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THE RELEVANCE OF MONETARY AGGREGATES FOR MONETARY POLICY PURPOSES IN MALAYSIA

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This paper analyses the long-run neutrality (LRN) of money on real output in Malaysia using a reduced form ARIMA model developed by Fisher and Seater (1993). Empirical results are sensitive to the type of data used. Low frequency data are generally more supportive of the neutrality hypothesis. Contrary to Olekalns (1996) and Leong and McAleer (2000), the outcomes of our LRN tests are robust to the measures of money employed.

I. INTRODUCTION

The Central Bank of Malaysia, Bank Negara Malaysia (BNM) was established in 1959 with one of the principal objectives to promote monetary stability and influence the credit condition for the benefit of the economy. To achieve that objective, strategy taken by BNM was targeting the monetary aggregates, particularly M1, M2 and M3. However, by mid 1990s, as a result of financial liberalization, the link between monetary aggregates and other macroeconomic variables was found to be unstable. Consequently, monetary aggregates have been de-emphasized as monetary policy tools, instead the policy tools have been shifted to interest rates targeting. The breakdown in the long-run relationship between M1 and economic activity was first noted in 1985 (BNM, 1985), and the weakening relationship between broad money (M2 and M3) and economic activity was noted in early 1990s (BNM, 1989).

Our question is: Is money irrelevant in Malaysia? However, empirical evidence on this matter is mixed for Malaysia. For example, Tan and Cheng (1995) found that money does affect output, while a study conducted by Ahmed and Khalid (1996) indicated that money does not affect output in Malaysia.

The purpose of the present study is to contribute to this debate – whether money