



**THE DETERMINANTS OF MALAYSIAN TRADE BALANCE:
A JOHANSEN AND JUSELIUS APPROACH**

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MODE B

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DECLARATION OF ORIGINAL WORK

**We, Khairunnisa bt Azrin (890413-14-5142) ,
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Hereby, declare that:

- i. This work has not previously been accepted in substance of any degree, locally and overseas and is not being concurrently submitted for this degree or any other degrees
- ii. This project-paper is the result of my independent work and investigation, except where otherwise stated.
- iii. All verbatim extracts have been distinguished by quotation marks and sources of my information have been specifically acknowledged.

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Date :

ABSTRACT

This paper examines the short- and long-run relationships between trade balance, real exchange rates, income and money supply in the case of Malaysia. Data for the variables were obtained from World Development Indicators (WDI) from 1975 to 2010. The results based on the Johansen Juselius there is at least two cointegration vector equations in the study using lag 1. Based on Johansen Juselius we found equilibrium relationships exist between trade balance and the determinants of trade. Based on Juselius there are two long-run relationships in the model. It was from hypothesis none and at most 1 where the figure of trace statistic is bigger than 5% critical value. We also use VECM test and Granger Causality test to examine the long-run relationships and short-run relationships in the model. We found that there is a directional relationship between GDP and REER because the probability is less than 0.05. There also shows that there is only one short-run relationship that appears in the model. Results show that trade balance and real exchange effective rates have long-run relationships because of negative values result on VECM test. The result was supported by previous study by (2007). A few policy implications can be recommended such as government should increase trade deficit of raw materials. Another than that, government also should increase export penetration to other countries. Then there are two other recommendations on increasing food production to increase trade balance.

CHAPTER 1

INTRODUCTION

1.1 BACKGROUND OF STUDY

External trade environment and domestic policies have a great impact on trade and economic growth. Is same goes to Malaysia. Trade environment give both direct impact and indirect impact to the trade balance if we aware.

As introduction, Malaysia is known as an upper-middle income economy and a new in industrialized economy compare to other industrialized country in the world. Malaysia gross national income of USD 7,900 per capita.(2013,World Bank) .Malaysia is a highly open economy whereby the exports comprise almost 100 percent from its GDP. Malaysia is among the leading exporter of electrical appliances, electronic parts and components, palm oil, and natural gas.

Malaysia is also externally competitive, ranking 18th (out of 135 economies) in the International Finance Corporation 2012 ranking of ease of doing business in the world. Malaysia's GDP growth is projected at 4.8% in 2012 and 4.6 % in 2012.(World Bank) Therefore as we can see even we are small in country but our economystill stable even there is many issue faces in global market..

Malaysia has progressed from being a producer of raw materials, such as tin and rubber, in the 1970s to being a multi-sector economy that grew on