CHAPTER I

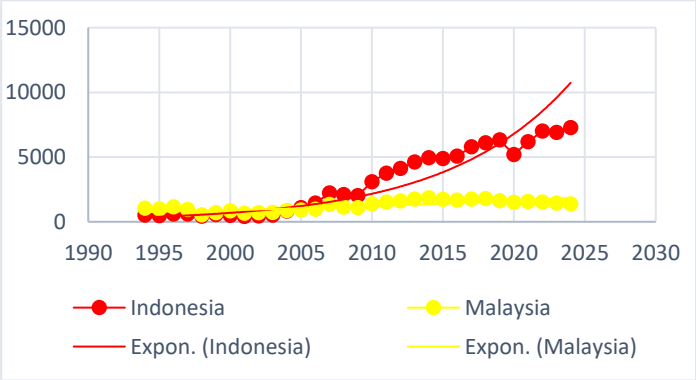
INTRODUCTION

1.1 Background

Over the last two decades, capital markets across Southeast Asia, especially those operating under the ASEAN umbrella, have emerged as increasingly prominent contributors to global economic expansion.. Indonesia and Malaysia, as the two largest economies in ASEAN, play a strategic role in the dynamics of the regional financial market, with Indonesia (IHSG) and Malaysia (KLCI) serving as the main stock indices reflecting the market conditions of their respective countries. Indonesia and Malaysia are the focus of this study based on their fundamental relevance. Both countries have served as founding members of the ASEAN Economic Community since 2015 (Widiyana & Djatmiko, 2019) , and demonstrate economic and financial integration through trade, investment, and capital mobility. This integration process creates cross-border macroeconomic transmission with complex characteristics, while its impact on stock indices remains incompletely understood.

The selection of Indonesia and Malaysia as subjects of comparison in this study is based not only on their geographical proximity and membership in the ASEAN region but also on the significant differences in fundamental economic characteristics between the two countries. Thus, a comparative analysis between Indonesia and Malaysia is relevant for identifying whether variations in the fundamental economic structures of these countries translate into distinct patterns in how sensitively, in what direction, and how rapidly each stock index responds to shifts in macroeconomic conditions..

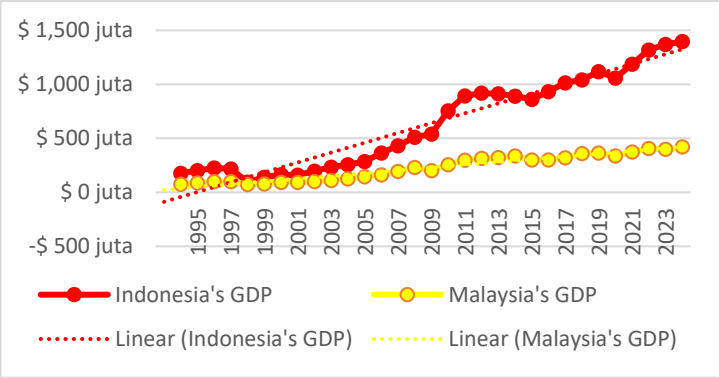
Figure 1.1 Comparison of IHSG & KLCI Values



Source: Investing.com, processed, 2025

From the chart above, it is evident that the growth dynamics of the IHSG and the KLCI are strikingly different. The IHSG has shown a pattern of very rapid growth, evident since 1994 when it stood at around 500 points and continued to rise until it reached the 7,000-point level in 2024. This sustained upward trend indicates the presence of various driving factors, particularly related to Indonesia's macroeconomic conditions. In contrast, the KLCI exhibits relatively stable or stagnant movement, with the composite stock index remaining within the 1,500–2,000-point range throughout the period from 1994 to 2024. The differences in growth characteristics between these two stock indices suggest that Macroeconomic indicators including inflation, GDP, the Real Effective Exchange Rate, and real interest rates do not affect each capital market uniformly, a pattern corroborated by the evidence presented in Pradhan et al.(2020) , thus necessitating a more in-depth comparative study.

Figure 1.2 Comparison of Indonesia's and Malaysia's GDP Values

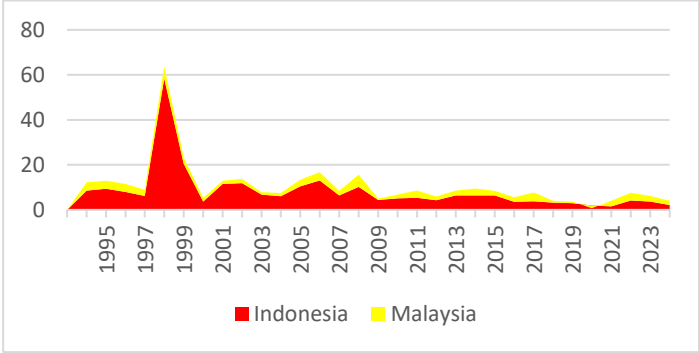


Source: World Bank Open Data, processed, 2025

The graph above clearly illustrates that Indonesia's GDP has maintained a steady upward trajectory from approximately USD 200 billion in 1994 to exceeding USD 1,400 billion in 2024, while Malaysia recorded growth from USD 60 billion to approximately USD 450 billion over the same period. This difference in the scale of growth is relevant when considered in light of modern financial theory, which clarifies that a nation's macroeconomic circumstances, especially its GDP, have a significant impact on stock price index fluctuations in addition to corporate fundamentals.. According to Mishkin (2019) Gross Domestic Product represents the aggregate monetary value of all goods and services generated by every productive sector within an economy over a given time period. Gross Domestic Product growth reflects aggregate economic conditions and is positively correlated with stock market performance. Data shows a consistent increase in Indonesia's GDP from approximately USD 200 billion in 1994 to over USD 1,400 billion in 2024, while Malaysia recorded growth from USD 60 billion to approximately USD 450 billion over a similar time period. Empirical findings by Hassan et al.(2024) through an analysis of five ASEAN capital markets reveal a significant influence of domestic

output growth on stock index movements, although this correlation varies across periods. Theoretically, an increase in GDP represents a rise in corporate profitability and fosters more optimistic investor expectations regarding the stock market, although this relationship is not always linear due to the involvement of various other macroeconomic variables in the investment allocation process.

Figure 1.3 Comparison of CPI Inflation Rates in Indonesia and Malaysia

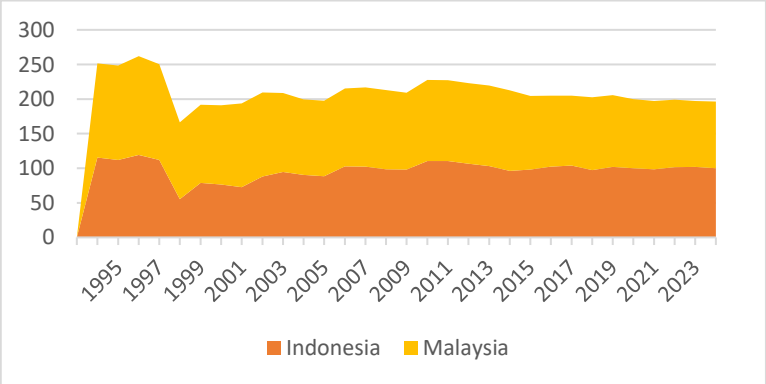


Source: World Bank Open Data, processed, 2025

The chart above illustrates a striking difference in inflation patterns between Indonesia and Malaysia over the 1994–2024 period. Inflation serves as a key macroeconomic variable in stock market dynamics because it affects investor purchasing power, corporate profitability, and discount rates in the stock valuation process. Indonesia recorded significantly higher inflation volatility compared to Malaysia, particularly during the 1998 Asian financial crisis when inflation reached approximately 60 percent, before gradually stabilizing in the range of 1 to 6 percent during the post-crisis period. In contrast, Malaysia was able to maintain inflation stability at a more controlled level, with most of the observation period showing inflation rates below 10 percent, along with a lower average and limited fluctuations. A recent study by Sholihah *et al.* (2025) shows that inflation has a dominant influence of 0.988 on the IHSG during the 2020–2024 period, indicating the Indonesian stock market's sensitivity to high inflationary pressures. The differences

in inflation rates and volatility between the two countries reflect variations in the effectiveness of monetary policy as well as the characteristics of their economic structures. Multiple empirical investigations have documented an inverse association between inflation and the IHSG, suggesting that even a marginal one-percent rise in inflation may be sufficient to drag the index down by a substantial number of points. Nevertheless, systematic comparative studies on the differing impacts of inflation on the Indonesian and Malaysian stock markets remain relatively limited.

Figure 1.4 Real Effective Exchange Rates (REER) of Indonesia and Malaysia, 1994–2024

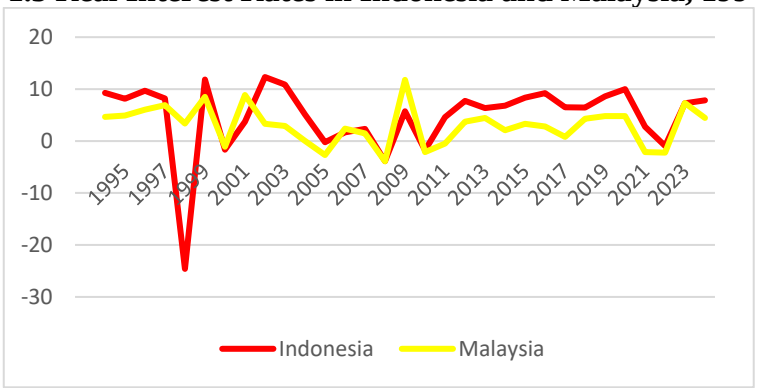


Source: Bank for International Settlements, 2025

Significant variations in REER levels and trends between Indonesia and Malaysia over the course of the observation period are depicted in the following graphic. Because it accounts for local inflation in relation to trading partners, the Real Effective Exchange Rate is a more complete measure of exchange rates than the nominal exchange rate. REER developments reveal differing patterns between Indonesia and Malaysia: Indonesia's REER ranged from 50 to 130 during the period from 2000 to 2024, while Malaysia recorded higher levels ranging from 150 to 250. This indicates the relative strength of the Malaysian currency over the long term. Malaysia's high REER level reflects consistent monetary stability and a more

diversified economic structure, particularly through the strengthening of the high-tech manufacturing sector and financial services. Research by Adi et al.(2022) using an ARDL approach identified significant long-term effects of foreign direct investment and trade openness on Indonesia's REER movements, while GDP was significant only in the short term. The REER is closely linked to export performance, foreign direct investment flows, and stock market performance. However, the use of this indicator in studies of the IHSG and KLCI remains relatively limited in the empirical literature. Most previous studies have focused their analysis on nominal exchange rates, even though this indicator is less capable of capturing long-term macroeconomic equilibrium related to stock index performance. This research gap warrants attention because the REER provides a more comprehensive picture of a country's competitive position and its implications for capital flows and the valuation of financial assets.

Figure 1.5 Real Interest Rates in Indonesia and Malaysia, 1994–2024



Source: World Bank Open Data, processed, 2025

The chart above illustrates the differences in real interest rate volatility between Indonesia and Malaysia over the 1994–2024 period. Real interest rates serve as a key instrument in monetary policy transmission because they reflect the cost of borrowing after accounting for inflation, thereby providing a more accurate

picture of investment incentives and portfolio allocation decisions compared to nominal interest rates. In the context of capital markets, changes in real interest rates affect stock valuations through several main channels, including an increase in the discount rate used to calculate the present value of future cash flows, adjustments to firms' cost of capital, and a shift in investor preferences from risky assets to fixed-income assets. The trends in real interest rates in Indonesia and Malaysia during the 1994–2024 period show quite distinct patterns. World Bank data indicates that Indonesia's real interest rates experienced high volatility, ranging from around minus twenty-five percent to nearly ten percent, particularly during the 1998 Asian financial crisis and the subsequent period of monetary policy adjustment. This extreme volatility reflects turbulent inflation dynamics and aggressive policy rate adjustments, thereby creating a greater environment of uncertainty for market participants.

In contrast, Malaysia exhibited a relatively more stable real interest rate profile, with movements ranging from near zero to about 10 percent throughout the observation period. This stability aligns with more controlled inflation and a more consistent monetary policy framework, resulting in more predictable expectations regarding the cost of capital and long-term financing conditions. A more stable real interest rate environment provides a higher degree of certainty for investors in planning asset allocation and managing portfolio risk in the Malaysian stock market. From a financial theory perspective, according to (Egger, 2022), an increase in real interest rates will drive up the discount rate used in stock valuation, thereby reducing the present value of future cash flows and ultimately putting downward pressure on stock prices. This effect is reinforced by the opportunity cost mechanism, whereby

a rise in real interest rates increases the attractiveness of low-risk financial instruments, thereby triggering a shift of funds from the stock market to fixed-income instruments. The study Sumaryana *et al.*(2024) shows that interest rates and inflation have a significant negative impact on the IHSG, consistent with the argument that tightening monetary shocks tend to reduce stock market performance. However, comparative empirical evidence on how changes in real interest rates simultaneously affect the IHSG and KLCI remains limited, particularly over the long term.

The differences in volatility and real interest rate levels between Indonesia and Malaysia, as illustrated in the graph above, indicate that the stock markets of the two countries operate in fundamentally different monetary environments. Indonesia faces higher and more volatile real interest rates, which could make the IHSG more sensitive to monetary policy shocks and changes in inflation expectations. Meanwhile, the KLCI operates within a framework of more stable real interest rates, so the market's response to changes in monetary conditions tends to be more moderate and measured. This gap in understanding regarding the differing mechanisms of real interest rate transmission on the IHSG and the KLCI underscores the urgency of a comparative analysis in this study.

Research on the impact of macroeconomic factors on the IHSG has grown rapidly over the past two decades, with the majority focusing on the individual effects of inflation, interest rates, exchange rates, and GDP on the movement of the Indonesian stock index. A classic study by Sholihah *et al.* (2025) shows that interest rates, inflation, and GDP growth have a significant impact on the IHSG, with inflation exhibiting a dominant effect of 0.988 in the estimated model. Research by

Fadila and Nurhayati, (2025), using data from 2021–2024, found that Bank Indonesia's interest rates and the LQ45 index have a significant positive impact on the IHSG in the long term, while inflation and the exchange rate did not have a significant impact during the observation period. Analysis by Faqih and Priyono (2025) covering the period from 2019 to 2024 revealed a significant negative relationship between changes in the exchange rate and the IHSG, whereas interest rates and inflation did not show a significant impact in the short term. Danila (2023) through volatility spillover analysis using the GARCH-BEKK and Dynamic Conditional Correlation approaches in the ASEAN-5 capital markets, identified significant interdependence among the region's stock exchanges, where Malaysia exhibited two-way volatility transmission while Indonesia showed one-way transmission, confirming that the interconnections among ASEAN capital markets are asymmetric and vary across countries. The majority of previous studies utilized short-term data spanning two to five years and limited methodological approaches such as Ordinary Least Squares regression; thus, they have not been able to comprehensively represent long-term relationships and macroeconomic dynamics in relation to stock index movements.

Comparative analyses involving the Malaysian capital market remain relatively limited when compared to studies focused on the IHSG. The study "*et al.* (2025) analyzed the impact of macroeconomic variables on the KLCI for the period 1994–2022 using OLS and the Granger Causality test, finding that Brent crude oil prices and the exchange rate had a significant impact, while GDP, interest rates, and the inflation rate did not significantly affect the KLCI. Hassan et al. (2024) , through a panel analysis of the ASEAN-5 for the period 2012–2022 using GMM, noted a

significant influence of interest rates and exchange rates on stock market movements, while Ghul et al. (2024) , in a study of six ASEAN countries, confirmed the dominance of the real exchange rate as the most influential macroeconomic variable on regional stock market performance. A recent study by Husni and Mustaffa (2025) identifies a significant positive effect of Gross Domestic Product on the KLCI with a coefficient of 0.2580, and confirms the role of exchange rate volatility and macroeconomic uncertainty in shaping Malaysian stock market returns. Limitations in the literature on the KLCI indicate a lack of comprehensive empirical studies on the Malaysian capital market, particularly those utilizing long-term time-series data and applying advanced methodologies such as the Autoregressive Distributed Lag (ADL) and Vector Error Correction Model (VECM).

Indonesia and Malaysia exhibit distinct economic structures with direct implications for the stock market's sensitivity to macroeconomic variables. As the largest economy in the ASEAN region, Indonesia's Gross Domestic Product is approximately three times that of Malaysia, around USD 1,400 billion compared to USD 450 billion in 2024. This economic scale reflects a broad production base encompassing the agricultural and manufacturing sectors, as well as large-scale informal activities, accompanied by a relatively high growth rate but followed by a higher level of volatility. Malaysia has a smaller economy but a much higher level of trade openness, reflected in a trade-to-GDP ratio of around 130 percent compared to Indonesia's approximately 23 percent. This structure indicates an export-oriented economy dominated by highly competitive manufacturing and financial sectors, with strong integration into global value chains. These structural differences suggest

that the IHSG may be more sensitive to domestic monetary conditions such as inflation and interest rates, while the KLCI tends to be more responsive to external dynamics and exchange rate movements. Setiawan, Purnamasari, and Ulum (2020), in their study , analyzed si ASEAN countries and found variations in the impact of macroeconomic indicators on economic growth, with stock market development variables showing differing positive contributions across countries, reflecting the structural characteristics of each economy. Comparative studies on the elasticity of the IHSG and KLCI to changes in macroeconomic variables as a reflection of the structural characteristics of each country's economy remain limited and open significant opportunities for further research.

Most previous studies have applied the standard Ordinary Least Squares approach without simultaneously considering lag dynamics and short-term and long-term relationships, which may result in biased and inefficient estimates. A number of follow-up studies have utilized the Vector Error Correction Model to examine long-term and short- relationships; however, the application of this method generally focuses on separate analyses of the IHSG or KLCI without conducting a systematic comparison between markets. The use of the Autoregressive Distributed Lag (ADL) model remains relatively limited in capital market studies, although this approach offers significant advantages in estimating long-term relationships through flexible sample sizes and the ability to accommodate variables with different levels of stationarity at orders I(0) and I(1) without strict cointegration requirements. Sukanto *et al.* (2024) applied the Panel ARDL approach in analyzing the interrelationships between macroeconomic variables (epidemic funding, net exports, CPI) and external debt in the ASEAN-7 region for the period 2000–2020,

obtaining more robust long-run estimates compared to conventional short-run estimates, making it suitable for long-term time series data. The ARDL model's ability to capture both short-run lag effects and long-run equilibrium relationships makes this approach relevant for analyzing the dynamic transmission of macroeconomic variables to stock indices. The application of ARDL combined with bounds testing for cointegration allows for a more comprehensive and reliable presentation of empirical evidence regarding differences in the transmission mechanisms of macroeconomic factors between the IHSG and the KLCI.

Based on the various identified research gaps, a systematic and comprehensive comparative study on the effects of Gross Domestic Product, the Real Effective Exchange Rate, inflation, and real interest rates on the IHSG and KLCI is of high urgency and relevance. This study has the potential to broaden understanding of the transmission mechanisms of macroeconomic variables in emerging market capital markets. The research's contribution to the literature is realized through several key aspects: 1) the presentation of a structured comparative analysis of the between the two largest capital markets in ASEAN based on long-term data, 2) the use of the Real Effective Exchange Rate as an alternative independent variable to the nominal exchange rate to represent international competitiveness more comprehensively, 3) the application of the Autoregressive Distributed Lag (ADL) methodology, which is suitable for long-term time-series analysis and capable of accommodating variables with different orders of integration, 4) Providing an explicit comparison between long-run and short-run relationships for each macroeconomic variable, 5) Offering insights into the differences in the adjustment speeds of the IHSG and KLCI to macroeconomic shocks based on each country's economic structure. From

a practical perspective, this research provides added value for investors, policymakers, and financial analysts in understanding the dynamics of ASEAN capital markets and supports investment and policy decision-making based on macroeconomic conditions. Furthermore, an understanding of the variations in transmission mechanisms between the IHSG and the KLCI supports the design of cross-country portfolio diversification strategies within ASEAN and strengthens monetary policy formulation to achieve financial system stability.

Based on a review of the various prior studies outlined above, there are three main research gaps that underpin the urgency of this study. 1) Methodological gap, The majority of prior studies still rely on the Ordinary Least Squares (OLS) approach, which is unable to simultaneously estimate long-term relationships and short-term dynamics, nor does it accommodate a mixture of I(0) and I(1) variables. The Autoregressive Distributed Lag approach with bounds testing for cointegration, developed by Pesaran, Shin, and Smith in 2001 (as cited in Bertsatos et al., 2022), has proven to be more reliable for long-term time-series analysis, yet it remains rarely applied in studies of ASEAN capital markets. 2) Variable gap, Most studies use bilateral nominal exchange rates, whereas the Real Effective Exchange Rate adjusted for inflation and the trade weights of major trading partners provides a more comprehensive and relevant picture of international competitiveness in the context of long-term macroeconomic linkages with stock indices. 3) Comparative gap, Studies that systematically compare the transmission mechanisms of macroeconomic variables on the IHSG and KLCI within a unified methodological framework using long-term time-series data remain very limited; consequently, the

heterogeneity in the responses of the two capital markets has not been adequately mapped.

The novelty of this study lies in four main aspects. 1) this study is a structured comparative analysis of the IHSG and the KLCI using long-term time-series data (1994–2024), with the observation period covering various episodes of major shocks such as the 1998 Asian financial crisis, the 2008 global financial crisis, and the 2020–2021 COVID-19 pandemic. 2) this study integrates the Real Effective Exchange Rate as a substitute for the nominal exchange rate, offering a more accurate representation of international competitiveness within the framework of long-term macroeconomic interdependence. 3) the application of the ARDL-ECM model allows for the simultaneous estimation of long-run elasticities and short-run adjustment dynamics within a single integrated framework for both countries. Fourth, this study explicitly measures and compares the speed of adjustment of the IHSG and KLCI to macroeconomic shocks through the Error Correction Term coefficient, providing new insights into the heterogeneity of transmission mechanisms in the ASEAN region.

Based on the preceding discussion, this study presents a comparative analysis of the effects of Gross Domestic Product, the Real Effective Exchange Rate, inflation, and the real interest rate on the IHSG and KLCI. The analysis uses annual time-series data from 1994 to 2024, comprising 31 observations, and applies the Autoregressive Distributed Lag approach to estimate long-run relationships and short-run dynamics. The study aims to obtain empirical evidence regarding the significance and differences in the effects of macroeconomic variables between the IHSG and the KLCI over the long term, the short-term adjustment patterns of both

stock indices to macroeconomic shocks, and variations in elasticity and adjustment speed based on the structural characteristics of the Indonesian and Malaysian economies. The study also focuses on the implications of the empirical findings for investors in formulating regional portfolio diversification strategies and for policymakers in designing effective macroeconomic policies. The use of the ARDL approach allows for a more reliable presentation of empirical results while helping to bridge the gap in the literature regarding comparative analysis of ASEAN capital markets. This study is expected to enrich the understanding of emerging market dynamics in the context of the interaction of macroeconomic variables in both the long and short term.

1.2 Research Questions

Based on the research gaps and novelty identified and discussed in depth in the Background section, this study is designed to answer the following questions.

1. Does Gross Domestic Product affect the Indonesian IHSG and the Malaysian KLCI in the long term and short term?
2. Does the Real Effective Exchange Rate affect the Indonesian IHSG and the Malaysian KLCI in the long and short term?
3. Does the inflation rate affect the Indonesian IHSG and the Malaysian KLCI in the long run and short run?
4. Does the real interest rate affect the Indonesian IHSG and the Malaysian KLCI in the long and short term?
5. Are there significant differences in the magnitude and direction of the impact of macroeconomic variables (GDP, REER, inflation, and interest rates) on the IHSG compared to the KLCI?

6. Are there significant differences in the speed of adjustment of the IHSG and KLCI to shocks in macroeconomic variables?

1.3 Research Objectives

This study aims to analyze and compare the effects of macroeconomic variables including GDP, the real effective exchange rate (REER), inflation, and the real interest rate (RIR) on the Indonesian IHSG and the Malaysian KLCI stock indices in both the long and short term, using an ARDL model for the period 1994–2024. Specifically, the objectives of this study are:

1. To analyze the impact of GDP on the movements of the Indonesian IHSG and the Malaysian KLCI, both in the long run and in the short run.
2. To analyze the impact of the REER on the movements of the Indonesian IHSG and the Malaysian KLCI, and to compare the sensitivity of each stock index to changes in a country's external competitiveness.
3. To analyze the effect of inflation on the movements of the Indonesian IHSG and the Malaysian KLCI, particularly the differing impacts resulting from variations in inflation rates and volatility between the two countries.
4. To analyze the impact of real interest rates on the movements of Indonesia's IHSG and Malaysia's KLCI, both in the long term and the short term, using real interest rate data sourced from the World Bank.
5. To compare the elasticity of the IHSG and KLCI to shocks in macroeconomic variables that is, to measure the percentage change in the stock indices when each macroeconomic variable changes by 1% to explain the differences in the sensitivity of the two countries' capital markets.

6. To compare *the speed of adjustment of the* IHSG and KLCI to shocks in macroeconomic variables through an Error Correction Model analysis,

1.4 Scope of the Study

A. Scope of Subjects and Region

1. The research subjects are limited to the Indonesian and Malaysian capital markets, with the IHSG used as a representative of the Indonesian capital market's and the KLCI as a representative of the Malaysian capital market.
2. This study does not address sectoral indices, sharia stocks, or other regional indices outside of the IHSG and KLCI.
3. This study does not analyze the performance of individual company stocks or stock returns by economic sector but focuses on the performance of aggregate indices as a representation of the capital markets as a whole.
4. Time and Data Scope
5. The observation period is limited to 1994–2024, with a total of 31 years of data covering various economic conditions, including normal periods, the financial crisis (1998), the global crisis (2008), and the pandemic (2020–2021).
6. The data frequency is annual for the time series model, resulting in 31 observations per country, which is sufficient for estimating an ARDL model with multiple independent variables and a lag structure.
7. The data used consists of secondary data sourced from official authorities and reputable international institutions, including: For GDP,

inflation, and interest rates: Bank Indonesia (BI) and World Bank Economic Data. For the REER: Bank for International Settlements (BIS). For the IHSG and KLCI: Investing.com

B. Scope of Variables

1) Dependent variable:

a. Indonesia's IHSG.

b. Malaysia's KLCI.

2) Main independent variables:

a. GDP: Gross Domestic Product each country (in the form of an index/growth rate or real GDP log).

b. REER: Real Effective Exchange Rate each country.

c. Inflation: inflation rate (Consumer Price Index, year-on-year).

d. Real interest rate: Real interest rate for each country (% per year), measured using real interest rate data (World Bank) for Indonesia and Malaysia.

C. Scope of the Analytical Method

1) The analysis is limited to a quantitative time-series approach using the Autoregressive Distributed Lag (ARDL) and Error Correction Model (ECM) to distinguish between long-run and short-run relationships.

2) Estimation technique used: ARDL Bounds Testing for cointegration, without conducting a formal Chow test for structural breaks. If necessary, sub-period analysis can be performed by estimating separate ARDL models for the pre-crisis, crisis, and post-crisis periods.

3) This study does not address micro-level aspects of individual stocks, psychological investor behavior, qualitative political factors, or specific

firm characteristics. The focus remains on aggregate quantitative relationships among macroeconomic variables and stock indices.

4) This study does not perform Granger causality analysis, impulse response functions, or variance decomposition, which fall within the scope of VAR/VECM analysis. The analysis is limited to the estimation of long-run and short-run elasticities.

D. Scope of the Analysis

1) The subject of the analysis is the movement of market indices as an aggregate representation of the capital market, not individual companies or issuers.
2) The unit of analysis is annual observations each country throughout the study period.
3) This study does not analyze sub-indices or individual stocks, cross-sectional data on issuers, or variations across economic sectors, but focuses on the aggregate national capital market.

1.5 Research Benefits

A. Theoretical Benefits and Contributions to the Field

1) This study provides the latest empirical evidence on the comprehensive relationship between GDP, the REER, inflation, and real interest rates with stock indices in two ASEAN emerging market countries with differing fundamental economic structures. The inclusion of the Real Effective Exchange Rate as an independent variable offers a more advanced approach compared to the use of nominal exchange rates, as commonly applied in previous literature, thereby broadening our understanding of the

transmission mechanisms of macroeconomic policies to the financial sector. The study's findings have the potential to serve as a key reference in explaining how macroeconomic factors operate in emerging market capital markets with relatively high levels of global financial integration.

2) This study offers a stronger methodological approach through the use of an ARDL model employing the Bounds Testing approach. The advantages of ARDL include the ability to:

a. Estimate long-run and short-run relationships simultaneously within a single unified model
b. Accommodate independent variables with different levels of stationarity (I(0) and I(1))
c. Provide flexibility in selecting lag lengths according to the data structure
d. Produce long-run elasticities and short-run dynamics that can be directly compared
e. The results of this study can serve as a reference for further research in analyzing the interrelationships between macroeconomics and financial markets across countries, particularly in the context of emerging markets and regional financial integration.

B. Practical Benefits for Policymakers

1. For monetary authorities (Bank Indonesia and Bank Negara Malaysia)

a. Assessing Capital Market Sensitivity to Monetary Policy: The study's findings enable the measurement of the response of the IHSG and KLCI to variations in real interest rates and inflation in each country. This information supports central banks in formulating balanced monetary policy

by considering financial market stability, in addition to price stability targets and the achievement of full employment.

b. Information regarding the role of the REER in influencing the IHSG and KLCI can help central banks evaluate the trade-offs between exchange rate stability, export competitiveness, and capital market performance when determining the exchange rate policy framework.

2. For capital market authorities

a. Differences in Elasticity and Market Adjustment Speed. Findings regarding variations in the elasticity and adjustment speed of the IHSG and KLCI in response to macroeconomic shocks can serve as a basis for formulating policies to strengthen market resilience, control volatility, and develop more targeted hedging instruments.

b. Development of *Hedging* Instruments: Knowledge of the sensitivity of the IHSG and KLCI to specific macroeconomic factors can inform the development of more targeted derivative instruments and hedging tools, such as equity index futures or index options that are sensitive to specific macroeconomic factors.

3. For the Ministry of Finance, the Ministry of Trade, and fiscal policymakers

a. Information regarding the relationship between GDP and the stock markets in both countries can help assess the extent to which capital markets can serve as leading indicators of macroeconomic conditions and investor confidence, thereby aiding fiscal planning and investment policy.

b. A sensitivity analysis of the IHSG and KLCI to macroeconomic factors opens up opportunities for the government to prioritize strategic

macroeconomic variables in order to attract foreign portfolio capital inflows. For example, if the study's findings indicate that the IHSG is highly sensitive to inflation, stabilizing inflation should be made a key policy priority to enhance the stock market's appeal to international investors.

c. The research findings open the door for policy cooperation and regulatory harmonization at the ASEAN level, particularly in discussions regarding ASEAN capital market integration and coordination strategies to attract and retain foreign capital flows within the region.

4. For market participants and investment managers

a. The research results can serve as a basis for decision-making regarding asset allocation and portfolio diversification between the Indonesian and Malaysian stock markets, taking into account the differing responses of each index to macroeconomic variables.

b. Information on the macroeconomic variables that most significantly influence the IHSG and KLCI provides an analytical foundation for investment managers to design market timing strategies, plan hedging against exchange rate and inflation risks, and manage long-term risks in a more structured manner.