ABSTRACT

In the early of 1993, Cambodia had a sustainable economic growth from 4.1 percent to 10.2 percent in 2007. To reflect to this situation; money supply growth, M1, increased from 1 percent in 1994 to 17 percent in 2008 while the exchange rate depreciated almost 51 percent by increasing from 2689 Riel per US dollar in 1993 to 4054.17 Riel per US dollar in 2008 and the inflation rate increased from 1 percent in 1995 to 19 percent in 2008.

The main purpose of the study is to examine the impact of exchange rate depreciation on the price level in the context of the monetary version that exchange rate and price level are monetary phenomena. Another purpose of the study is to investigate the interrelationship between money, exchange rate, and price level in Cambodia.

This study used Vector Autoregressive (VAR) model of three variables consisted of money supply, exchange rate, and price level. All variables were expressed in terms of natural logarithm. Monthly data were used in this study from January 1999 to December 2008 and all of the data were collected from the International Financial Statistics of the International Monetary Fund.

The result of the study revealed that exchange rate depreciation as well as money supply growth led inflation rate in Cambodia. Moreover, exchange rate and price level are monetary phenomena because money supply Granger-caused both variables. Surprisingly, exchange rate does not Granger-caused price level, but price level Granger-caused exchange rate. This result can be explained that whenever the exchange rate depreciate, the price of imported goods from foreign countries go up so to keep the profit remain the same as before the sellers might have to increase the price of imported goods then increasing in the domestic price levels. In this situation, the National Bank of Cambodia (NBC) would intervene the domestic foreign exchange market in order to increase the value of domestic currency so that the price levels drop. However, in order to increase the value of domestic currency, the National Bank of Cambodia would use the US dollar auction which is selling US dollar to money changers and absorb Khmer Riel back into the central bank and the US dollar would flow to the hand of the public. In doing so, the international reserve as well as the domestic currency in circulation of the NBC's Balance Sheet would decrease which caused money supply to decrease also. This process would affect both the money supply and the exchange rate in the economy. According to the result of the study, the interaction between money, exchange rate, and price level was mainly derived from the policy-induced by the central bank. Furthermore, the variation of inflation was explained weakly by exchange rate depreciation and money supply growth. In the period of one year, the variation of the inflation which caused by exchange rate depreciation and money supply growth were not more than 1.78 percent and 9.77 percent, respectively. With referred to the cointegration test between the price index of Cambodia and the price indexes of Thailand and Vietnam, the variation of price level of Cambodia could be explained well by its main trading partners' price levels. In the period of one year, the variation of the price level of Cambodia was explained by the price levels of Thailand and Vietnam, 5.69 percent and 8.29 percent, respectively.