DETERMINANT FACTORS OF MONETARY POLICY IN MALAYSIA

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UiTM, SABAH

AZZIRRAH BT. RAHMAN

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ABSTRACT

In this research, its aim is to provide an empirical evidence of the determinant factor of monetary policy in Malaysia. This analysis uses a test of the sensitivity of lending rates towards monetary policy and other economic variable in Malaysia.

In the other research done by Fazel Shokoofeh, journal of Humanomics, monetary policy can be seen not effective in the respects of mortgage rates which include investment and aggregate demand. Other than that, it also aims to examine the effectiveness of monetary policy on all sectors in the economy especially lending rates.

Sample that being use in this project paper are taking from the population in Malaysia which is from 2000 until 2009. This research takes three types of variables which are based lending rates, inflation and money supply (M3). The tests used in this research are unit root test and log linear model. It will take in a form of natural log of simple and multiple regressions. The comparison will be done between non difference variable and difference variable. This research carries three hypotheses. The general conclusion support that based lending rate is not solely depending on the money supply and inflation but due to the omission of some other variables.

This project paper is divided into five chapters. The first chapters will be introduction for my research. It is including background of study, problem statement, objectives of study, research questions, scope of study, limitations of study, significance of study and definitions of terms.

The second chapter will be review about the previous study that also examines the main point of this research which is monetary policy, inflation and lending rate. This is to provide a better understanding about my research. The third chapter will be discussing about research methodology and design that use in this research. In this chapter, it will include theoretical framework, dependent variables, independent variables, data collection method, sample size, data processing and analysis, model specification, procedures for data analysis and multiple regression analysis.

The next chapter which is chapter four will be revealing the finding of my research which is analysis and interpretation of data. This chapter will be discussing about the result of using unit root test and

CHAPTER ONE:

INTRODUCTION

1.1 BACKGROUND OF STUDY

Several factors has been identified that can cause the impacts of the monetary policy. In a research done by Shokoofeh (2006), monetary policy can be seen as not effective in the respects of mortgage rates which include investment and aggregate demand.

This research will show the same effectiveness test of monetary policy by testing the sensitivity of based lending rate towards the changes in money supply and economic variables. Economic variable that use in this research is only inflation. Since this research using the same effectiveness test, the independent variable will be replaced from mortgage rate to based lending rate and dependent variable from consumer sentiment index (CSI) and money supply (M1 and M2) to inflation and money supply (M3).

1.1.2 Trends and patterns of money supply in Malaysia

Based on Bank Negara Malaysia's annual report, in 2000, it was reported that monetary policy has remained accommodative because of a stable and low inflation. In this year, a stable financial market environment created resulting from the pegged exchange rate arrangement. The result from this situation, it was able to provide the foundation for the strengthening economic fundamentals. Example for the foundation can be seen in the substantial current account surplus, reserve with high level, low inflation rate, and improve business and consumer confidence.

At the same time, Bank Negara Malaysia (BNM)'s main aim is to achieve stable liquidity conditions during high liquidity in the banking system. In order to support economic growth, interest rate remains low but well managed to keep the balance needed and to keep the stability of price and to maintain the level of nation's saving.