

ADVANCED DIPLOMA IN BUSINESS STUDIES (FINANCE)
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**Relationship Between Inflation And Interest Rates In
Malaysia**

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Abstract

Prior to this writing, many renowned economists have tested, discussed and criticized the inflation - interest rate linkage developed by the American economist, Irving Fisher.

This paper is aimed at determining the validity of **Fisher's Theory of Interest** from the Malaysian's economic perspective and also study the effect of money growth on inflation and interest rates.

The findings of this research are channeled to supplement investors with a better understanding on the Malaysian inflation - interest rate relations and to assist them in perfecting their investment strategies in the near future.

2.1 MONEY SUPPLY

Money is an important element in our daily lives. The existence of money has brought us forward in developing ourselves towards a more civilised and efficient nation.

Webster's New World dictionary defines money as "stamped pieces of metal, or any paper notes, authorised by a government as a medium of exchange."⁴

Stanley Fischer and Rudiger Dornbusch defines money as "a means of payment or medium of exchange."⁵

In the Malaysian economy there is a vast variety of financial assets, from currency to complicated claims on corporations. Which part of these assets is called money? Money and Banking in Malaysia published by Bank Negara gives a clear definition of the types and components of money. The book quotes "in Malaysia, there are three types of money: coin, paper money (currency notes) and current or demand deposits (chequeing accounts) held by the private sector. Narrow money supply (M1) consisting of coin, currency notes and demand deposits held by the private sector."⁶

"M2 is currently defined as M1 plus the following financial assets of the private sector :

- (i) savings deposits of the private sector at commercial banks;
- (ii) fixed deposits of all maturities of the private sector at commercial banks;

⁴ Webster's New World Dictionary, pp 278.

⁵ Dornbusch R. and Fischer S., Macroeconomics, pp345.

⁶ Money and Banking in Malaysia, Bank Negara Malaysia, pp 410.