

ABSTRACT

Along with the scope of financial liberalization, various aspects of reform processes emerged and they include financial sector reform, deregulation, re-regulation and financial innovation. These reforms have changed the types of monetary instruments and targets used and consequently changed the mechanism of monetary transmission. Moreover, in the light of financial liberalization, the relationship between income and money has become increasingly unstable. All this posed a major challenge in the formulation and implementation of monetary policy because the basic framework within which monetary policy operates has changed.

This research attempts to investigate the role of financial variables (monetary aggregates, credit aggregates and interest rates) in containing the significant information about the future movements in the real income and price levels during the pre and post liberalization periods in Malaysia. Johansen co-integrating technique and the error correction model were used to analyse the long run and short run relationship between the financial variables and the ultimate goal variables, respectively. The empirical findings suggest that credit aggregates and monetary aggregates especially broad money M2 and M3 are no longer reliable as the main intermediate target. On the other hand, interest rates seem to have gained significant role in the monetary policy operations in the post liberalization period.



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