UNIVERSITI TEKNOLOGI MARA

DETERMINANTS OF EXCHANGE RATE VOLATILITY IN MALAYSIA

NUR AMIRA SHAHIRA BINTI IDHAM

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ABSTRACT

Exchange rate has become an important role in the country's level trade activity. The profit or losses from import and export activities are depending on current exchange rate. This research paper will study about the determinants of exchange rate volatility in Malaysia over 1970 until 2015. This research use Ringgit Malaysia as a proxy of currency of exchange rate which is dependent variable with six (6) independent variables; gross domestic product (GDP), inflation rate, interest rate, trade openness, foreign direct investment and foreign debt. The key question in this research is which determinant is the most influence the exchange rate volatility in Malaysia. For this research, diagnostics test which is Multicollinearity test, Heteroscadesticity test, Serial Correlation test, Stationary Test, Normality test and RAMSEY test have been used to answer the key question. The result from the tests are the data are normally distributed (normality test), there is a serial correlation (autocorrelation), there is no heteroscadesticity (Heteroscadesticity), no correlation (multicollinearity test) and there is no misspecification of functional form (RAMSEY). As a conclusion, the result than can be drawn from this research paper is foreign direct investment, foreign debt, reserve, trade and unemployment rate are positively related to exchange rate volatility in Malaysia whereas gross domestic product (GDP), interest rate and inflation rate are negatively related.

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CHAPTER ONE

INTRODUCTION

1.1 INTRODUCTION

Every country has its own currency. Currency can be defined as a system of money in general use in every country. The exchange rate can be defined as the price for each currency that's being used to trade with another currency. The exchange rate is very important as it acts as a medium for international trade for goods and services or trade of funds between countries. Besides, it helps us to make a comparison between the prices of goods and services between countries. This is because the prices of goods and services are different between countries. Those prices are determined by the country's current exchange rate. The exchange rate is volatile and it may influenced by many factors.

This study will focus on macroeconomic factors which are interest rates, trade openness, gross domestic product, country reserve, foreign debt, inflation, unemployment rate and foreign direct investment whether they have a direct or indirect impact towards exchange rate in Malaysia. The study will focus on Malaysia as recently Malaysia is facing the downfall of its currency value. This can be proved by the statement made by independent financial analyst, Miss Tee Lin Say. According to Say (2017), the Ringgit is now down to 4.49 as compared the US dollar. According to Bernama (2016), Ringgit will experience some losses against US Dollar once the momentum of the currency came to a pause. Currently, sensitivity of Ringgit is high as it is influenced by economy condition. Decreasing in Ringgit Malaysia currency is seriously affecting the economy's condition. The unstable macroeconomics variables are influenced by the current economic situation.

Basically, there are three major types of exchange rate, which are floating exchange rate, fixed exchange rate and pegged exchange rate. The floating exchange rate is a type of exchange rate regime that allowed the currency to freely fluctuate without any intervention of government or else. Next, fixed exchange rate is a type of exchange rate regime that the government tries to maintain the value of currency with another currency. Pegged exchange rate is basically an action of pegged the currency