

Changing Monetary Transmission Mechanism in Thailand

by

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Plan of Presentation

- **What is Transmission Mechanism?**
- **Transmission mechanism in Thailand**
 - **under fixed exchange rate regime**
 - **under floating exchange rate regime**
- **Inflation targeting and effectiveness of the transmission mechanism**

Chain of Developments

1

BOT

2

Financial Markets

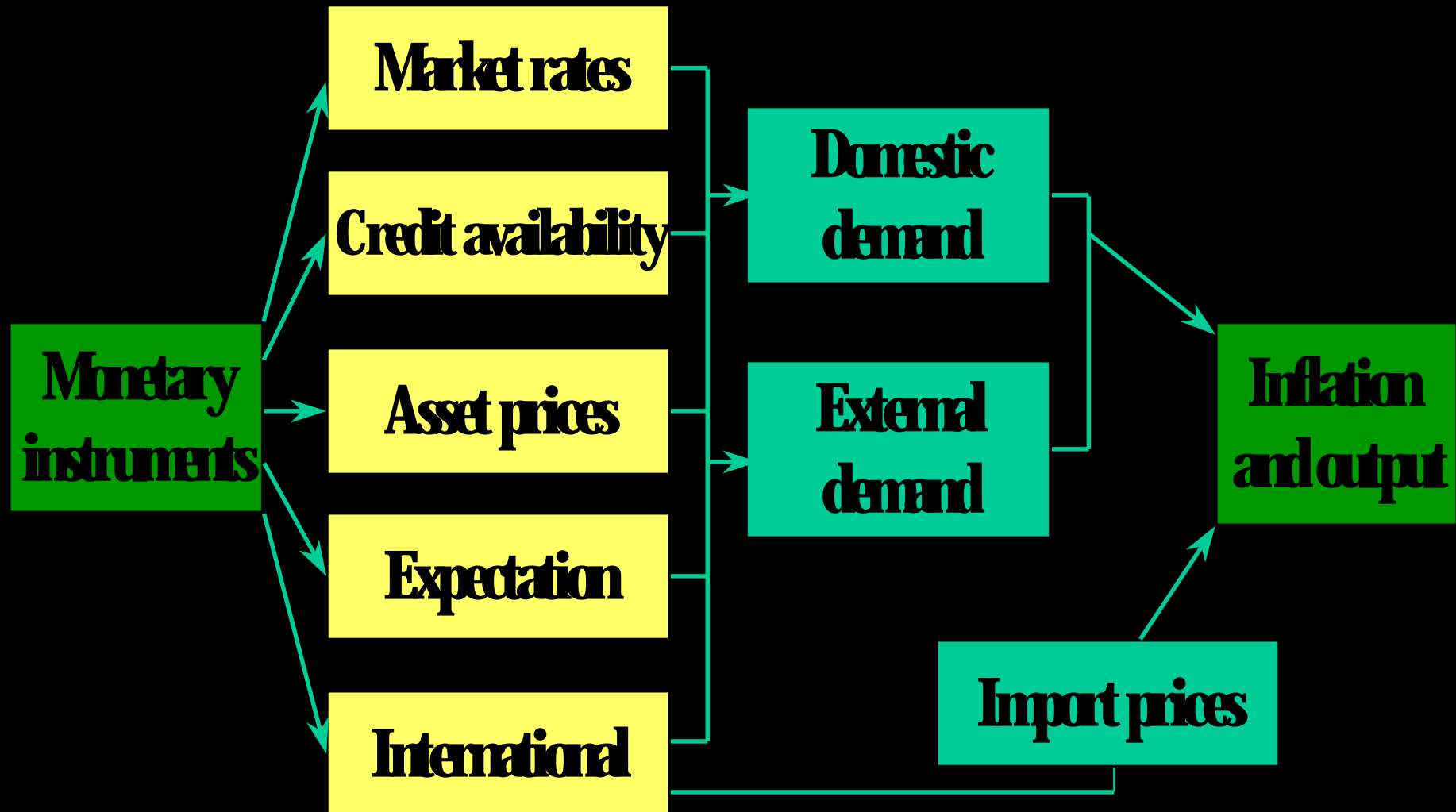
3

Aggregate Spending

4

Inflation and Output

Transmission Mechanism in General



Transmission Mechanism under Fixed Exchange Rate Regime

- **Monetary policy was not effective**
- **Domestic interest rates were influenced by external interest rates**
- **Continued credit expansion was the impetus responsible for economic growth before 1997**

Figure 1 : Domestic Interest Rate and LIBOR 1M

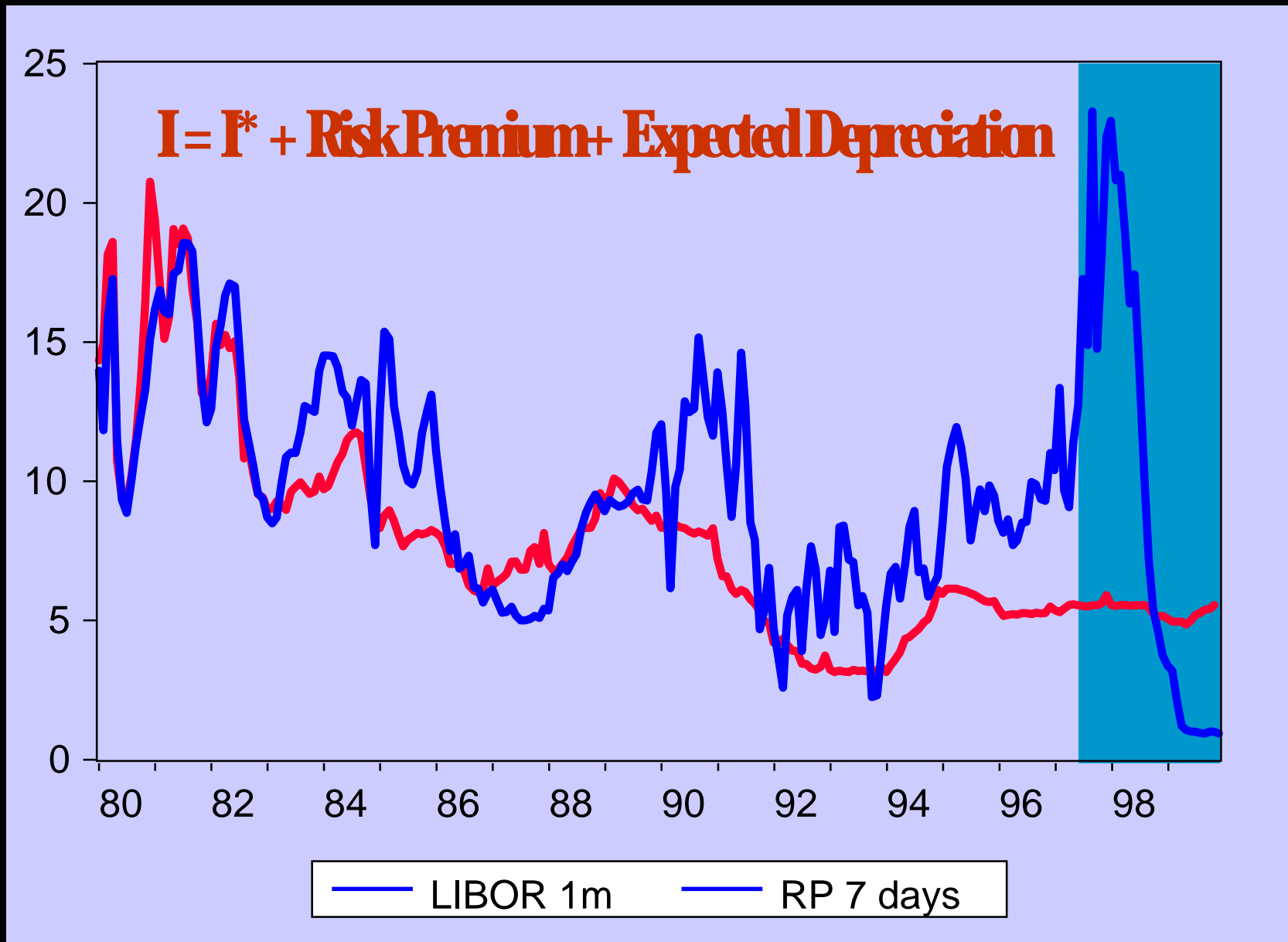


Figure 2 : Impulse-Responses Functions

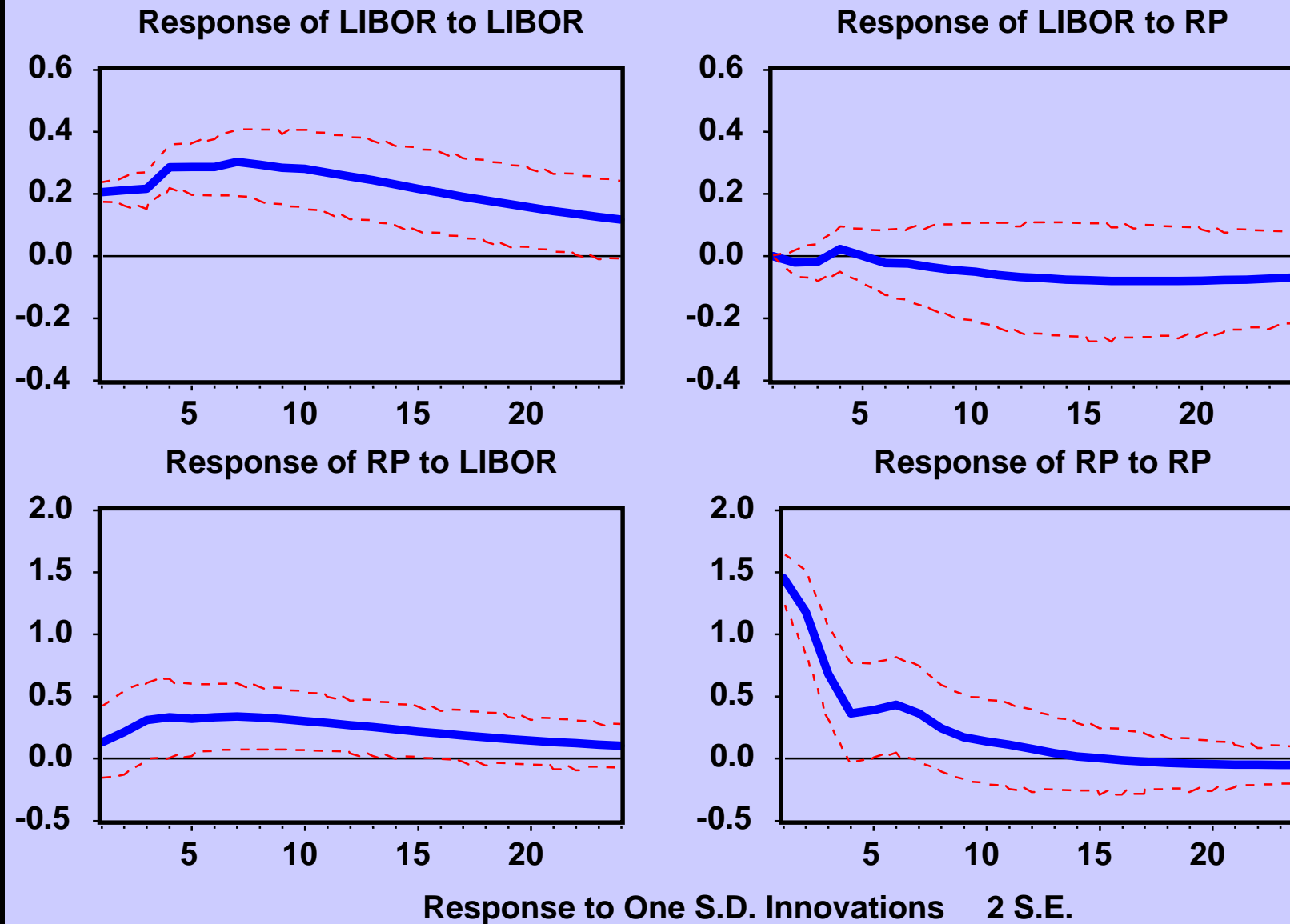


Figure 3 : Credit Growth and Private Investment Index

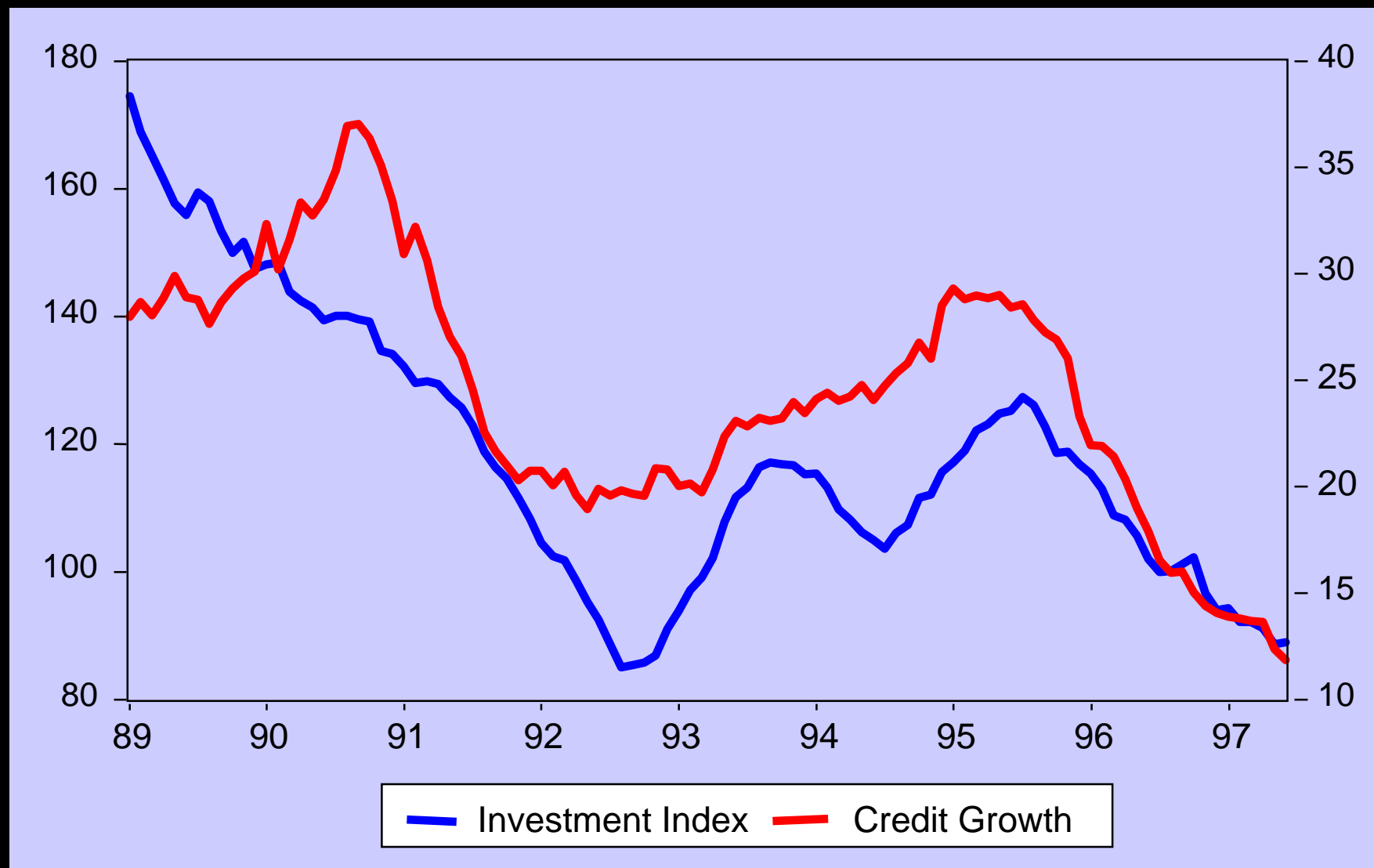
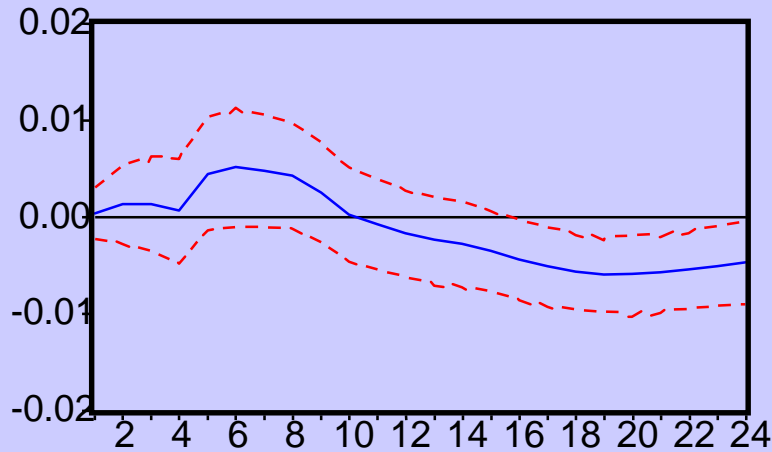


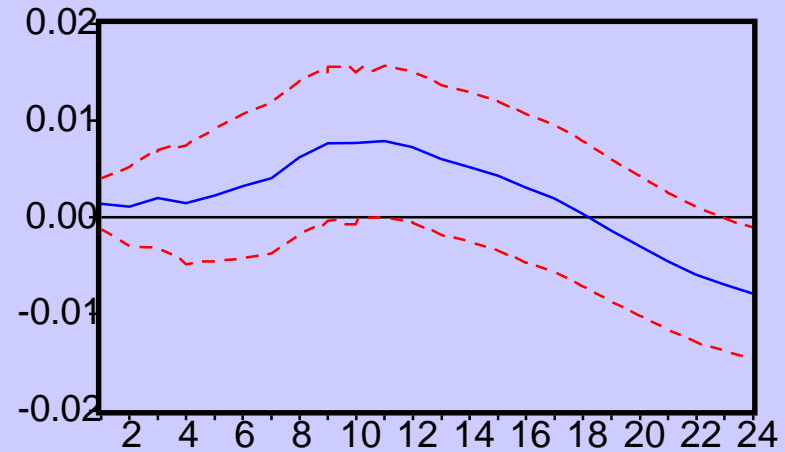
Figure 4 : Impulse-Responses Functions

Response to One S.D. Innovations 2 S.E.

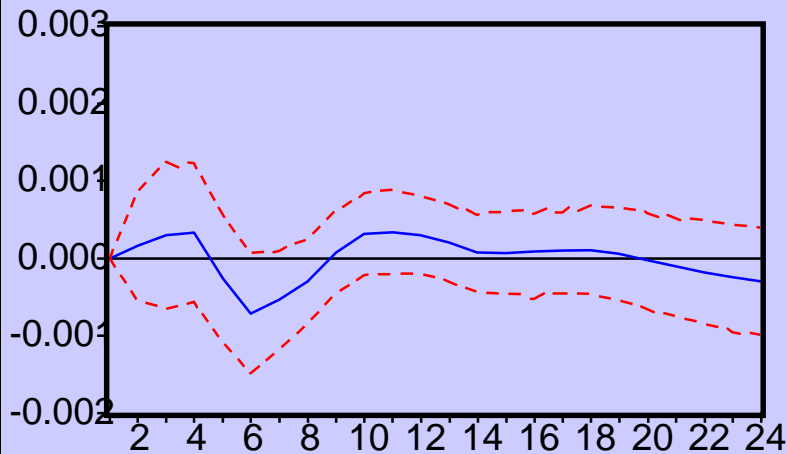
Response of LPPI to MLR



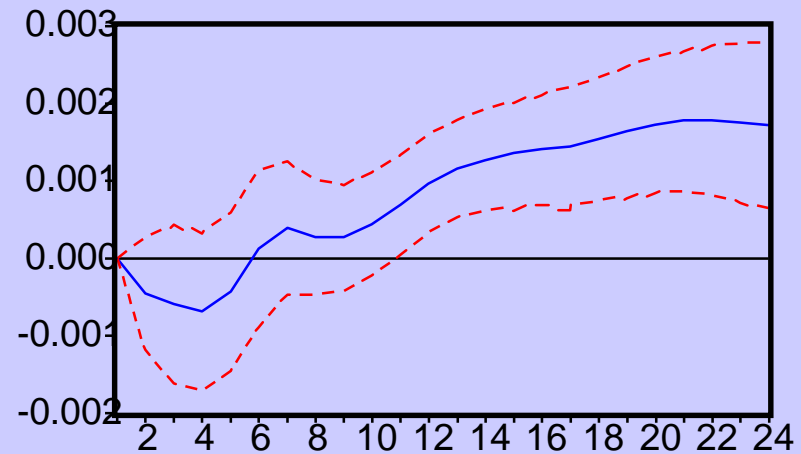
Response of LPPI to LBLO



Response of LCPI to MLR



Response of LCPI to LBLO



Transmission Mechanism under Floating Exchange Rate Regime

- Thailand has regained autonomy over her monetary policy
- Short-term domestic interest rates can now move more freely
- **Interest rate channel will become a critical channel of the monetary transmission mechanism**

Short-Term Interest Rates under Floating Exchange Rate Regime

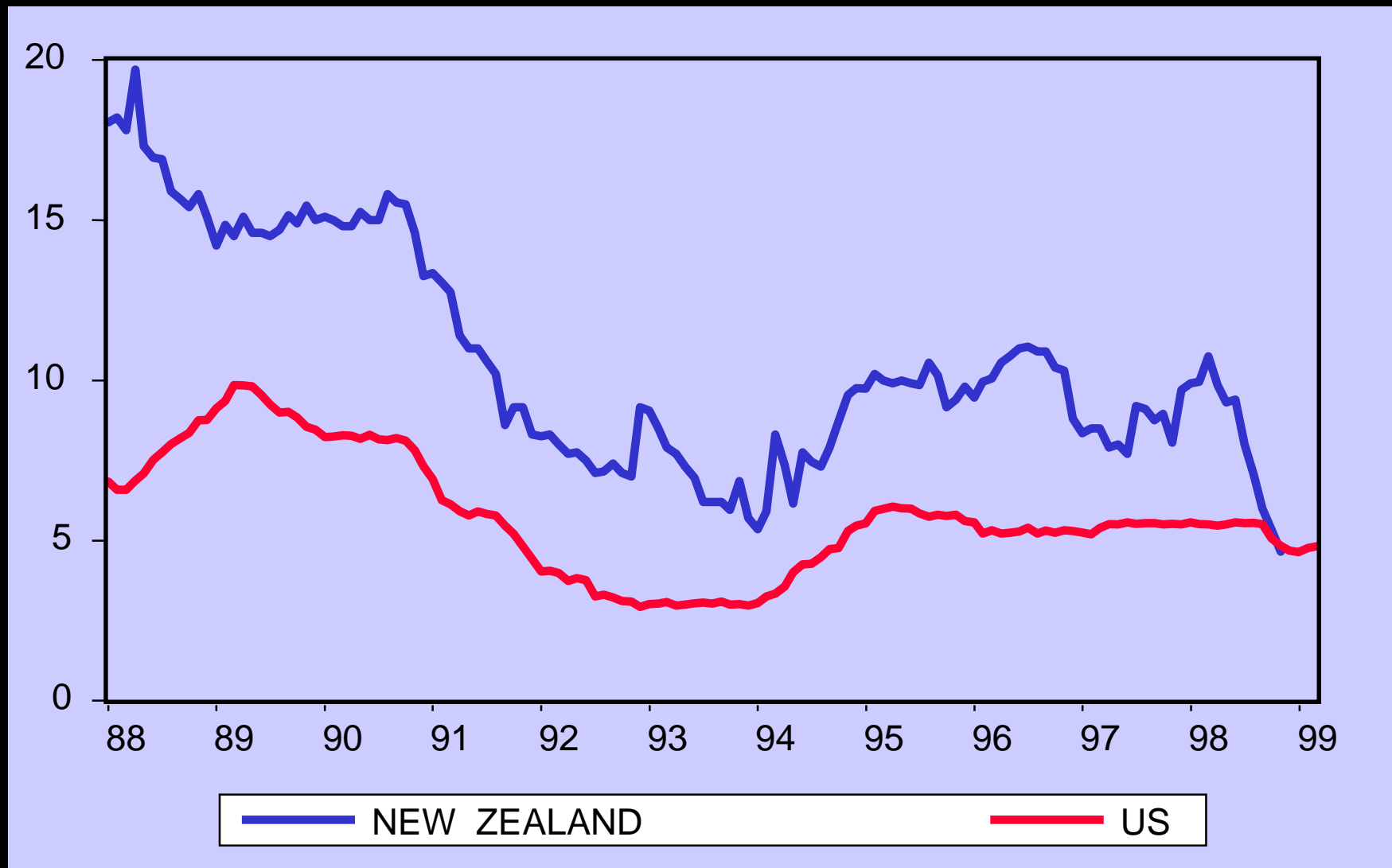
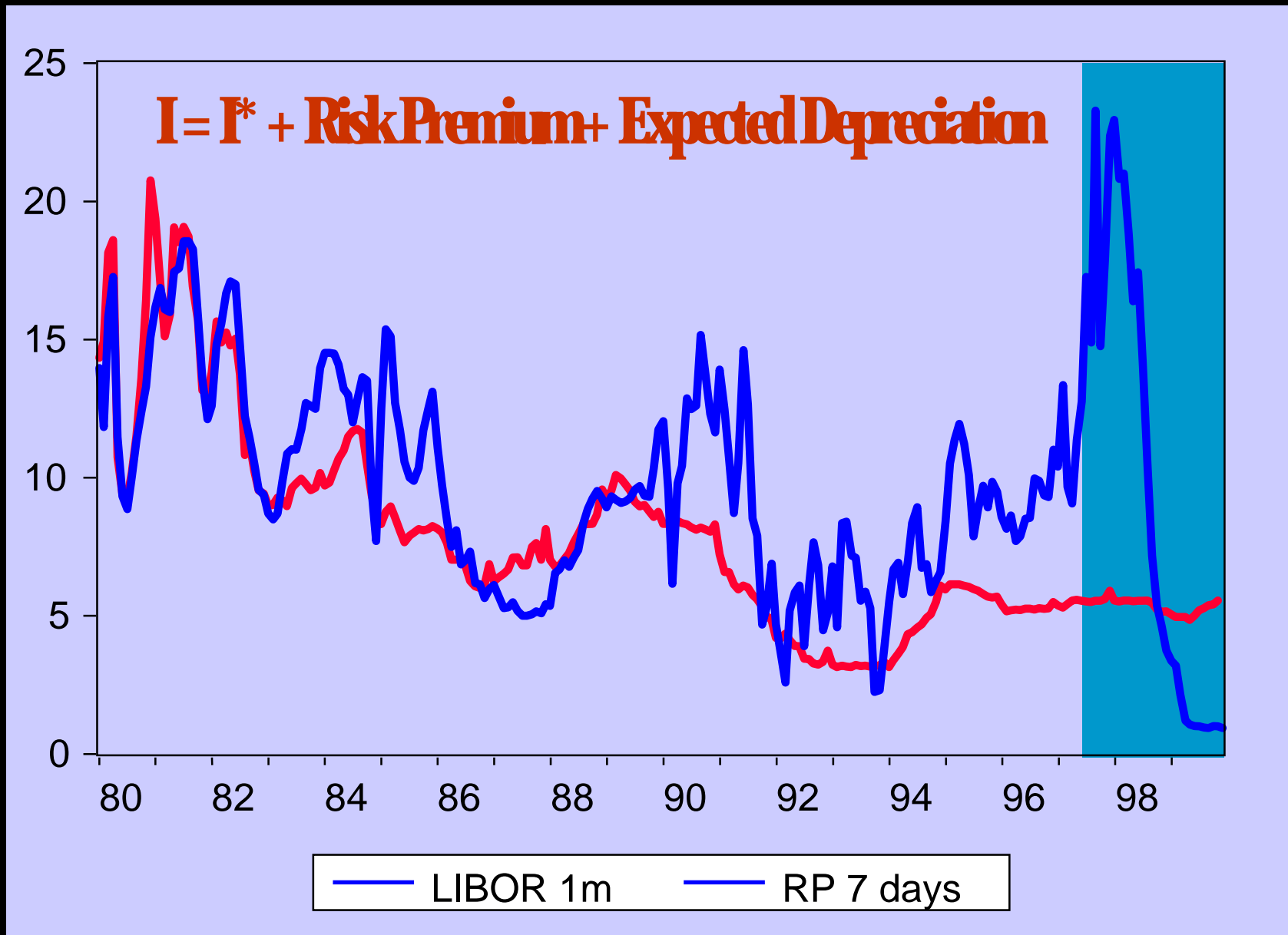
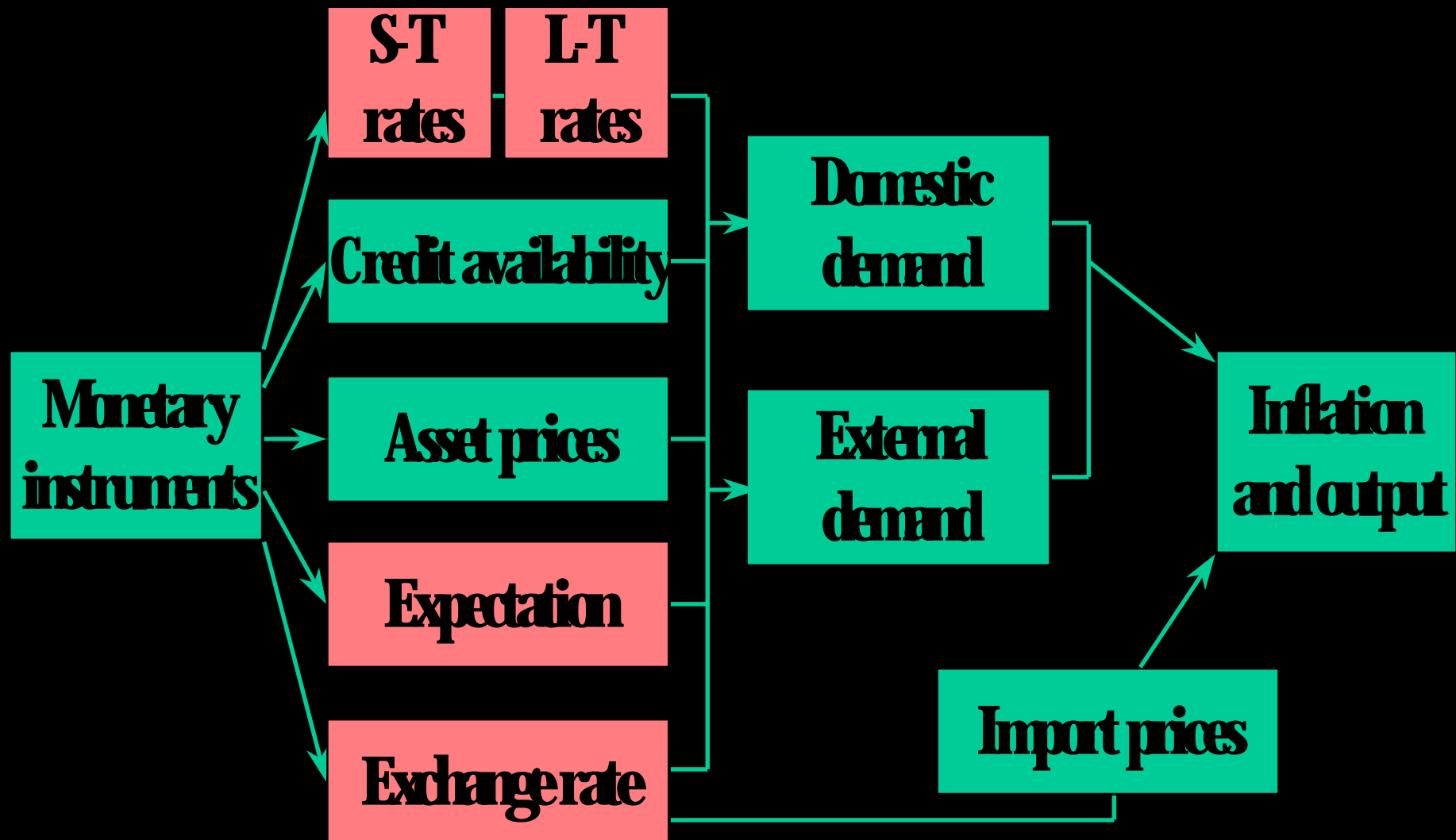


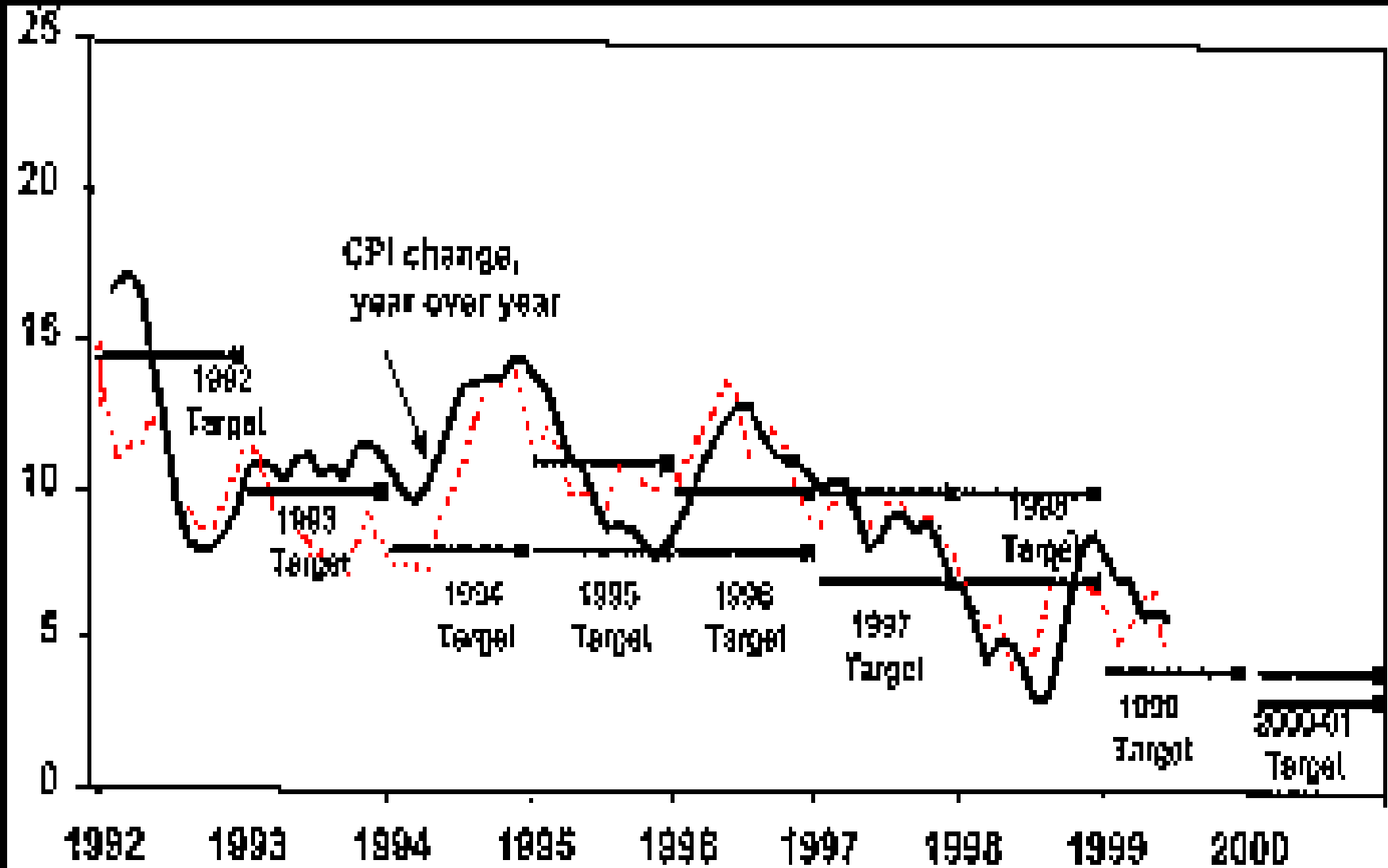
Figure 5 : Domestic Interest Rate and LIBOR 1M



New and Improved Channels of Transmission Mechanism after July 1997



Inflation expectation and Actual inflation in Israel during 1992-1999



Inflation Targeting Framework and Effectiveness of Transmission Mechanism

Features

- **Using short-term rates as policy rate**
- **Announced inflation target and forecast**
- **Greater transparency of monetary policy**

Benefits

- **Closer linkages between interest rates**
- **An anchor for inflation expectation**
- **Reduction in policy uncertainty**

Conclusion

- **The structure of monetary transmission mechanism has changed following the switch of the exchange rate regime**
- **Domestic short-term interest rates can now move more freely and interest rate channel will become a critical component of the transmission mechanism**
- **Greater transparency under inflation targeting framework will increase efficiency of the transmission mechanism**