The impact of capital flows on the scope of monetary control and monetary policy the cases of Indonesia and Malaysia

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Abstrak

Over the last decade, developing countries have experienced a significant increase in capital flows. These capital flows became highly insurgent in the early 1990s. The development of these capital flows can significantly influence the domestic monetary base, and lead to domestic financial instability in these countries. Thus, this analysis focuses on assessing the ability of the monetary authorities to neutralize monetary disturbances of the capital flows in developing countries. It also attempts to analyze the impact of capital flows on the conduct of monetary policy in these countries. The study, however, is only applied to two ASEAN developing countries; Indonesia and Malaysia. The study is undertaken by running regression on three estimating equations developed in one chapter of the thesis. Regressions are run by using Ordinary Least sequares (OLS) method. The study shows that both monetary authorities in Indonesia and Malaysia have no loss of monetary control in faced of capital flows. The study also shows that the authorities in Indonesia and Malaysia direct their monetary policy to intervene in the exchange market; aims to preserve exchange rate stability as well as to maintain competitiveness of their exports. A policy implication also emerges from this study. That is, if the monetary authorities desired to have a higher degree of monetary authonomy, they must be ready to pursue a more flexible exchange rate policy.