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ANALYSING THE IMPACT OF FINANCIAL MARKET ON
MALAYSIAN FOREIGN DIRECT INVESTMENT



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**ANALYSING THE IMPACT OF FINANCIAL MARKET ON MALAYSIAN
FOREIGN DIRECT INVESTMENT**

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ABSTRACT

This study investigates the impact of financial market on foreign direct investment (FDI) in Malaysia using yearly data over the period of 1981 to 2014. Using stock market and credit market as proxy of financial market, the Johansen cointegration test and Vector Error Correction Model (VECM) are employed to determine the long run relationship. The VECM results indicate that the stock market does not have significant influence on FDI while the credit market has a significant and positive impact on FDI. This shows that even though the financial market does not become the main source of financing for foreign investors, its development is still an important agenda in attracting foreign investors to invest in Malaysia. Hence, this study provides insights for policy recommendation in the future in promoting FDI. In order to attract foreign investment, policy makers should not just focus on providing various incentives, but also should look at other factors which may indirectly affect the flows of FDI, such as the development of the financial market.

Keywords: Financial market, Foreign direct investment, cointegration test, VECM

ABSTRAK

Kajian ini mengkaji hubungan di antara pasaran kewangan dan pelaburan langsung asing di Malaysia menggunakan data daripada tahun 1981 hingga 2014. Ujian kointegrasi Johansen dan VECM digunakan ke atas pasaran saham dan pasaran kredit iaitu proksi bagi pasaran kewangan untuk mengkaji hubungan jangka panjang antara pemboleh ubah. Dapatan VECM menunjukkan bahawa pasaran saham tidak mempengaruhi pelaburan langsung asing manakala pasaran kredit mempunyai kesan positif terhadap pelaburan langsung asing. Ini menunjukkan bahawa walaupun pasaran kewangan tidak menjadi sumber utama pembiayaan bagi pelabur asing, pembangunannya masih merupakan agenda penting dalam menarik pelabur asing untuk melabur di Malaysia. Oleh itu, kajian ini membantu dalam memberikan pandangan mengenai polisi bagi meningkatkan pelaburan langsung asing di masa hadapan. Dalam usaha untuk menarik pelaburan asing, pembuat dasar tidak seharusnya hanya memberi tumpuan kepada menyediakan pelbagai insentif, tetapi juga perlu melihat faktor-faktor lain yang secara tidak langsung boleh mempengaruhi aliran pelaburan langsung asing, seperti pembangunan pasaran kewangan

Kata kunci: Pasaran kewangan, Pelaburan langsung asing, ujian kointegrasi, VECM

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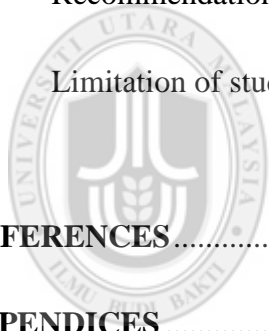
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LIST OF ABBREVIATIONS

ADF	Augmented Dickey-Fuller
AIC	Akaike Information Criterion
BNM	Bank Negara Malaysia
FDI	Foreign Direct Investment
FPE	Final Prediction Error
GDP	Gross Domestic Product
HQ	Hannan-Quinn Information Criteria
KPSS	Kwiatkowski-Phillips-Schmidt-Shin
LR	LR Test Statistic
OLS	Ordinary Least Square
PP	Phillip-Perron
PRIVCR	Private sector credit
SCAPT	Stock Market Capitalization
SIC	Schwarz Information Criteria
VAR	Vector Autoregressions
VECM	Vector Error Correction Model

CHAPTER 1

INTRODUCTION

1.1 Background of Study

For a few decades, foreign direct investment (FDI) has become one of the main sources of capital flows. The debt crisis in 1980s eventually caused the policymakers to develop policies that attract more direct cross-border investment capital flows. By 1990s, FDI became the largest source of external financing for developing countries (Chowdhury & Mavrotas, 2006). Compared to 1980, the total of FDI net inflow has increased worldwide about 17 times from \$51.46 billion to \$1561.36 billion in 2014 (World Bank, 2016). FDI could be defined as the direct investment of equity that flow into the economy of a country. It consists of equity capital, reinvestment of earnings and other capital of one country that enters into another country. However, the foreign investor must at least own ten percent of voting shares in order to be considered as FDI (World Bank).

One of the main benefits of FDI is its positive impact on economic growth (Bosworth, Collins and Reinhart, 1999). There are a number of studies examining the effect of FDI on economic growth. Many studies reveal that there is a positive relationship between FDI and economic growth. The FDI can benefit countries by improving employment, productivity and knowledge transfer as well as allowing incorporation with global value chains which then will cause the growth to accelerate (Echandi, Krajcovicova and Qiang, 2015).

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