A paper submitted to MARA Institute of Technology
in partial fulfillment of the requirement for the
Advanced Diploma In Business Studies (Finance)

THE EFFECT OF INFLATION ON STOCK RETURNS: SOME KLSE EVIDENCE

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November,1994

ACKNOWLEDGEMENT

Undeniably, the dissertation requirement is the most challenging stage in completion of my ADBS (Finance) course. This dissertation could not have been completed without a special thanks to be mentioned to all who directly or indirectly contributed to this project.

First of all, Syukur Alhamdulillah to Allah AlMighty for his consent to make it happen. I owe my gratitude to my advisor, Tuan Haji Amir Zainol Abidin for devoting his utmost of time and efforts with generosity and patience. Thanks also due to all School of Business and Management lecturers for their guidance.

My sincere thanks to all the Librarians and Officers whom I consulted through a countless visits particularly to staffs of PTAR 2 ITM, KLSE, Bank Negara and Perpustakaan Utama Universiti Malaya. I am indebted to all my friends and colleagues for their sightful

ABSTRACT

Fisher's Hypothesis stated that the expected rate of return on assets consists of a **"real return"** and **"expected inflation rate"**. When applied to stock investment, it it said that the stock market should provide a complete hedge against inflation, thereby indicating a positive relation between inflation and stock returns.

The study try to determine whether Fisher's proposition are acceptable in the Malaysian stock market. The period from 1984 to 1993 is examined, using quarterly Consumer Price Index (CPI) and selected stock indices data. The returns on stock indices are regressed against the growth of CPI using Least Square Method on a Single Linear Function.

The empirical study shows mixed results. The Industrial Index indicates a negative relationship, while the EMAS, Composite, Finance and Property Indices proposed a positive relationships. Although the latter Indices

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CHAPTER 1

INTRODUCTION

1.1 INTRODUCTION

Inflation is an economic phenomenon associated with general rise in price level. It may brought about by an earlier rise in the cost of production, which is not accompanied by a corresponding increase in productivity, or an increase in demand for goods and services without a corresponding increase in supply, or both. Although Malaysia has been able to contain inflation at an average rate at about 4% per annum as measured by the Customer Price Index (CPI) over the years, the CPI registered a growth of 4.7% in 1992, the highest attained since 1982.The growth of CPI moderated to 3.6% in the following year and subsequently increased to 4.5% in the first quarter in 1994[1]. This has cause concern among the public and prompted the government to set up a cabinet

1. ———, "Can Inflation Be Control" Public Bank Economic Review (Mac - April 1994) : 4 - 6.