

**TESTING FOR COINTEGRATION WITH  
THRESHOLD EFFECT BETWEEN STOCK PRICES  
AND EXCHANGE RATE IN MALAYSIA**

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## **ABSTRACT**

### **TESTING FOR COINTEGRATION WITH THRESHOLD EFFECT BETWEEN STOCK PRICES AND EXCHANGE RATE IN MALAYSIA**

Since globalisation has integrated the world economy through trade and finance, the main macroeconomic variable responsible in influencing the profitability of firms is exchange rate. This is supported by researchers based on the traditional approach, the portfolio selection approach and the cash flow approach. Exchange rate is further distinguished into expected and unexpected shock in the changes of the exchange rate based on the rational expectation hypothesis introduced by Barro (1977). This study empirically aims to examine the exchange rate effects of the Malaysia ringgit (RM) on stock prices using monthly Malaysian data covering the period January 1980 to December 2010. In addition the study employs advance econometric methodology by incorporating threshold effect cointegration and error correction model (TECM). The results from this study showed that in the short-run, there were no cointegrating relationships between stock prices with both the expected and unexpected exchange rates. However, in the long-run, there were positive relationships between stock prices and exchange rates. The findings supported the study conducted by Yau and Nieh (2009).