

**POST KEYNESIAN MONEY SUPPLY ENDOGENEITY IN
MALAYSIA: AN EMPIRICAL INVESTIGATION**

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**POST KEYNESIAN MONEY SUPPLY ENDOGENEITY IN
MALAYSIA: AN EMPIRICAL INVESTIGATION**

By

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**RESEARCH AND POST GRADUATE
COLLEGE OF ARTS AND SCIENCES**

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ABSTRAK

Kestabilan, kemajuan dan kebajikan umum sesebuah ekonomi akan sangat bergantung kepada tahap penawaran wang dalam ekonomi tersebut disamping polisi kewangan yang dilaksanakan oleh pihak berkuasa kewangan ekonomi tersebut. Dengan demikian maka isu pokoknya ialah, apakah kuantiti penawaran wang menentukan tahap-tahap kegiatan ekonomi dan pengeluaran, atau apakah kegiatan-kegiatan ekonomi dan pengeluaran yang menentukan tahap penawaran wang di dalam sesebuah ekonomi?

Berdasarkan analisis pasca Keynes, penawaran wang yang bersifat *endogenous*, adalah beasaskan kepada empat hipotesis. Ke empat-empat cabang ilmu ekonomi pasca Keynes ini dikenali sebagai *Horizontalist*, *Structuralist*, *Liquidity Preference View* dan *Circuit Theory of Money*. Kajian ini bercadang untuk menyiasat secara empirikal terhadap isu penawaran wang *endogenous/ exogenous* berdasarkan persekitaran ekonomi Malaysia. Projek penyelidikan ini dirancang untuk memenuhi dua objektif utama. Pertama, untuk mengenal pasti samada penawaran wang di Malaysia ditentukan secara *exogenous* ataupun secara *endogenous*. Kedua, sekiranya penawaran wang di Malaysia didapati ditentukan secara *endogenous*, data akan di analisis seterusnya untuk mengenali pasti kumpulan pemikiran ekonomi pasca Keynes yang disokong oleh data Malaysia.

Data untuk kajian ini dianalisis dengan memanfaatkan kaedah kointegrasi Johansen (1990/91). Analisis ekonometrik Johansen melibatkan tiga langkah; iaitu ujian unit root, ujian kointegrasi dan model analisis vector pembetulan ralat (VECM). Penemuan-penemuan empiris kajian ini boleh diringkaskan kedalam lima perkara pokok utama: Pertama KDNK Malaysia adalah penyebab kepada penawaran wang (iaitu M1, M2 dan M3). Kedua, pinjaman bank adalah penyebab kepada penawaran wang agregat iaitu M0, M1, M2 dan M3). Penemuan ketiga kajian ini ialah bahawa kadar bunga polisi atau kadar bunga antara bank (IBR) adalah penyebab kepada tiga jenis kadar bunga: Kadar bunga dasar (BLR), kadar bunga bil perbendaharaan (TBR) dan juga kadar bunga sekuriti kerajaan Malaysia lima tahun (MGS5R). Bahawa deposit menjadi penyebab kepada rizab adalah penemuan ke empat kajian ini. Penemuan yang terakhir bagi kajian ini melibatkan pertalian antara pinjaman bank dan pengganda wang: Pengganda wang M1 (M1MPR), pengganda wang M2 (M2MPR) dan pengganda wang M3 (M3MPR).

Bukti empiris yang terdapat dalam tesis ini adalah merupakan sokongan kuat kepada hipotesis bahawa penawaran wang di Malaysia ditentukan secara *endogenous*. Ringkasnya, bukti yang terdapat dalam kajian ini menunjukkan dengan tegas hakikat bahawa penawaran wang di Malaysia didorong oleh kredit dan juga ditentukan oleh permintaan terhadap kredit.

ABSTRACT

The stability, progress and the general welfare of an economy would depend much on the level of its money supply as well as the monetary policy initiated by its monetary authority. The central issue is, does the quantity of money supply determine the levels of economic activities and production, or are economic activities and production that actually determine the level of money supply in an economy?

According to Post Keynesian analysis, money supply endogeneity are based on four 'sub-school' i.e., *Horizontalist, Structuralist, Liquidity Preference View and Circuit Theory of Money*. This study attempts to investigate empirically the issue of endogeneity/exogeneity of money supply, based on the Malaysian economic environment and planned to meet two major objectives. First, is to identify whether the supply of money in Malaysia is endogenously or exogenously determined. Secondly, if money supply in Malaysia is endogenously determined, the data will be analyzed further to identify the sub-school of Post Keynesian economics that these data supports.

The data are analyzed by utilizing the Johansen (1990/91) cointegration procedure, involving three steps; namely, *unit root tests, cointegration tests and vector error correction model (VECM) analysis*. The empirical findings are summarized into five major points. First, the Malaysia GDP causes money supply (i.e., M1, M2 and M3). Secondly, bank loan causes monetary aggregate (i.e., M0, M1, M2, and M3). The third finding that policy rate or interbank rate (IBR) causes base lending rate (BLR), T-bill rate (TBR) and the Malaysian government securities for five years rate (MGS5R). Followed by the fourth finding, deposits cause reserves. The last major finding of the study involves the relationships between bank loan and money multipliers: the M1 money multiplier (M1MPR), the M2 money multiplier (M2MPR) and the M3 money multiplier (M3MPR).

The empirical evidence provided in the present thesis is strongly consistent with the hypothesis that money supply in Malaysia is endogenously determined. Simply put, our evidence strongly points to the fact that money supply in Malaysia is credit-driven and demand determined.

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(Trace Statistic)

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LIST OF ABBREVIATIONS

ADF	Augmented Dickey- Fuller test
BLR	Base Lending Rate
BNM	Bank Negara Malaysia
CTM	Circuit Theory of Money
GDP	Gross Domestic Product
G7	Group of Seven Developed Countries
IBR	Interbank Rate
JJ	Johansen & Juselius
KPSS	Kwiatkowski, Phillips, Schmidt, and Shin's test
LP	Liquidity Preference View
MGS5R	Malaysian Government Securities for 5 years
MMPR	Money Multiplier
OLS	Ordinary Least Square
OPR	Overnight Policy Rate
PP	Phillips-Perron test
TBR	T-Bill rate
VECM	Vector Error Correction Model

DEFINITION OF TERMS

Base Money (M0):

In Economics, base money (also monetary base, high-powered money, reserve money) is a term relating to money supply, the amount of money in the economy.

Base money = Currency in Circulation + Required Reserves + Excess Reserves

Endogenous Money:

Endogenous money refers to the theory that money comes into existence as it is needed by the real economy and that banking system reserves are enlarged or drained as needed to accommodate the demand for lending at the prevailing interest rates.

Liability Management:

Any reduction in the bank reserve requirement ratio by the Central Bank will cause a sudden fall in the monetary base. Concomitantly, banks are obliged to purchase certificates of deposits issued by the Central Bank and/or they may borrow from interbank market, that is liability management activities.

M1 Money Supply:

M1 = Currency in Circulation + Demand Deposits

M2 Money Supply:

M2 = M1 + Narrow Quasi-Money

Narrow Quasi-Money = Savings Deposits + Fixed Deposits + NIDs + Repos + Foreign
Currency Deposits + other deposits

M3 Money Supply:

M3 = M2 + Deposits Placed with Other Banking Institutions

Post Keynesian Economics:

Post-Keynesian Economics is a school of economic thought with its origins in The General Theory of John Maynard Keynes, although its subsequent development was influenced to a large degree by Michal Kalecki, Joan Robinson, Nicholas Kaldor and Paul Davidson. The Post Keynesian School has remained closet to the spirit of Keynes' work, particularly in his monetary theory and in rejecting the theory of exogenous money.

CHAPTER 1

INTRODUCTION

Malaysia is considered as an advanced developing economy. It is practicing a market oriented production economy popularly known as a mixed economy. Under this system, while economic activities in general are determined by the market, the government intervenes in the economy through both its fiscal and monetary policies – for the purpose of sustain economic growth as well as stability.

1.1 Malaysia and its Monetary System: An Overview

Since the present research project on endogeneity of money supply is based on the Malaysian data, it worth at this stage to have an overview of the Malaysian monetary system.

1.1.1 The Financial System

The present structure of the Malaysian financial system is divided into three segments, namely the banking sector, the non-bank financial intermediaries and the financial markets.

1.1.1.1 The Banking Sector

Based on the recent report by the Bank Negara Annual Report (2009), the Malaysian banking sector consists of the monetary institutions and non-monetary institutions.

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