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Analyzing Bank Negara Malaysia's Behaviour in Formulating Monetary Policy: An Empirical Approach

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Declaration

Unless otherwise indicated this thesis is my own work.

MOHAMAD HASNI SHAARI
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Abstract

In an economic system, the central bank is entrusted with the responsibility of formulating monetary policy. Despite its important role and significant contribution in influencing the well being of other economic agents in the economy, in general, little is known about a central bank's underlying behaviour in executing this task. Among the key questions that the non-policymakers raise on this area are: How do central bankers actually formulate monetary policy? Do they behave systematically and follow any form of rule? What are the objectives that they want to pursue? How do they prioritize these different objectives? How does their policy behaviour evolve over time? What happens if they act differently?

Existing studies which analyze a central banks' behaviour in formulating monetary policy, are mostly concentrated on the experience of developed economies. However, developing economies face a different institutional structure, as well as a different set of constraints and shocks, hence, it would be interesting to analyze how a central bank under this different economic environment performs its monetary policy mandate. This thesis looks at the behaviour of Bank Negara Malaysia (The Central Bank of Malaysia) in formulating monetary policy in Malaysia during the period 1975-2005.

There are four major aspects of Bank Negara Malaysia's (BNM) policy behaviour that are examined in this thesis. Firstly, with regard to its policy reaction function - does BNM set interest rates according to some form of policy rule or purely on a discretionary manner? After identifying the systematic component of its policy action, we try to establish BNM's policy objectives and preferences. This will help in understanding the rationale behind its policy action. The third aspect is whether BNM's policy behaviour changes over time. Lastly, with the use of an estimated Dynamic Stochastic General Equilibrium (DSGE) model, we conduct some policy experiments to observe the possible impact on the Malaysia's economic outcomes were BNM to behave differently to what we envisaged its policy behaviour has been.

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