ABSTRACTS

We examined the impact of monetary policy using Malaysia data on Malaysia Government Securities which allow us to decompose nominal interest rates into inflation expectations and ex-ante real interest rate. Data were collected from financial market to separate the reaction of both real interest rates and inflation expectations to monetary policy shocks and also reaction of monetary policy shocks to short term and long term end of real interest rates.

By using VAR approach, we examined the effects of monetary policy shock to these macroeconomic variables. Before proceeding to the VAR analysis, there are some of steps such as Unit Root Test and Johansen Cointegration was utilized.

Monetary policy shock defined by raising the overnight rate the Bank Negara Malaysia charges member banks, lower real interest rates and inflation expectations. Long term real interest rates are less impacted than short term interest rates.

Real interest rates have the effect to the economy but the inflation expectations have a greater effect to the economy. These were proven by the impulse response function of the nominal interest rates and real interest rates to the changes of inflation expectations by the investors.