ABSTRACT

This thesis examines the effects of monetary policy in Indonesian using a structural VAR model. These thesis also develop an approach that provides a solution to the empirical anomalies in an open economy setup. We use a structural VAR approach with non-recursive contemporaneous restrictions and we identify monetary policy shocks by modeling the reaction function of the monetary authorities and the structure of the economy. The model we use is a modification of the small open economy model developed for the G7 countries less the United States by Kim and Roubini (1999). The success of the Kim and Roubini model across these economies makes it a natural starting point to analyze monetary policy in Indonesia. Consistent with Kim and Roubini, we find no evidence of the price or exchange rate puzzles identified in the literature. We also use the model to examine the effects of shocks to the Indonesian economy and the role of monetary policy in response to these shocks. Generally, we find that monetary policy has served to dampen both output and price fluctuations.

Our empirical findings are that effects of monetary policy shocks on exchange rates and other macroeconomic variables are consistent with the predictions of a broad set of theoretical models. We find that monetary policy shocks have a delayed and gradual effect on the price level and a small temporary effect on output. The evidence is consistent with significant, but transitory, real effects of monetary shocks. The price puzzle is addressed and there is little evidence of open economy anomalies. Specially, initially the exchange rate appreciates in response to a monetary contraction. Overall, our identification scheme gives results that contribute to resolve the empirical anomalies about the effects of monetary policy shocks found in the literature.

Keywords : monetary policy, structural vector autoregressions, economic puzzle, contemporaneous restrictions