Fiscal Policy Impact on Real Exchange Rate and Trade Balance of Malaysia: With Reference to the late 1990's crisis

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ABSTRACT

The objective of this study is to see the linkage between fiscal policy, real exchange rate and the trade balance in Malaysia. The study reflected that increase in government spending in relative to government revenue causes the real exchange rate to appreciate while increase in government revenue in relative to government spending causes the real exchange rate to depreciate. The study also showed that a depreciation of the real exchange rate does increase exports and causes imports to reduce. The linkage between the public sector, real exchange rate and the trade balance remains an important link that needs to be strengthened to overcome the present crisis plaguing the economy. The link is vital mainly because each policy that is focused on a certain sector ultimately has a chain effect on the performance of the overall economy. This study has shown that the right policy mix is needed to strengthen the economy. Finally the study reflects that policies implemented in the economy must have a positive chain effect in the economy in order to stimulate economic growth, International Monetary Fund policies are vital for a stable exchange exchange rate but it does not promise immediate economic growth, therefore it is important for policy makers to choose the correct policy mix to achieve economic growth and also to stabilise the exchange rate.

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