

Some Empirical Evidence on the Quantity Theoretic Proposition of Money in ASEAN-5

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Abstract

This study examines the international evidence on long-run neutrality (LRN) of money based on low frequency data from five emerging ASEAN economies, namely, Indonesia, Malaysia, the Philippines, Singapore, and Thailand, using a nonstructural reduced-form bivariate ARIMA model proposed by Fisher and Seater (1993). Empirical evidence shows that the classical proposition cannot be rejected with respect to real export except for Thailand. However, the LRN test results are not robust to changes in money supply in countries under study with respect to real output. The narrow monetary aggregate seems to have greater impact on Indonesia, Malaysia, and Thailand economic activities as compared to the other two countries.

Keywords: Long-run neutrality of money; ARIMA model; ASEAN

JEL classification: C32; E50; O53

I. Introduction

The study on the relationship between money supply and real economic activity has created much debate both theoretically and empirically. Researchers try to examine the consequences of innovation in money supply towards real macroeconomics variables, by investigating different countries at different time period with the assistance of various econometric techniques. The controversy over this issue, however, remains unsolved. The debate regarding the role of money in the economy finds its origins in the classical quantity theory of money. It is believed that real economic variables in the economy are determined by real forces and those monetary forces only affected nominal quantities. The inability of changes in the stock of money to affect real economic activity except for the general price level is called the long-run neutrality (LRN) of money.

The classical economists believed that the markets could always be in the most efficient condition without the intervention of government. Supply should always equal demand as the price levels can be adjusted immediately and completely to the shocks in the economy. Therefore, the role of money has been relegated to the background, and money is said to be long run neutral in the classical world. On the contrary, the Keynesian economists propose that government should take an active role in the markets. They do not believe on the self-correcting mechanism in the markets, as prices are somewhat rigid in the present of menu costs and efficiency wages. Consequently, the government could use discretionary monetary policy to moderate fluctuations in the business cycle. Thus, Keynesian economists contend that money is non-neutral in the long run.

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