

ABSTRACT

Thesis Title : An Analysis of the Relationship between Interest Rate and
Inflation in Thailand : A Case Study of Fisher Effect

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The purpose of this thesis is to investigate the relationship between interest rates and inflation in Thailand according to the Fisher Effect hypothesis. By using Co-integration technique, this study has tested the long-run relationship between various interest rates and the expected inflation rate. As for the short-run analysis, Error Correction Model (ECM) has been used. Interest rates in this study consist of interbank lending rate (INT_t), repurchase rate (IRP_t), MLR ($IMLR_t$), bank rate (IBR_t), saving deposit rate (ISD_t) and time deposit 3-6 months (ITD_t). The analysis is divided into two different regimes, the Basket of Currencies regime (May 1992 to June 1997) and the Managed Float regime (July 1997 to December 2000).

In the Basket of Currencies period, it is found that there is a long term co-integrated equilibrium relationship between expected inflation and interbank lending rate, repurchase rate and time deposit 3-6 months. In the Managed Float period it is found co-integration relationship in every interest rates variables except saving deposit rate. It shows that, changing in exchange rate from the Basket of Currencies to the

Managed Float system make price mechanism be more efficiency and improving the co-relationship between interests and expected inflation rate. By testing the Fisher Effect hypothesis, it is found that only the repurchase rate in the Basket of Currencies period, and the bank rate in the Managed Float period have Fisher Effect. Therefore, the conclusion of this thesis is that, there is a Partial Fisher Effect between interest rates and expected inflation rate.

In term of policy implication, this thesis may suggest that the repurchase rate (IRP_t) in the Managed Float period, represents the best monetary policy instrument to secure price stability in Thai economy especially in short-run.