UNIVERSITI TEKNOLOGI MARA

MACROECONOMIC FACTORS THAT IMPACT EXCHANGE RATE FLUCTUATION IN MALAYSIA

ALIA NATASHA BINTI AZIZI
2020992919

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ABSTRACT

The purpose of this research is to identify which macroeconomic variables influences the exchange rate fluctuation on Malaysia which will be performed by analyzing the relationship between Malaysia foreign exchange rate and macroeconomic factors, namely, inflation rate, interest rate, export value and gross domestic product. The data that was used in this research was annual secondary data depicted from The World Bank organization. Important to highlight, this study uses a time series analysis to examine the data that was collected from the past 30 years which is from year 1991 to 2020. To see which factors gives out a significant relationship with exchange rate, descriptive analysis, correlation analysis, regression analysis and a normality test was performed. As a result, from the test considerations that was performed, it is concluded that all the independent variable has a strong positive relationship with exchange rate and that the most influential factor is inflation rate. Besides that, from the study it also shows that inflation rate, export and gross domestic is has a significant relationship with exchange rate which is indifferent from interest rate as it recorded an insignificant relationship with exchange rate.

Keywords: Exchange Rate, Inflation Rate, Export, Interest Rate, Gross Domestic Product, Malaysia

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CHAPTER ONE: INTRODUCTION

1.1 Introduction

To start off, the exchange rate represents a currency against another currency in the foreign exchange market. It is also one of the most important factors for a country's economic growth as its fluctuations or appreciation would have a direct effect on the import and export behavior of a country which would affect the current account balance and foreign currency reserves managed by the country's central banks (Zhao,2020). To illustrate, when a country's currency appreciates the price of local goods will increase significantly in the foreign market which gives an impact on the export causing the imports to become inexpensive. In a bigger picture, an impact to the export and import would also give an effect to direct investments and also service sectors mainly banking, insurance, education as well as tourism (Ramasamy,2015).

Important to also highlight, exchange rate can be divided into two main types, namely, fixed, and floating exchange rate. To illustrate, a fixed exchange rate is when the country's exchange rate is determined by their government. Country that utilizes this type of regime usually maintain the fluctuation of the local exchange rate by instructing their central bank to purchase and withdraw its own currency in the foreign exchange market in return for the currency to which it is pegged (Boyle, 2021). Some of the examples of countries that implements a fixed currency against U.S. Dollar are Bahrain, United Arab Emirates and Hong Kong (Zucchi, 2021). In like manner, Hong Kong has decided to peg their currency over dollar back in the year 1983 when people have started losing their trust on the country's financial system and the government's actions in improving it. Due to those circumstances, it has brought the country to a situation where people started selling their Hong Kong dollar away, sellers no longer accept Hong Kong dollars when purchasing at their stores and more investors shying away as the Hong Kong dollar loses their attractiveness. Therefore, to put a full stop on this issue, the government finally decided to implement the fixed exchange rate system in order to rebuild foreign investors' confidence and giving a picture that they are also improving the country's financial system (Yeung, 2020).