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**AN ANALYSIS ON THE SIGNIFICANT
RELATIONSHIP BETWEEN STOCK PRICE
PERFORMANCE AND ECONOMIC VARIABLES
AFTER THE ECONOMIC RECOVERY IN
MALAYSIA
(1999 -2002)**

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ABSTRACT

For generations researchers have been trying to identify factors that affects the performance of the stock market. Different countries with different economic environment, different political situation, different social, belief and religions and different geographical condition will have different factors that affects their stock market performance.

This study attempts to identify the economic factors that might affects the stock price(market) performance in Malaysia. The study was based on a four years period (1999 to 2002), after the Malaysian economy has recovered from the severe deflationary impact of the regional crisis. In the study, three economic variables have been identified; interest rate, inflation rate, and gross domestic products. The study includes an analysis on the relationship between the stock price performance as a dependent variable and the three economic variables as independent variables.

From the study it was found that the three economic variables did have certain level of relationship and impacts on the stock price performance even though the degree of relationship varied throughout the four years period. Through the analysis that has been carried out, GDP has the most significant relationship with stock price performance,

CHAPTER 1

1.1 INTRODUCTON

The Malaysian economy has recovered in 1999 from the severe deflationary impact of the regional crisis which resulted in a¹ 7.5% contraction of the economy in 1998. Real Gross Domestic Product, GDP which had contracted by an unprecedented 10.9% and 10.3% in the third and fourth quarter of 1998. It however registered a significantly milder contraction of 1.3% in the subsequent first quarter before recovering with a positive growth of 4.1% in the second quarter of 1999.² As mentioned by the then BNM Governor, the strong economy rebound of the Malaysian economy in the third quarter of 1999 confirms that the economy has recovered and is officially out of recession. The Malaysian economy grew by 8.1% in the third quarter of 1999, the highest growth rate since the onset of the economic crisis in 1997.

The economic recovery has been underpinned by policies initiated by the National Economic Action Council in line with its National Economic Recovery Plan as well as others favourable domestic and external developments. The imposition of selective exchange controls and pegging

¹Ministry of Finance, Economic Report 1999/2000, "The Performance of the Malaysian Economy in 1999 and Prospect for 2000" : 17, 26-27, 32, 155-156

²BNM Governor and Malaysian Insurance Institute Chairman, Tan Sri Dato' Seri Ali Abdul Hassan bin Sulaiman, "Seminar on Human Resource and Management" (1999) :1-5

CHAPTER 2

2. LITERATURE REVIEW

Introduction:

This section reviews the findings of some of the studies carried out on the relationship between monetary variables, the economy and the stock price.

2.1 Money Supply and the Economy

¹²Friedman and Schwartz of the United States have thoroughly documented the relationship between changes in the growth rate of the money supply and the subsequent changes in the economy. Specifically, they demonstrated that declines in the rate of growth of the money supply have preceded business contractions by an average of 20 months, while increases in the growth rate of the money supply have preceded economic expansions by about 8 months.

Friedman suggests a transmission mechanism through which changes in the growth rate of money supply affects the aggregate economy. He hypothesizes that to implement planned changes in monetary policy, the Federal Reserve engages in open market operations, buying or selling

¹² Frank K. Reilly and Keith C. Brown "Investment Analysis and Portfolio Management" Chapter 14 :484-486