The BOT's Response to the Exchange Rate Shock after Adopting of Inflation Targeting Policy

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ABSTRACT

This paper analyzes the response of Bank of Thailand (BOT) to the exchange rate shock by examining reactions of the policy interest rate to the exchange rate shock. We use Vector Autoregressive (VAR) method to analyze policy interest rate, inflation rate, MPI and USD/THB during May 2000 to November 2009. The impulse response analysis and forecast error variance decomposition are used to explain the response of the BOT to the exchange rate changes. We find that the policy interest rate responds more to the inflation shock than to exchange rate shock. The effects of inflationary shock on the policy interest rate last more than 12 months while the effects of exchange rate shock last only 6 months. The fact that the policy interest rate responds more to the inflation proves that the BOT care more about inflation level during the study period. This finding implies that the BOT tries to control the exchange rate in order to attain the target inflation, suggesting fear of Inflation rather than fear of Float.