

CHAPTER V

CONCLUSION AND SUGGESTION

5.1 Conclusion

This study examined the long-run and short-run effects of four macroeconomic variables the Federal Funds Rate, the CBOE Volatility Index (VIXCLS), the USD/IDR exchange rate, and the Indonesian government bond yield on the MSCI Indonesia Index over the period January 2015 to December 2024, using the Vector Error Correction Model framework. In addition to the variable-specific findings presented below, the estimation confirms a statistically significant error correction mechanism: whenever the MSCI Indonesia Index deviates from its long-run equilibrium with these four variables, the system adjusts back toward equilibrium at a notably high speed within each monthly period, reflecting the rapid information-processing capacity of the institutional investors who dominate the index. The conclusions below are presented in the order corresponding to each of the four research questions, one for each explanatory variable.

The first conclusion confirms that the Federal Funds Rate exerts a significant negative effect on the MSCI Indonesia Index in the long run, while producing a counterintuitive positive effect in the short run. In the long-run equilibrium, sustained increases in the Federal Funds Rate are structurally associated with a lower equilibrium level of the MSCI Indonesia Index, consistent with the conventional channel through which tighter U.S. monetary policy raises the relative attractiveness of dollar-denominated assets and induces capital outflows from emerging market equities.

In the short run, however, the relationship reverses direction during the initial one- to two-month period following a change in the Federal Funds Rate. This finding is explained by the sectoral composition of the MSCI Indonesia Index, which carries substantial weight in commodity-exporting and banking-sector constituents. The early phase of a monetary tightening cycle typically coincides with robust U.S. economic growth and firming commodity prices, conditions that temporarily benefit the earnings outlook of these constituents before the contractionary transmission through capital outflows and higher discount rates fully materializes. This divergence between the short-run and long-run direction of the relationship illustrates how an index's specific sectoral composition can delay and temporarily offset the conventional transmission of external monetary policy.

The second conclusion confirms that global risk sentiment, proxied by the CBOE Volatility Index, exerts a significant negative effect on the MSCI Indonesia Index in both the long run and the short run, and stands as the single most dominant variable within the long-run cointegrating relationship. In the long run, elevated global risk sentiment is structurally associated with a depressed equilibrium level of the index, reflecting the fact that the MSCI Indonesia, as a benchmark compiled primarily for international institutional investors, is governed above all by the global risk appetite cycle rather than by domestic fundamentals alone.

In the short run, this suppressive effect is highly persistent, continuing across multiple consecutive monthly lags rather than dissipating after a single period. This persistence demonstrates that elevated global uncertainty creates a sustained environment of downward pressure on Indonesian equities, as international investors

progressively and systematically reduce their exposure to emerging market risk assets over an extended horizon. The dominance of this variable in the long-run equilibrium relationship confirms that the structural trajectory of the MSCI Indonesia Index cannot be meaningfully understood, nor reliably forecasted, without close attention to the prevailing global risk environment.

The third conclusion confirms that the USD/IDR exchange rate exerts a significant negative effect on the MSCI Indonesia Index in both the long run and the short run, consistent with the currency risk transmission channel. When the rupiah depreciates against the dollar, the index declines, reflecting the fact that dollar-based foreign investors experience compounded losses when both equity prices and currency values move adversely at the same time. This channel operates as a powerful amplifier of negative sentiment, particularly during periods when currency pressure coincides with elevated global risk conditions.

Despite the statistical significance of this relationship at both horizons, the exchange rate contributes relatively little independent explanatory power once the informational content of global risk sentiment and the domestic bond market is accounted for within the system as a whole. This indicates that currency pressure in Indonesia is itself substantially driven by the same underlying global and domestic forces already captured by the other variables in the model, rather than constituting an independent structural driver of the index in its own right.

The fourth conclusion confirms that the Indonesian government bond yield exerts a significant negative effect on the MSCI Indonesia Index in the long run, operating through a portfolio substitution mechanism, while showing a marginally positive effect

in the short run. In the long-run equilibrium, sustained increases in government bond yields are structurally associated with a lower equilibrium level of the index, as institutional investors rationally rebalance their portfolios away from equities toward the relatively more attractive fixed-income instruments, reducing demand for MSCI Indonesia constituents in a self-reinforcing crowding-out process.

Beyond its long-run structural role, the Indonesian government bond yield emerges as the single largest exogenous contributor to forecast error variance over the medium-to-long-run horizon, with its explanatory contribution increasing progressively over time rather than stabilizing or declining. This pattern confirms that the bond-equity tradeoff operates not merely as an episodic adjustment but as a structural and deepening constraint on MSCI Indonesia valuation, underscoring the growing importance of the domestic fixed-income market as a determinant of equity market dynamics over longer time horizons.

5.2 Suggestion

For investors, the study recommends adopting a tactical asset allocation approach based on VIX dynamics gradually reducing exposure to MSCI Indonesia stocks when VIX consistently stays above the level of 25 and increasing exposure as volatility subsides while avoiding automatic portfolio liquidation when the Federal Reserve raises interest rates, since the contractionary effect only materializes after a five-to-six-month lag. Investors should also monitor government bond yields as a leading indicator of portfolio rotation and integrate all four variables (VIXCLS, FFR, exchange rate, and

bond yield) into a single, unified analytical framework. For policymakers, Bank Indonesia and the Financial Services Authority (OJK) are advised to strengthen the global risk early warning system, maintain bond market stability to prevent crowding-out effects on the equity market, coordinate bond issuance schedules among the Directorate General of Budget Financing and Risk Management (DJPPR), Bank Indonesia, and OJK (including buyback programs during periods of sharp yield pressure), and periodically evaluate the level of financial integration through rolling VECM.

For academics and future researchers, the study recommends applying the Nonlinear Autoregressive Distributed Lag (NARDL) model to test for asymmetry in the long-run relationship specifically whether the impact of risk-off episodes (rising VIX) is larger than that of risk-on episodes as well as employing Time-Varying Parameter VAR (TVP-VAR) or Dynamic Conditional Correlation GARCH (DCC-GARCH) to capture changes in the strength and direction of inter-variable relationships across different economic regimes throughout 2015–2024. Future research should also conduct sectoral decomposition to better understand the natural hedging mechanism within the exchange rate transmission channel, as well as comparative studies on MSCI indices of other ASEAN countries (Malaysia, Thailand, the Philippines, and Vietnam) to determine whether the dominance of VIXCLS and Indonesia bond yield is a characteristic unique to Indonesia or a broader regional pattern