Chapter 6

Conclusion

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It can be concluded from our analysis that the overall regression can be used to explain the exchange rate determination.

1. The coefficient of 1-month forward exchange rate is significantly indifferent from zero at 5 percent level of significance which shows that the foreign exchange market is not efficient under risk neutrality and rational expectation. It refers to the notion that the market do seem to entail unexploited profit opportunities. Hence, the forward exchange rate is not an unbiased estimator of the future spot exchange rate. This may be because of a failure of rational expectation or because there exists a sizeable time varying risk premium. Alternative, there could be elements of irrational behaviour in the market caused by the mechanics of the trading process itself.

2. The empirical results shows that the lagged forward exchange rate which is based on past information and news which is unexpected changes in the rate of interest have no effect to changes in the current spot exchange rate. The explanation is the structural change the economic system, therefore, an important news item in one period may not be viewd as an important factor at another time period. It suggests that the coefficients may not be statistically

significant over all the subsample period of the data, and may appear unstable overtime.

3. The result of the determination of the exchange rate in the long-run, It can be concluded that the deviations from purchasing power parities for consumer price indices has occured in this sample period. It indicates that the exchange rate is not follow the purchasing power parities. Besides, the deviations from purchasing power parities for consumer price indices can be characterized by a first-order autoregressive process.

Policy implication

Nowaday Thailand's economics situation is unstable and the exchange rate system has changed to managed float regime, so the exchange rate in this sample period is also unstable. The government has used the policy to keep the high interest rate in order to induce the capital inflow and maintain the stability of the exchange rate in Thailand.

From the result of our analysis, we find out that there is no relation from the interest rate differential and the spot exchange rate during the floating period. Therefore, the adjustment in the interest rate differential will not be able to stimulate the capital inflow because of the failure of the price mechanism in the money market.

Hence, the interest rate adjustment will not effect to changes in the current spot exchange rate in this sample period.

Suggestion

1. This study used the daily data because Thailand just changes to flexible exchange rate from July 2, 1997, so the news may have a slightly effect on such a short time period. Using the weekly or monthly data may be able to improve the result.

2. The news which is the unexpected changes in the rate of interest may not consistent to the real event in the sample period. We should try to use other indicators which may reflect better.

3. Using of the other estimation methods may be able to improve the model such as the cointegration method or the instrumental variable method.

4. The autocorrelation and the partial autocorrelation show the pattern of deviation from the purchasing power parities. If we want to find the direction of this pattern, the vector autoregression model may be more appropriate.