MONETARY POLICY AND INFLATION IN MALAYSIA

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ABSTRACT.

The Malaysian experience in the past three decades has confirmed that inflation was indeed a monetary phenomenon. As such, monetary policy could assist in reducing inflation. However, the implementation of monetary policy alone was not adequate. Monetary policy only be effective when all policies - fiscal and monetary policy, were implemented in a delicate manner. Monetary policy at micro level becomes crucial to address particular areas, particularly since 1989. Consumption spending and inflows of short-term speculative capital had emerged as important influences on the effectiveness of monetary policy. While the use of the broader monetary aggregate, M3, as the intermediate target could work, the influence of these factors on this target deserved special attention. In addition, the effect of monetary policy on interest rate movements and exchange rate development could not be ignored. The impact of external influences could also negate the desired effect of monetary policy. Malaysia could not effort to have a higher interest rate to attract further capital inflows. This will dampen productive investments and business sentiments. Both external and internal prices stability must be maintained at all costs. The Malaysian experience had showed that implementation of monetary instruments as a package can achieve this balance. Each instrument, with its own strengths and weakness, would then complement each other to enhance the attainment of the desired goals.

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