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CAUSAL RELATIONSHIPS BETWEEN EXCHANGE RATES AND STOCK PRICES IN MALAYSIA AND THAILAND DURING THE 1997 CURRENCY CRISIS TURMOIL

Huzaimi Hussain

Department of Economics, UiTMCS, Kota Samarahan, Sarawak.

Venus Khim-Sen Liew

Faculty of Economics and Management, UPM, Serdang, Selangor.

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ABSTRACT

Using Granger (1969), Sim (1972) and Geweke *et al.* (1982) causality tests, this study finds a feedback causal relationship between exchange rate and stock price in Malaysia, whereas a unidirectional causal relationship running from exchange rate to stock price in Thailand. The stock markets of these countries are also found to be closely linked, with a feedback causal relationship between them. Most importantly, this study is able to identify the path through which the fall in Thai baht was transmitted to Malaysian ringgit plunge during the 1997 Currency Crisis turmoil.

JEL classifications: F31, G10.

Keywords: Granger causality, exchange rates, stock prices, Malaysia, Thailand.

1.0 INTRODUCTION

The discovery of causal relationship in foreign exchange and stock exchange markets is of great importance in the policy matters. By causal relationship (more commonly known as Granger-causal relationship in the literature) we are referring to the situation whereby the movement of one market precedes the movement of the other. In particular,