

IS MONETARY POLICY IN SAUDI ARABIA ACTIVE OR PASSIVE? AN EMPIRICAL INVESTIGATION

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Abstract

Saudi Arabia economy; a small open economy with a fixed exchange rate regime - the Saudi riyal is pegged to the US dollar. The exchange rate anchor provides the long-term framework for monetary policy. The Saudi Arabian Monetary Agency (SAMA) is entrusted with the conduct of monetary policy, which can be done using monetary policy instruments such as money supply or interest rate target.

There is a great deal of literature seeking to determine changes in the way monetary policy was conducted and its effect on the economy under fixed exchange rate. Furthermore, the independence and effectiveness of monetary policy under such regime of exchange rate is questionable according Predictions of Mundell-Fleming Model and the balance of payments approach. Therefore, the objective of this study is to examine the extent of the effectiveness of the monetary policy in in the case of Saudi Arabia, using an annual time series data for the period 1970-2013. For this purpose, Structural Vector Auto Regressive (SVAR) model for Saudi economy will be developed and consequently estimated to assess the extent and the degree of the effectiveness of SAMA's monetary policy.