ABSTRACT

This paper studies the complexity interrelationships among output, inflation, policy interest rate, and stock returns by using Vector Autoregressive (VAR) model. In particular, the main objective is to investigate the impact of Thailand’s key policy rate on stock returns over the period May 2000 – July 2010.The results from impulse response indicate that tightening monetary policy leads to decline in stock market returns for approximately 6 months. However, forecast error variance decompositions show that stock returns respond most to its own shocks the corresponding impact of the policy interest rate shocks small.

Another objective of this paper is to study the negative relation between inflation and stock returns based on “Fama Hypothesis” and “Anticipated Policy Hypothesis”. Our results do support the anticipated policy hypothesis which implies that countercyclical monetary policy is responsible for the negative relation between inflation and stock returns. However, the empirical results support Fama hypothesis only in the short run. In the long run, the relationship between output and inflation are consistent with the Phillip Curve, and stock returns negatively respond to output shocks several months later.