MACROECONOMICS DYNAMICS OF THE MALAYSIAN ECONOMY

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Introduction

In this study we reexamine the dynamic causal link among money, real output, interest rates and inflation by using more recent techniques of time series analysis. The paper differs from all previous work done for Malaysia at least in the following ways. First, we used high frequency (monthly) data and examined the statistical properties of the series as suggested by Johansen (1990). The sample time period employed in our analysis covers the current float rate. Second, our analysis were based on the relationship between real output, prices, interest rates and several monetary aggregates. The monetary aggregates considered in the analysis are M1 (narrow money), M2 (M1 plus fixed and saving deposits) and M3 (M2 plus all private sector deposits with BNM). Finally, the Johansen multivariate maximum likelihood method employed in this study allows us to examine the short and long-run macroeconomics dynamics of the Malaysian economy.

Materials and Methods

Data covering the period from 1978:1 to 1995:1 were gathered from various issues of Monthly Bulletin of BNM and International Financial Statistics of the IMF. The results of the Johansen's multivariate cointegraion test suggest a stable long-run equilibrium relationship exist among the four variables, implying despite the short-run disequilibrium that may be due to internal and external shocks, output is adjusted through changes in money stock and interest rate in the long-run. While the relationship between the macroeconomics can easily be established for M1 and M2, the non-cointegrating relationship cannot be rejected for M3, the broader measure of money. Further analysis using the error-correction model also confirms that the equilibrium path of income is maintained by the two measures of money and interest rates.

Results and Discussion

The empirical results suggest that money is non-neutral, at least in the short-run. This is consistent with the new Keynesians' view that money supply affects output through interest rates and investments. The aggregate demand shocks have effect on real income because of sluggish adjustment of prices. The impulse response analysis shows that inflation in Malaysia is essentially a monetary phenomenon. Both real income and price move in same direction in response to demand shocks. Price stability as measured by consumer price index (CPI) can be successfully managed through a prudent monetary policy, particularly by managing M1 (narrow money). Shocks due to M1 takes about 14 months to move back to the equilibrium path while M2 and M3 takes more than 24 months to adjust fully on the long-run path. A clear picture that emerged from this study is that the broader definition of money, M3 is the most effective intermediate target to promote economic growth since it has the least effect on price stability and the strongest causal effect on output. On the other hand, if the objective is mainly to curb inflation than the most effective tool that the monetary authority can use is M1. However, a tight monetary policy based on M1 is likely to soften real output, since it is found that M1 granger cause output. Finally, in this study the emphasis is given on the relationship between monetary aggregates and output. Fiscal and foreign variables were not considered in our analysis. Although the empirical results tends to suggest that money matters for real output and the relationship between monetary aggregates and macroeconomics variables may be exploited by the monetary authorities, policy makers cannot under score other factors that may influence economic growth. Monetary policy can be more effective when there is a coordination of trade, fiscal and exchange rate policies.

Conclusions

The results of our study suggest that money supply (narrow as well as broad) can be an independent stimulus to the economic activity in the short-run. Our evidence suggests that money is non-neutral in short-run and thus is consistent with Keynesian and monetarist views. Finally our results suggest that money matters in Malaysia.

References

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