The impact of foreign direct investment and real exchange rate on economic growth in Malaysia: some empirical evidence

Abstract

This study is an attempt to examine the relationship between exchange rate and foreign direct investment towards economic growth in Malaysia during the periods between 1970 to 2011. The ARDL method was used to establish the long-run relationship as well as the direction of causation between variables. For this purpose two equations were estimated. The standard the bivariate relationship and the trivariate model includes the exchange rate variable. Both models exhibit strong evidence on long-run cointegration relationship. The impact of foreign direct investment in the long run equation found to be positive and significant, whereas the impact of real exchange rate is not. In the short run, both exchange rate and foreign direct investment found to be significant but slightly minimal in the percentage effect. We offer two possible reasons with regards to exchange rate movements in the short run as well in the long run, i.e. the hold-up effect and the price adjustment effect.