
ABSTRACT

The predictive power of the monetary model for the Malaysian ringgit/US dollar (RM/USD) rate is analysed using quarterly data ending in 2006:Q3. We find compelling evidence of a long-run relationship between exchange rates and the economic fundamental determinant. Macroeconomic factors systematically affect the long-run movement of the RM/USD rate. Additionally, the RM/USD rate was overvalued by about 10% several quarters before the 1997 crisis; after the crisis, rates fluctuated close to the equilibrium value. The out-of-sample forecasts demonstrate that the monetary model outperforms the naïve random walk model. The monetary and Purchasing Power Parity (PPP) models do well at the four to eight quarters horizon.

Keyword: Exchange rate; US-Dollar; US Dollar; Malaysia.