Exchange rate determination: Empirical evidence from the monetary model in Malaysia

Abstract

This study examines the determination of exchange rate in Malaysia using the monetary model. The results of the autoregressive distributed lag (ARDL) approach shows that there is a long-run relationship between exchange rate and its determinants, namely relative money supply, relative demand, interest rate differential, and oil price. More specifically, an increase in relative money supply or interest rate differential will lead to a decrease in exchange rate in the long run. Conversely, an increase in oil price will lead to an increase in exchange rate in the long run. The results of the generalised forecast error variance decompositions show that oil price is relatively least important than relative money supply in the determination of exchange rate in Malaysia.