	Homoskedastic

The Jarque-Bera probability value of 0.3829 exceeds 0.05, demonstrating that the error terms follow a normal distribution. Serial correlation risks are absent since the Breusch-Godfrey LM test probability stands at 0.0743, retaining the null hypothesis of no residual dependency up to two lags. The Breusch-Pagan-Godfrey estimation yields a probability value of 0.3712, confirming that the residual variance is homoskedastic and constant across observations.

ARDL Model Estimation

Long-Term

Long-term parameter coefficients are evaluated at a 5% significance threshold to determine the permanent effects of the independent indicators on foreign direct investment inflows. Mathematical signs of the estimated coefficients indicate the direct or inverse direction of these long-run relationships.

Table 5. Long-Run Coefficients Estimation

Variable	Coefficient	Std. Error	t-Statistic	Probability	Status
RATE	-0.005616	0.008618	-0.651695	0.5178	Non-Significant
LN_GDP	0.765185	0.622298	1.229.612	0.225	Non-Significant
LN_KURS	-0.873122	0.212576	-4.107.347	0.0002	Significant (-)
GOV_INDEX	0.01913	0.008764	2.182.889	0.0341	Significant (+)
LN_BIST	0.776473	0.199617	3.889.821	0.0003	Significant (+)
C	-1.270.002	1.263.151	-1.005.424	0.3198	Non-Significant

Statistical estimations in Table 5 reveal that the Interest Rate (0.5178) and Gross Domestic Product (0.2250) exert no long-term influence on foreign direct investment due to probability values exceeding 0.05. Conversely, the Exchange Rate shows a highly significant negative long-run impact with a coefficient of -0.8731 and a probability of 0.0002. Positive long-term driven shifts are confirmed for both the Government Index and the BIST 100 Index, yielding significant coefficients of 0.0191 (p = 0.0341) and 0.7764 (p = 0.0003), respectively. Based on the long-run coefficients estimation, the formal long-term ARDL model equation is formulated as follows:

$$\boldsymbol{LN\_FDI_t = \beta_0 - 0,0056 RATE_t + 0,7651 LN\_GDP_t - 0,8731 LN\_KURS_t + 0,0191 GOV\_INDEX_t + 0,7764 LN\_BIST_t + \epsilon_t \ldots\ldots\ldots (1)}$$

The long-run equation demonstrates that foreign direct investment inflows in Turkey are highly sensitive to macroeconomic stability, financial sector performance, and institutional certainty. Exchange rates and capital market performance exert the most dominant permanent impacts on capital inflows, whereas interest rates and economic growth show marginal, statistically non-significant contributions. Holding all independent variables constant fixes, the baseline foreign direct investment log value at -12.7000. A 1% increase in the interest rate or a 1% expansion in Gross Domestic Product alters foreign capital inflows by -0.0056% and +0.7651%, respectively, though both parameters lack statistical significance. Conversely, a 1% depreciation in the exchange rate

significantly reduces foreign inflows by 0.8731%. Institutional and financial improvements yield strong positive returns, where a 1-unit increase in the Government Index point expands capital inflows by 0.0191%, and a 1% growth in the BIST 100 index boosts direct investment by 0.7764%.

Short-Term

Short-term dynamics show how rapidly independent variations influence foreign direct investment inflows and evaluate the speed of adjustment toward long-run equilibrium via the error correction term. The condensed short-term parameters and core lag responses are structured below:

Table 6. Short-Run Coefficients Estimation

Variable	Coefficient	Std. Error	t-Statistic	Probability	Status
COINTEQ (ECT)	-1.326.265	0.132655	-9.997.884	0	Significant (-)
D(RATE)	-0.022165	0.017157	-1.291.864	0.2038	Non-Significant
D(RATE(-1))	-0.02638	0.017296	-1.525.252	0.1351	Non-Significant
D(LN_GDP)	0.270361	0.400028	0.675855	0.503	Non-Significant
D(LN_KURS(-1))	251.674	0.655846	3.837.392	0.0004	Significant (+)
D(LN_KURS(-2))	253.662	0.791533	3.204.695	0.0027	Significant (+)
D(GOV_INDEX(-2))	-0.121355	0.038897	-3.119.887	0.0034	Significant (-)
D(LN_BIST(-1))	-1.554.232	0.347725	-446.972	0.0001	Significant (-)
D(LN_BIST(-2))	-1.379.802	0.353545	-3.902.756	0.0004	Significant (-)

Based on the short-run coefficients estimation, the formal short-term ARDL model equation is formulated as follows:

$$\Delta FDI_t = -1,3262ECT_{t-1} - 0,0221\Delta RATE_t + 0,27031\Delta LN\_GDP_t + 2,5167\Delta LN\_KURS_t - 0,1213\Delta GOV\_INDEX_t - 15542\Delta LN\_BIST_t + \epsilon_t \ldots\ldots\ldots(2)$$

The short-run equation captures a clear time lag in investor reactions to short-term changes. The error correction coefficient of -1.3262 is highly significant (p = 0.0000). Falling between -1 and -2, this value indicates that foreign direct investment fluctuations dampening macroeconomic shocks oscillate rather than adjust smoothly before reaching long-run equilibrium. Approximately 132% of short-run imbalances are corrected in the following quarter. Variations in the Interest Rate and Gross Domestic Product yield no short-term effects due to probability values exceeding the 0.05 threshold. Conversely, the Exchange Rate shows strong positive adjustments at lag 1 (2.5167) and lag 2 (2.5366). The Government Index at lag 2 drives a significant negative adjustment of -0.1213, while the BIST 100 Index induces significant inverse adjustments at lag 1 (-1.5542) and lag 2 (-1.3798).

Stability Diagnostics

Structural stability of the estimated long-run and short-run ARDL parameters is evaluated during the final stage of the econometric analysis. Testing utilizes the Cumulative Sum of Recursive Residuals (CUSUM) and the Cumulative Sum of Squares of Recursive Residuals (CUSUMQ) procedures at a 5% significance threshold.

Table 7. Parameter Stability Test Result

Stability Test	Statistical Plot	Critical Boundaries (5% Level)	Status
CUSUM	Inside the boundaries	Parallel straight lines	Stable
CUSUMQ	Inside the boundaries	Parallel straight lines	Stable

Statistical diagnostics summarized in Table 7 verify the structural consistency of the model coefficients across the entire observation period. The recursive residual plots for both the CUSUM and CUSUMQ procedures remain strictly within the critical 5% significance boundaries without experiencing any boundary breaks. This continuous structural containment confirms that the estimated parameters are free from structural breaks or parameter instability issues. Meeting these stability requirements validates the reliability of the previously calculated long-term and short-term coefficients for policy conclusions.

Hypothesis Testing

Coefficient of Determination R^2

The coefficient of determination evaluates the capacity of the model framework to explain variations within the dependent variable. Statistical outputs reflecting the overall explanatory boundary of the specified parameters are presented below:

Table 8. Coefficients of Determination Result

Metric	Value
R-Squared	0.637806
Adjusted R-Squared	0.446057

Statistical outputs presented in Table 8 reveal an Adjusted R-squared value of 0.446057. This metric indicates that 44.61% of the variation in Turkish foreign direct investment inflows is explained by changes in the specified independent indicators. The remaining 55.39% of the variation is determined by alternative factors operating outside the scope of this analytical framework.

Simultaneous Significance Test (F-Test)

The simultaneous significance test evaluates whether all included independent variables combined exert a statistically significant influence on the dependent variable. Joint probability thresholds determine the validation status of the structural parameters as follows:

Table 9. F-Test Result

Statistic	Value
F-statistic	3.326245
Prob(F-statistic)	0.001238

Statistical values presented in Table 9 show a joint probability value of 0.001238. This significance level falls well below the standard 0.05 critical

threshold, leading to the rejection of the null hypothesis. It is concluded that the independent indicators simultaneously exert a highly significant impact on Turkish foreign direct investment inflows.

Partial Significance Test (t-Test)

The partial significance test evaluates the individual effects of each independent variable on Turkish foreign direct investment inflows across both long-term and short-term horizons. Probability values are compared against the standard 0.05 significance threshold to determine hypothesis validation.

Table 10. Summary of Partial Hypotheses Estimation

Hypothesis / Variable Relationship	Long-Run Coefficient	Long-Run Prob.	Short-Run Coefficient	Short-Run Prob.	Hypothesis Status
H1: RATE → FDI	-0.005616	0.5178	-0.022165 [t]-0.026380 [t-1]	0.20380.1351	Rejected (No Effect)
H2: LN_GDP → FDI	0.765185	0.225	0.270361 [t]	0.503	Rejected (No Effect)
H3: LN_KURS → FDI	-0.873122	0.0002	2.516740 [t-1]2.536620 [t-2]	0.00040.0027	Accepted in Long-Run (-)
H4: GOV_INDEX → FDI	0.01913	0.0341	-0.121355 [t-2]	0.0034	Accepted in Long-Run (+)
H5: LN_BIST → FDI	0.776473	0.0003	-1.554232 [t-1]-1.379802 [t-2]	0.00010.0004	Accepted in Long-Run (+)

Statistical evaluations summarized in Table 10 reveal distinct parameter dynamics across different temporal horizons. Rejection of both H1 and H2 indicates that the Interest Rate and Gross Domestic Product fail to exert individual structural impacts on foreign direct investment inflows in either the short run or the long run. Conversely, H3 is supported over the long term, showing that exchange rate depreciation significantly restricts permanent capital inflows despite demonstrating a positive net adjustment in short-run lag responses. Institutional verification validates H4 in the long run, proving that political stability and government index enhancements permanently stimulate direct investments, although localized negative shocks occur at the second short-run lag. Financial verification confirms H5, establishing that strong capital market performance serves as a powerful positive signal that expands long-term foreign capital inflows, even though inverse adjustments emerge throughout the short-term lag structures.

DISCUSSION

Estimation outputs derived from the Autoregressive Distributed Lag framework reveal distinct structural dynamics regarding the determinants of foreign direct investment inflows in Turkey from 2011 Q1 to 2024 Q4. Long-term statistical validations support three of the proposed hypotheses (H3, H4, and H5), whereas two indicators (H1 and H2) fail to demonstrate statistical significance. The specific analytical implications of these individual parameters are detailed below:

Impact of Interest Rates on Turkish Foreign Direct Investment

Statistical estimations demonstrate that the interest rate exerts no statistically significant influence on foreign direct investment inflows into Turkey across both long-term and short-term horizons. Long-run estimation yields a probability value of 0.5178, while the short-run current and lag 1 parameters show probabilities of 0.2038 and 0.1351, respectively. These values exceed the standard 0.05 critical threshold, leading to the rejection of the first hypothesis.

Interest rates typically represent the cost of capital, where higher rates increase borrowing costs and reduce investment incentives. Foreign direct investors in Turkey overlook this monetary instrument because their real asset allocations are long-term commitments focused on broader structural indicators. Unorthodox monetary policies implemented in Turkey during recent years diminish the function of interest rates as a reliable gauge for risk or real investment returns. Foreign capital allocation decisions prioritize exchange rate stability and institutional certainty over short-term capital costs.

High domestic interest rates often function as central bank tools to manage inflation or stabilize currency depreciation, yet unpredictable policy shifts create institutional risks that outweigh corporate borrowing costs. Foreign direct investment inflows enter or exit based on alternative indicators such as political stability and financial market performance rather than domestic credit pricing. This outcome aligns with Aldalou and Sarsour (2022), who confirm that foreign capital decisions in Turkey are not significantly driven by interest rates or capital costs, as multinational firms prioritize market size, currency stability, and economic openness.

Impact of GDP on Turkish Foreign Direct Investment

Gross Domestic Product metrics demonstrate no statistically significant influence on foreign direct investment inflows into Turkey across both long-term and short-term horizons. Long-run estimation yields a probability value of 0.2250, while the short-run parameter shows a probability of 0.5030. These values exceed the standard 0.05 critical threshold, leading to the rejection of the second hypothesis and indicating that domestic market size is not a primary driver of foreign capital inflows.

Gross Domestic Product typically serves as an indicator of market size, which is highly attractive to market-seeking investors. The lack of statistical significance in Turkey reflects a shift in investor orientation caused by volatile macroeconomic conditions. Real economic growth failing to guarantee returns without exchange rate stability causes foreign entities to prioritize efficiency-seeking investments geared toward export markets rather than relying on a domestic market whose purchasing power is vulnerable to high inflation and currency depreciation.

High volatility in the Turkish Lira reduces the relevance of expansionary Gross Domestic Product growth because rapid currency depreciation can instantly diminish asset values and corporate returns when converted back into foreign denominations. This outcome aligns with PehlİvAn, (2019), who utilizes an ARDL framework and confirms that economic growth fails to exert a statistically significant long-run impact on Turkish foreign direct investment,

demonstrating that production growth factors are consistently less dominant than monetary stability indicators in driving foreign investment decisions.

Impact of Exchange Rates on Turkish Foreign Direct Investment

Exchange rate variations demonstrate statistically significant long-term and short-term impacts on foreign direct investment inflows into Turkey, exhibiting contrasting directions across different time horizons. Long-run estimation reveals a significant negative relationship with a probability value of 0.0002 and a coefficient of -0.8731. This outcome confirms the third hypothesis, indicating that exchange rate increases representing Turkish Lira depreciation restrict permanent capital inflows over the long term.

Exchange rates serve as a primary indicator of international competitiveness and macroeconomic stability. Depreciating domestic currencies raise imported input costs and create structural uncertainties regarding future corporate profitability. Foreign direct investors perceive the persistent depreciation of the Turkish Lira as a severe macroeconomic risk that complicates capital repatriation and increases operational expenses due to production dependencies on foreign-sourced materials. Maintaining currency stability is therefore a fundamental requirement for preserving investment climate appeal.

Prolonged exchange rate volatility causes foreign entities to respond negatively over the long-run horizon to avoid structural capital losses. This negative long-term effect aligns with Pehlivan (2019), who confirms that exchange rate expansions harm Turkish foreign direct investment inflows because foreign manufacturing operations in Turkey are deeply dependent on imported industrial inputs. Currency stability remains a decisive determinant for international investments as supported by Aldalou and Sarsour (2022). Furthermore, Alshubiri (2022) demonstrates a significant negative long-run exchange rate impact on capital inflows across distinct country groups, reinforcing the concept that uncontrolled currency depreciation signals higher transaction costs and macroeconomic uncertainty that deter international capital commitments.

Impact of Government Index on Turkish Foreign Direct Investment

Government index configurations demonstrate statistically significant long-term and short-term impacts on foreign direct investment inflows into Turkey, presenting contrasting signs across different temporal frameworks. Long-run estimation reveals a significant positive relationship with a probability value of 0.0341 and a coefficient of 0.0191. This outcome supports the fourth hypothesis, confirming that improvements in political stability and governance quality stimulate permanent capital inflows over the long term.

Institutional framework quality and political stability represent essential criteria evaluated by international entities prior to making long-term physical asset commitments. Stable political environments ensure legal certainty and property rights protection, which simultaneously minimize non-commercial operational risks for multinational firms. The positive long-run coefficient proves that strengthening governance structures sends a favorable signal to international capital markets.

Abrupt administrative adjustments or past governance shifts can trigger temporary adverse sentiments that briefly restrict capital deployment. Over time,

administrative consistency in maintaining structural stability remains the primary fundamental driver sought by permanent investors to guarantee operational sustainability. This long-term mechanism aligns with Chebli & Saidi, (2024), who establish that political stability is a vital catalyst determining the macroeconomic returns of capital allocation, demonstrating that institutional volatility in middle-income markets clearly impedes the positive expansion of foreign investment and reinforcing the requirement for institutional strengthening to secure sustainable capital inflows.

Impact of BIST 100 Index on Turkish Foreign Direct Investment

Capital market dynamics demonstrate statistically significant long-term and short-term impacts on foreign direct investment inflows into Turkey, presenting shifting coefficient signs across different temporal horizons. Long-run estimation reveals a significant positive relationship with a probability value of 0.0003 and a coefficient of 0.7764. This outcome validates the fifth hypothesis, confirming that robust capital market performance correlates with increased permanent foreign capital inflows over the long term.

Capital markets function as a primary barometer for aggregate economic health. Rising equity indices reflect optimized corporate earnings expectations and expansionary growth prospects. The positive long-run coefficient shows that growth within Borsa Istanbul signals strong macroeconomic optimism to international real asset allocators. Liquid and developed financial ecosystems simplify asset valuations, enhance alternative corporate financing options, and facilitate structured exit strategies for multinational enterprises. The performance of the BIST 100 index therefore strengthens the structural appeal of the domestic investment climate. This temporary divergence reflects a localized asset substitution effect or brief market volatility, where rapid short-term equity market expansions attract volatile portfolio capital allocations rather than permanent physical commitments.

As markets stabilize over time, capital market expansion acts as a fundamental driver that elevates national investment capacity by reinforcing domestic asset bases. This transmission mechanism matches Kurul (2021), who identifies significant long-run interactions between foreign direct investment inflows and domestic capital formation in Turkey.

CONCLUSIONS AND RECOMMENDATIONS

Estimation outputs from the Autoregressive Distributed Lag framework across quarterly observations confirm that interest rates and Gross Domestic Product growth demonstrate no statistical significance regarding foreign direct investment inflows in Turkey. Conversely, exchange rates, institutional index configurations, and stock market performance operate as the primary long-term determinants of capital inflows. Long-run currency depreciation exerts a significant negative effect on foreign investment, whereas structural enhancements within government quality and stock market development show significant positive impacts on sustaining capital inflows, indicating that foreign investors prioritize institutional quality and financial market depth over nominal macroeconomic indicators.

Policy implementations require the central bank to prioritize currency stability and orthodox monetary measures to mitigate exchange rate volatility. Reversing rapid depreciation stabilizes transaction costs and provides essential predictability for foreign capital repatriation. Institutional authorities must focus on structural strengthening by optimizing government quality, maintaining regulatory consistency, and securing property rights to reduce non-commercial operational risks for international firms making long-term asset commitments.

Financial regulators should implement structural reforms aimed at increasing transparency and liquidity to foster stock market development. Enhancing financial market depth transforms the stock exchange into a robust barometer that attracts permanent direct investments rather than speculative short-term capital. These combined structural, institutional, and currency adjustments remain critical to establishing a highly competitive and secure investment environment in Turkey.

ADVANCED RESEARCH

The analytical scope of this framework is constrained by its reliance on aggregate macroeconomic indicators, which omits micro-level determinants such as firm-specific characteristics, infrastructure quality, and specific trade agreements that also influence capital allocation decisions. Future research should extend these findings by incorporating sector-specific data to differentiate how these variables affect manufacturing, services, and primary industries differently within Turkey.

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