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EXCHANGE RATES, MONETARY AGGREGATES, INDUSTRIAL PRODUCTION AND SHOCK ADJUSTMENTS IN MALAYSIA AFTER THE CAPITAL CONTROL

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ABSTRACT

Malaysia imposed capital control and fixed exchange rate during 1999-2005 due to Asia financial crisis 1997/98. The capital control was liberalized and the pegged ringgit was lifted in July 2005. This study examines the dynamic relationship among macroeconomic stability and industrial performance in the post-capital control era with de-pegged regime. Macro variables such as industrial production (Y), exchange rate (RM/USD), monetary aggregates (M3) and interest rate (R) were being analyzed. The long- and short-run relationships were discovered among the variables at different signs and magnitudes. By VECM specification, the production function was bearing most of the short-run adjustments towards the long-run equilibrium but the adjustments were slow (> 6 years), in respond to shocks in the system. The impulse response function and variance decomposition analyses reveal that changes in macroeconomic variables have led to similar patterns of behavior with significant effects differing mainly in terms of shock adjustment. Dynamic causal effects were also being detected among the variables to justify the export led-growth strategy but the monetary effects were less prominent. In brief, monitoring the macro stability and foreign exchange shocks are essential in sustaining the industrial performance of Malaysia.

Keywords: Small and open economy (SOE); Macro stability; Industrial performance; Foreign exchange policy; Shock adjustments

1. INTRODUCTION

Assessment of industrial or economic performance and the contributory factors has been skyrocketed over the past decade globally. However, theories and empirical evidences are still far from getting consensus in the literature. Different findings are found in the past studies that diversity in culture, macro stability, trade openness and export strategy, central bank's monetary rules and foreign exchange policy, and the extent of financial integration, have played some important roles in the economic performance of one country (see Chan and Baharumshah, 2013;

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