THE INFLUENCE OF MACROECONOMIC VARIABLES ON MALAYSIAN STOCK MARKET PERFORMANCE (A TEST ON MONEY SUPPLY, EXCHANGE RATE AND EMPLOYMENT RATE) (1998-2006)

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ABSTRACT

Much has been said about the relationship between macroeconomic variables and the performance of stock market. Do these economic variables really affect the stock market performance? Thus, the purpose of this paper attempts to find the answer.

This paper explores influence of macroeconomic variables toward the stock market performance by utilizing Regression, Anova and Pearson Correlation. The sample period is from 1998 until 2006, a period after the Malaysian economy has recovered from a recurrence of the 1997-98 Asian economic crisis. In this research, the Malaysian stock market has been chosen as a dependent variable and money supply, exchange rate and employment rate as the independent variables.

The outcomes from the Regression and Pearson Correlation suggest that the macroeconomic variables (money supply, exchange rate and employment rate) influence the stock market performance at definite level of strength. The major findings are:

(i)   Money Supply is the most overwhelming determinant of stock market performance

(ii)   Employment Rate is also the predominant force on the performance of stock market

(iii)   Exchange Rate is the weakest impact on stock market performance.

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1.0   INTRODUCTION

1.1   An Overview of Malaysian Economy

The contagion effect of the financial crisis in 1997 had adversely affected the Kuala Lumpur Stock Exchange Composite Index (KLCI). In fact, by year-end 1997, the KLCI had declined 53% from its February 26 high of 1271.57. Since then, the KLCI has not shown much improvement for the next few years.

Over the same period (1997) the Malaysian Ringgit (MYR) had nominally depreciated 56% against the U.S dollar (USD). Effective 1 September 1998, the MYR was pegged and subsequently devalued at 3.8000 against per unit of the U.S Dollar. On July 21, 2005 the government removed the 7-year-old peg. Since then, the Ringgit has appreciated by about 3% against the U.S Dollar reflecting both the strong current account performance of Malaysia and reflects the strong market confidence in the currency.

During the period 1 October- 27 November 2006, the Ringgit appreciated against the US dollar, amidst continued trade & investment flows, but depreciated against other major currencies. The U.S dollar depreciated amidst weaker US economic data, which in turn led to expectations for a continued pause in benchmark interest rate increase.

CHAPTER 2 ˒

LITERATURE REVIEW

2.1   Economic variables and stock market performance

The result of the previous studies suggested that macroeconomic factors significantly influenced to stock returns in the developed markets of USA and Japan as referred to Lee (1992), Mukherjee & Naka (1995). Most of the studies regarding this issue, however, fail to explain the same relationship in European and other developed countries. In addition, the influence of economic roles on other Asian stock market relatively less explored.

Chen, Roll & Ross (1986) showed that economic variables have a systematic influence on stock return as a result of their effect on future dividends and discount rate. Through their study, they provided the foundation for the belief in the existence of a relationship between stock price and related macroeconomic variables.

Wangbangpo and Sherma (2002) examine the role of Gross National Product, the consumer prices in Indonesia, Malaysia, the Philippines, Singapore and Thailand and find causal relationship for the macroeconomic variables to stock prices. They observe that the stock prices are negatively related to inflation. Interest rate is negatively related with stock prices in the Philippines, Singapore and Thailand but positively related with stock prices in Indonesia and Malaysia.

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