MONEY SUPPLY AND INFLATION: A VAR MODEL EVIDENCE FROM MALAYSIA

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ABSTRACT

The main objective of this study is to identify what is the relationship between money supply and inflation. Investigate which factors that influencing growth of money that lead to create inflation, identifies their relationship, long and short run causality and does them correlated to each other are also concerned.

To be more specific, this study only covering in Malaysia and the variables that have been chosen are inflation rate, money supply, gross domestic product (GDP), government expenditure, consumption, interest rate, exchange rate, saving, investment and population, as well as. This study using time series data covered thirty years period from 1985 until 2014 which obtained from Bank Negara Malaysia. Vector Autoregression (VAR), Vector Error Correction Model (VECM), Johansen Cointegration test and VAR Granger Causality will be used. These samples will be analyzed to prove the hypotheses developed. The results from various test are, there is relationship between money supply and inflation, and, inflation and money supply which is positive relationship but does not significant. In VAR model, there is no significant impact from independent variables used to inflation. But, in this model there is cointegration equations and long run relationship. Based on the Granger Causality test, government spending captured as the variable that cause the inflation while inflation does causes GDP and public saving. And money supply turns to be cause of exchange rate.

Key words: Inflation, Money Supply, GDP, Government Spending, Final Private Consumption, Interest Rate, Exchange Rate, Public Saving, Investment, Population, VAR, VECM, Johansen Cointegration Test and VAR Granger Causality.