CHAPTER I

INTRODUCTION

In recent years, there has been a growing realization that money does have an extremely important influence because it is the asset used by society which minimizes the economic costs associated with collecting market information and conducting market transactions. Many researchers have demonstrated that changes in the money stock are a reliable summary measure of the effect of monetary policy actions on economic activity. It was suggested that the monetary authorities could best achieve ultimate policy objectives such as full employment and stable prices, by controlling the growth rate of the money stock.

In order to understand the supply of money, one must be familiar with the determinants of the money supply. In past decades, several economists have investigated the factors which affect the money stock. The notable studies are Friedman and Schwartz (1963) and Cagan (1965). They found that the supply of money was influenced by various factors both endogeneous and exogeneous to the economic system. Cagan's analysis was based on the relation between the stock of money and its three determinants--the high-powered money stock, the reserve ratio, and the currency ratio.

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Cagan also analyzed factors that affected these three determinants. There is no similar work being done for a small developing country like Thailand. Trescott (1971) has written a book dealing mainly with the structure of the monetary system in Thailand. In this work, the only discussion relevant to the determinants of the Thai money supply are some brief remarks concerning the monetary base. Ahrensdorf and Kanesathasan (1960) did an empirical analysis of the money multiplier for selected developing countries, not including Thailand. Bhatia (1971), following the same line of thinking, did a study for some African countries. Grachangnetara (1972) and Jinchitra (1975) studied the money supply in Thailand using the technique suggested by Ahrensdorf and Kanesathasan and Bhatia. Their work was concentrated on the relation between the money supply in Thailand and the monetary base.

The literature about Thailand cited above has failed, however, to explore rigorously the impact of the three determinants on the money supply and the factors that have affected their behavior. This study is designed to investigate the behavior of the determinants of the Thai money supply and various factors that affect them. It will start with a survey of literature concerning the development of the theory of the money supply and its determinants. Chapter III provides a brief summary of the Thai monetary system from 1850. It will give the readers some background information and a brief history of the development of the Thai monetary system. In Chapter IV, the present writer will analyze changes in the money stock by studying the behavior of the three sectors of the economy that determine the amount of money stock--the government, the commercial banks and the public. Starting from the basic definitions of the theory of money supply, the present writer divides the supply of money into three determinants-- high-powered money, the reserve ratio and the currency-money ratio. By taking natural logarithms and then differentiating with respect to time, we can show the rate of change of money stock as the summation of three terms related to the rates of change in each of the determinants. Data obtained from the Bank of Thailand will be applied to determine the contribution of each determinant to the Thai money supply. In Chapter V, the behavioral analysis of each determinant will be discussed. Time series analysis is employed to investigate factors influencing each of the three determinants. Finally, there will be a brief discussion of the monetary policy implications of the evidence.