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**THE INFLUENCE OF ECONOMIC VARIABLES
TOWARD SHARE PRICE PERFORMANCE :
A STUDY ON THE ACTIVE COUNTERS LISTED AT
THE KLSE MAIN BOARD**

**ROLFANDY BIN AWI
99529827**



**BACHELOR OF BUSINESS ADMINISTRATION
WITH HONOURS (FINANCE)
FACULTY OF BUSINESS MANAGEMENT
MARA UNIVERSITY OF TECHNOLOGY
SARAWAK**

APRIL 2003

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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 towards the share price performance by utilizing regression and general analysis on the Kuala Lumpur Stock Exchange . The sample period is from 1999 to 2002, 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 GDP, interest rate and inflation rate as the independent variables.

The outcomes from the regression and general analysis suggests that the macroeconomic fundamentals in Malaysia i.e. GDP, inflation and interest rate influence the stock price at definite level of strength. The major findings are (a) GDP is the most overwhelming determinant of share price performance, (b) interest rate is also the predominant force on the performance of the share price, and (c) the weakest impact on stock price is inflation.

CHAPTER ONE

1.1. INTRODUCTION

Since its independence in 1957, Malaysia has faced some economic crises and the most recent one is in 1997. The 1997 Asian Financial Crisis has caused the Malaysian currency to lose about 40 percent of its value within half a year, the real GDP began to slow down with a negative growth beginning the first quarter of 1998. As for the stock market, movements of stock prices on the KLSE were affected by exchange rate fluctuation, developments in regional economies and a sharp loss of confidence in emerging markets by foreign investors.¹

This period of 1997 to 1998 was very critical because Malaysia has not just undergone an economic crisis but at the same time also burdened with political tribulation due to the dismissal of Dato' Seri Anwar Ibrahim on September 2, 1998.

According to the 2002 Bank Negara Malaysia Annual Report, the recovery of the Malaysian economy gained momentum in 2002 with real Gross Domestic Product (GDP) expanding by 4.2% (0.4% in 2001). Reflecting the continued expansionary fiscal stance, real public consumption increased substantially by 13.8%, while real public

¹ Samuel Basse Okposin & Cheng Ming Yu, Economic Crisis in Malaysia, Pelanduk Publication (2000): pg 117-118

CHAPTER TWO

LITERATURE REVIEW

2.1 INTRODUCTION

The issue concerning the relation between macroeconomic variables and stock markets has been broadly studied for the past two decades. The prior studies are mainly centered on the developed stock markets such as the USA, Japan and the United this issue in the Asian market.

This chapter will survey the existing literature that examine the relationship between GDP and stock price, inflation and stock price, interest rate and stock price, money supply and stock price and the combination of macroeconomic variables, business cycle, economic activities, and stock market.

2.2 INFLATION AND STOCK PRICE

Studies concerning inflation have been done including Douglas Pearce's "An Empirical Analysis of Expected Stock Price Movements" in 1984. However, after 1972, Pearce found that the relationship between stock prices and inflation became less significant due to OPEC crisis in 1970s.¹⁴ A study conducted by Niemira and Klein(1994) supports the changing relationship between inflation and the stock market and found that an inverse relationship between inflation and the stock market when using the leading indicator of inflation as their data source for inflation.¹⁵

¹⁴ Nathan Taulbee, Influences on the Stock Market: An Examination of the Effect of Economic Variables on the S & P 500, The Park Place Economist, Vol.IX. : pg. 92.