

CHAPTER VI

SUMMARY AND CONCLUSION

CHAPTER 6

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6.1 Introduction

This chapter summarizes and concludes the study. The implication of the findings are discussed. Recommendations for further analysis are covered in the last section of the chapter.

6.2 Summary of the Empirical Findings

The empirical result obtained from this study was based on the monthly data series of over the period 1999 to July 2003, which examined the impact of the monetary policy shocks on the nominal and real variables (financial market variables)) in Malaysia. The results may be summarized as below.

The Augmented Dickey Fuller (ADF). The ADF unit root test procedures were used in testing for stationarity of the variables. ADF test shows that all the series are first order integrated, $I(1)$. This implies that some of these series under study are non stationary in the level form, through stationary in the first difference.

The next step was to apply the Johansen Juselius (1990) maximum likelihood method, which is generally applied to $I(1)$ variables. The results of the

Johansen Juselius cointegration test with lag interval 1 to 3 indicates that relationship among these variables are not cointegrated.

By using the VAR approach, with lag of 2, the estimates coefficients do show significant impact of the monetary policy. The simple regression shows that the adjusted R square for all variables are significant. So, the model can be explain the relationship of the variable.

The impulse response functions are also employed in this paper. The impulse response result shows that inflation expectation lower 1 year ahead, lower one-year-ahead inflation expectation, decrease real interest rates, mostly in the short term end of the term of structure of real interest rates:1-5 years forward, and little affect the long term end of the real interest rate term structure.

6.3 Discussion and Policy Implications

In Malaysia, monetary policy operates through short term interest rates to achieve the objective of price stability. Price stability will lead to efficient resource allocation, improve investment sentiment, provide incentive to save and enhance economic welfare.

In financial markets, investors employ inflation expectations to predict the market interest rate. Since changes in nominal interest rates are the net of two effects

– the effect on real interest rates and the effect on expected inflation. In this study, both of the effects show they were in similar directions.

The findings show that inflation expectations affect nominal interest rates and real interest rates but the effect to the real interest rates is more compared to the nominal interest rates. A change in the nominal interest rate was not so responds to the expectation inflation but it is more responds to the real interest rates. Therefore, inflation expectations have a greater effect instead of the real interest rates still has the effect to the economy.

Thus, the results shown that the inflation expectation lower one year ahead, decrease in the real interest rates and little effect to the long term end of the real interest rates compared to the short term end of the term of structure of real interest rates.

6.4 Recommendations for Further Studies

This study has shown a number of interesting issues relating to the choice of data, literature reviews, methodology and the empirical results, and the sample period covers from 1999 to 2003. Therefore, the direction of this thesis will pay attention to the following issues.

First, these financial variables were investigated after the financial crisis (1997 to 1998) and this may have affected the results obtained. Whereby , there

many of policies was change due to contained the crisis. This is especially for BNM interest rate. Thus, the inflation expectations were affected as well. With the instability of economic, investors more speculate and beware with economic signal. With variables which selected from financial market (money market especially), most probably we faced some unstable and misleading for the early period of series. Several statistical techniques may be utilized, for example Johansen Test.

Second, the scope of data is too small, which was collected for 54 observations only. To get more accurate results and wide view, for future research, series may be extended to be longer period. But also suggested to use other variables to get the different results such as money supply (M1 and M2), and unemployment rate.

The finally issue is the application of the “fully recursive VAR method to estimate response functions. That is when shocks to endogenous variables are not independent; it is difficult to interpret the impact of an individual shock on the system. So the correlated shocks may make the estimated response functions depend on the order in which the endogenous variables are included in the model.

6.4 Conclusion

In conclusion, this paper had examined the effect of monetary policy on real interest rates and inflation expectations in Malaysia using the VAR approach and found that monetary policy affects real interest rates and inflation expectations in opposite directions in Malaysia.