ABSTRACT

The purpose of this study is to assess the effect of the monetary and fiscal policies on the Malaysian economy. In addition to this. the exchange rate policy is analyzed as well.

A simple structural model is developed based on the hybrid of Monetarist and Keynesian variants. Money multiplier approach is employed to explain the money supply process. The monetary sector is linked up with the real sector by the presence of real money supply as an argument in the consumption, investment and price functions. Government expenditure is endogenized. The domestic sectors and the external sector are linked up via the import function.

The model constructed is then subjected to dynamic and one-time shock simulation test in which it fares reasonable well as a whole. Monetary, fiscal and exchange rate policy simulations are conducted on the model. It is appears that a restrictive monetary policy is an effective means of improving the balance of payments position and curbing inflation. Whereas an expansionary fiscal policy tends to boost economic growth but deteriorate the balance of payments as well as exerts mild inflation. Finally, the findings suggest that exchange rate policy changes yield the largest influence upon the macrovariables of the economy, which may be reflected of the relative openness of the Malaysian economy.