

THE IMPACT OF MONETARY POLICY ON STOCK MARKET PERFORMANCE IN NINE ASEAN COUNTRIES: THE MODERATING ROLE OF INSTITUTIONAL QUALITY

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ABSTRACT

This study examines the impact of monetary policy on stock market performance in nine ASEAN countries, while also investigating the moderating role of institutional quality. Monetary policy variables, such as interest rates, gross domestic product, and inflation rates, are analysed to determine their influence on stock market returns. Recognising the growing importance of governance and institutional frameworks in shaping economic outcomes, this study incorporates institutional quality as a moderator to assess how it strengthens or weakens the effect of monetary policy on the stock market. Using panel data from 2015 to 2023, the study employs econometric techniques including descriptive analysis, Pearson's correlation, multiple regression analysis, fixed and random effects models, and diagnostic tests to ensure robustness. Specifically, stronger institutional environments amplify the negative impact of rising interest rates on stock market performance, indicating heightened market sensitivity to policy changes. Additionally, institutional quality enhances the positive effect of GDP and reduces the influence of inflation on stock returns. These findings underscore the critical role of institutional strength in shaping the effectiveness of macroeconomic policy on financial markets, offering valuable insights for policymakers and investors in emerging economies.

Keywords: *Monetary Policy, Stock Market Performance, Institutional Quality, ASEAN Countries*

INTRODUCTION

According to macroeconomic theory, monetary policy controls inflation and stimulates economic growth by changing macroeconomic variables such as interest rates, money supply, and GDP levels. As a result, it can help reduce inflation while fostering long-term economic growth. Inflation is a broad, long-term increase in the cost of goods and services. Monetary policy allows central banks to regulate bank reserves, alter benchmark interest rates, and interfere in financial markets to control inflation. The key goal of economic policy is stable and sustained growth, and monetary policy plays a crucial role in achieving it (Wahyudin, 2025).

Stock markets are often influenced by government actions, especially monetary policy, which has been shown to raise stock prices in 18 of 19 countries studied. During recessions, more assertive monetary and fiscal measures are adopted to support growth. These actions boost investor confidence, stabilise markets, and often lead to bull runs. As a result, counter-cyclical policy-driven stock price increases are more common in downturns. Such policies not only aid recovery but also stimulate broader economic activity (Baker et al., 2022).

Policymakers must strengthen institutional frameworks to fully benefit from trade and policy tools. Trpeski et al. (2024) emphasise that strong institutions are key to sustainable growth by enhancing long-term gains from commerce, education, and finance. By protecting property rights, reducing corruption, and promoting investment, institutions support both short- and long-term growth. In addition, modern databases and analytical tools can improve understanding of institutional dynamics and their interaction with market forces and policy, contributing to economic strength and societal prosperity.

Association of Southeast Asian Nations (ASEAN), which includes Brunei, Cambodia, Laos, Myanmar, Vietnam, Indonesia, Thailand, Singapore, Malaysia, and the Philippines, mainly uses monetary targeting to reduce inflation. Over time, these nations have improved their policy frameworks to address emerging economic issues. Given the role of monetary policy in maintaining price stability, its importance continues to grow in promoting long-term prosperity across this diverse economic region. Despite these efforts, ASEAN economies must enhance resilience to shocks by adopting responses that absorb or neutralise both external shocks like global market shifts, trade disruptions, and financial instability, and internal ones, such as inflation (Nookhwun & Waiyawatjakorn, 2024).

Monetary policy has a significant impact on economic conditions and financial markets, particularly stock market performance. Central banks implement monetary policy primarily through interest rate adjustments, which directly affect borrowing costs, investment decisions, and overall economic activity (International Monetary Fund, 2023). Monetary policy plays a vital role in stabilising economies by influencing inflation, interest rates, and liquidity conditions (Suhaibu et al., 2017). At a global level, major economies such as the United States significantly impact monetary policy trends worldwide, and U.S. monetary policy is one of the drivers of the Global Financial Cycle (Miranda & Rey, 2020). The Federal Reserve's monetary decisions, particularly regarding interest rate adjustments, influence capital flows, exchange rates, and stock market performance globally (Miranda & Rey, 2020). For instance, the 2008 Global Financial Crisis led to unprecedented monetary easing in the U.S., prompting central banks worldwide, including those in ASEAN-5 (Indonesia, Thailand, Singapore, Malaysia, and the Philippines), to adopt accommodative policies to stabilise their economies (Peiris et al., 2016).

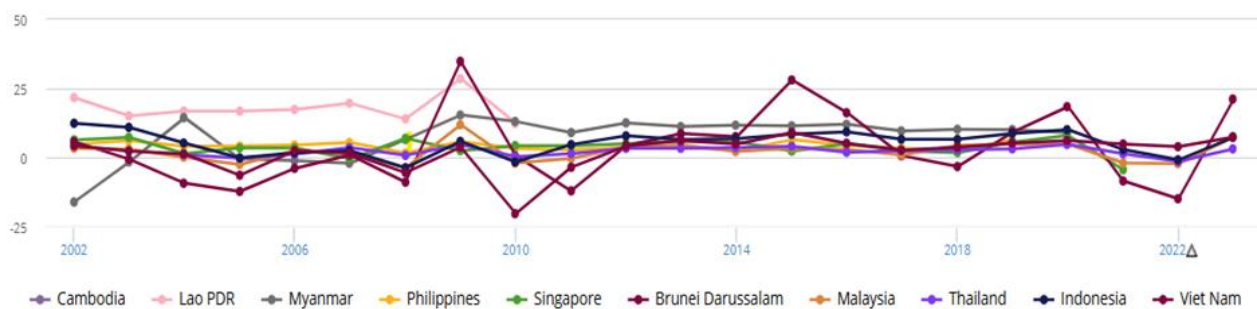


Figure 1: Real Interest Rate ASEAN (2002–2023)
Source: World Development Indicators

Interest rate trends across ASEAN economies reflect diverse monetary policy approaches shaped by institutional maturity, economic development, and exposure to global shocks. Indonesia experienced substantial volatility, with real interest rates peaking at 12.3% in 2002 and declining to -1.0% in 2022, indicating countercyclical policy shifts. Malaysia maintained moderate fluctuations, balancing growth and inflation through a flexible post-crisis framework. The Philippines and Thailand demonstrated relatively stable trends, consistent with inflation-targeting strategies, while Singapore's exchange rate-based policy also resulted in

notable rate shifts (from 7.2% in 2003 to -4.5% in 2020) due to global inflation pressures. In less-developed ASEAN countries, monetary volatility was more pronounced. Brunei and Lao PDR recorded extreme rate fluctuations driven by commodity dependence and macroeconomic imbalances. Myanmar's rates ranged from -16.3% to persistent double-digit positives, signalling structural monetary challenges. Vietnam experienced severe misalignments before stabilizing in recent years. Data gaps in Cambodia underscore limitations in financial transparency. Overall, these patterns highlight the central role of monetary policy in ensuring macroeconomic stability, while underscoring the need for deeper institutional and financial development across the region.

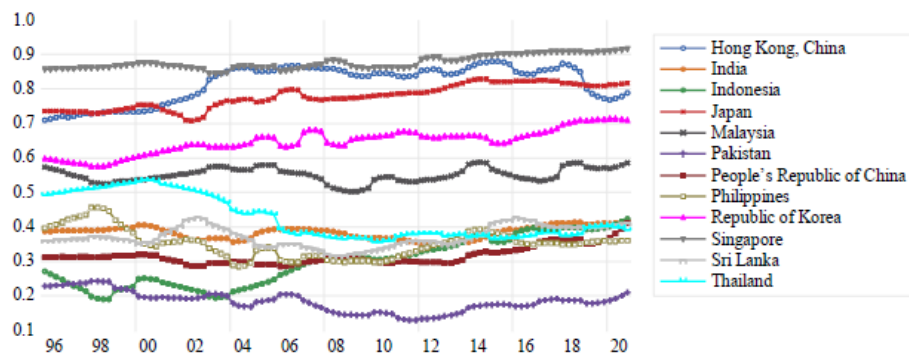


Figure 2: Institutional Quality Index of Asian Economies
Source: Beime & Panthi (2022)

Figure 2 shows institutional quality levels across Asian economies from 1996 to 2020 (Beime & Panthi, 2022). Singapore consistently ranks highest, driven by strong governance, regulatory efficiency, and low corruption. This institutional strength boosts investor confidence, enhances stock market transparency, ensures equal access to information, and standardises fees and regulations (Shi et al., 2019). In contrast, ASEAN countries like Malaysia, Indonesia, the Philippines, and Thailand face institutional challenges, such as political instability, weak regulatory enforcement, and corruption, that undermine investor confidence and hinder effective policy implementation, negatively affecting stock market performance (Khan et al., 2023). The 2024 Corruption Perceptions Index (CPI) for Asia-Pacific reveals that many governments are struggling to combat corruption, particularly amid the growing climate crisis, which demands greater transparency and accountability (Mohamed et al., 2025). While Singapore remains a model of political stability and economic success, it faces concerns over rising income inequality and civil liberties (Hutagalung, 2025). Indonesia, despite being the region's largest democracy, deals with political fragmentation and vulnerability to radical ideologies. Malaysia, though benefiting from a unity government, still grapples with corruption, economic disparities, and emerging cyberterrorism threats. These dynamics highlight the pivotal role of institutional quality and governance in shaping resilient stock market performance across ASEAN.

Monetary policy plays a crucial role in shaping economic stability and stock market performance, particularly in ASEAN economies (Peiris et al., 2016; Corbacho & Peiris, 2018). Despite the adoption of frameworks like inflation targeting in Indonesia, Thailand, and the Philippines, and exchange rate-based approaches in Malaysia and Singapore, policy effectiveness remains inconsistent (Juhro et al., 2021). Events like the 2008 Global Financial Crisis revealed structural weaknesses that limit monetary responsiveness (Nasution et al., 2022). Real interest rate fluctuations across ASEAN highlight challenges in maintaining monetary stability amid global financial pressures. Although monetary policy targets inflation

and growth, its impact on stock markets remains unclear due to differing institutional qualities, financial development, and resilience.

Institutional quality is essential for market stability, but disparities exist in ASEAN. Singapore's strong governance fosters investor confidence and market stability, while other nations like Malaysia, Indonesia, the Philippines, and Thailand struggle with instability, weak enforcement, and corruption (Shi et al., 2019). These issues create uncertainty, deter FDI, and affect market performance. The 2024 CPI underscores corruption's persistence, weakening governance, and transparency (Mohamed et al., 2025). While monetary policy influences sentiment and capital flows, its success depends on institutional strength. Strong institutions ensure smoother policy transmission, whereas weak ones amplify volatility. Despite their critical link, how institutional quality moderates the monetary policy–stock market relationship in ASEAN remains underexplored. In short, this paper aims to answer what the impact of monetary policy is on stock market performance in ASEAN countries. And how does institutional quality moderate the relationship between monetary policy and stock market performance in ASEAN countries?

LITERATURE REVIEW

Monetary Policy

Monetary policy refers to the techniques and measures used by a country's central bank to control the supply of money, interest rates, and inflation in order to ensure financial market stability and long-term economic growth (Martin et al., 2022). This enables the central bank to react swiftly to any shifts in the financial and economic landscape (Singh, 2023). To preserve economic stability, central banks employ several monetary policy instruments, including interest rate setting, open market operations, reserve requirements regulation, credit policy, and currency policy. Interest rate setting is a primary instrument through which a central bank alters benchmark rates to influence borrowing costs and the performance of an economy. An increase in rates becomes an instrument to suppress inflation, while a decrease in rates promotes economic growth through less attraction of savings and investments. Korkor et al. (2024) explained that open market operations are another instrumental manifestation through which a central bank affects purchases or sales of government securities as a means of regulating the money supply and liquidity in any given economy, which will also influence short-term interest rates. The regulatory requirements for reserves deal with the minimum reserves held by banks, hence controlling their maximum ability to lend on these reserves while influencing credit availability at large. Monetary policy furthers policies that direct economic activity. Through targeted credit, central banks can lend directly to approved sectors while using credit arrangements to impose constraints on lending by commercial banks to maintain financial stability. Likewise, currency policy includes interventions by the central bank in the foreign exchange market aimed at affecting exchange rates and thereby stabilising inflation and economic competitiveness (Wahyudin, 2025).

Aliu (2022) and Martin et al. (2022) explained that monetary policy may be either expansionary or contractionary. An expansionary strategy is decreasing interest rates and increasing the money supply to stimulate economic activity by lowering borrowing costs, which can increase the value of stocks and bonds and, as a result, improve capital market performance. In contrast, contractionary policy entails raising interest rates and decreasing liquidity to control inflation by making borrowing more expensive, which may have a negative impact on stock prices and undermine capital markets (Judijanto et al., 2024). As interest rates rise, the increased cost of borrowing can discourage investment and spending, which leads to a decline in stock returns and overall market performance. Likewise, Sousa (2010) pointed out

that due to a contractionary shock, investors may shift their investments from the stock market to safer assets, which would cause an enormous drop in stock market values. Recent research by Cobbinah et al. (2024) supports these theoretical perspectives, revealing that higher interest rates in Ghana significantly impact stock market performance. This observation underscores the sensitivity of stock markets to adjustments in monetary policy, especially the fluctuations in borrowing costs and the adverse effects of contractionary monetary policy. The degree of uncertainty that economic agents face has an indirect impact on the factors that determine dividends and the stock return premium, while studies conducted in African nations have also demonstrated that monetary policy influences stock values by directly influencing the cost of capital and investment decisions (Suhaibu et al., 2017).

Moreover, monetary policy works closely with the stability of the financial system. Central banks have a duty to maintain and protect the smooth functioning of financial markets and the banking system from undue risks. Hence, another aspect of monetary policy is overseeing and regulating financial institutions to avoid financial crises, which could threaten the economy's stability in general (Nair & Anand, 2020). Based on the research of Schäfer and Semmler (2024), the scholars found that monetary policy becomes a vital public policy in times of crisis, especially when economic conditions are uncertain. In such situations, central banks usually adopt a monetary policy to stimulate the economy or, on the contrary, reduce overall lending in the market. Using this approach can accelerate economic recovery and reduce the impact of fiscal or economic crises. However, it also has disadvantages. For example, strict interest rate increases tend to control high inflation, which in turn reduces capital expenditures and consumption, slowing growth (Schäfer & Semmler, 2024).

The influence of monetary policy on stock markets might differ from one economy to another due to differences in financial market structure and growth. According to research by Lee and Choi (2023), developed countries like the UK's stock markets react more immediately and strongly to interest rate changes because of their well-established financial systems, highly efficient markets, and open financial markets. Conversely, in emerging countries such as China, money supply growth typically exerts a greater influence on property prices compared to fluctuations in interest rates due to their regulatory environment, where the Chinese government often uses monetary policy to regulate money supply (Zhou et al., 2023). This governmental oversight directly affects the money supply and the liquidity available for property investments, which leads to volatility in the market.

Stock Market Performance

Stock markets have played a pivotal role in driving economic growth and attracting investments. According to Jain (2024), stock market performance refers to the evaluation of a stock market's overall health and efficiency, typically assessed through indicators such as stock price indices, market capitalisation, trading volume, and valuation metrics like price-to-earnings ratios. These measures collectively provide insights into investor confidence, market liquidity, and the broader economic outlook.

Stock market returns are significantly shaped by macroeconomic factors. Jamaludin et al. (2017) looked at how currency rates, inflation, and the money supply affected the returns on conventional and Islamic stock markets in Singapore, Malaysia, and Indonesia between 2005 and 2015. Their results show that both inflation and exchange rates have a major impact on stock market returns, with inflation having a stronger negative impact. This suggests that higher inflation rates can erode investment returns, underscoring the importance of stable monetary policies to foster robust capital markets (Jamaludin et al., 2017). Similarly, Nasser et al. (2017) investigated the correlation between macroeconomic factors, including GDP, interest

rates, inflation rates, exchange rates, and unemployment rates, and stock indices in five ASEAN nations. The strong substantial correlations between key macroeconomic indicators and stock indices were found by the study using generalised least squares regressions, underscoring the complex link between market performance and economic fundamentals.

In addition to macroeconomic variables, institutional frameworks and governance quality have a big impact on stock market dynamics. Jumaah et al. (2023) conducted a more recent study that looked at the relationship between governance quality parameters and stock market performance in ASEAN exchanges between 2002 and 2020. According to Jumaah et al. (2023), they found that aspects like voice and accountability, as well as political stability, positively impact stock market performance. Conversely, the rule of law exhibited a negative effect, suggesting a complex relationship between legal frameworks and market outcomes. These results suggest that in integrated markets, better governance improves stock market performance. In a more recent study, Shi et al. (2019) looked into how the development and volatility of the stock markets in ASEAN plus three countries were affected by institutional quality factors as regulation, government size, sound money, and trade flexibility. Their investigation, which covered data from 1991 to 2014, showed that strong institutional frameworks successfully lower price volatility in addition to fostering stock market development. This emphasises how important it is to have stable regulatory frameworks in order to maintain market stability.

Institutional Quality

The strength and efficacy of a nation's institutions in influencing market stability, governance, and economic performance is referred to as institutional quality. Kaufmann et al. (2011) state that a number of factors, such as voice and accountability, political stability and the absence of terrorism or violence, rule of law, government effectiveness, regulatory quality, and corruption control, are used to gauge the quality of an institution.

Voice and Accountability (VA) reflects citizens' ability to participate in governmental processes and enjoy freedoms such as expression and association, as well as access to an independent media (Kaufmann et al., 2011). Jumaah et al. (2023) report that higher levels of voice and accountability correlate positively with stock market performance. Their findings suggest that participatory governance and media freedom can enhance market confidence, promote transparency, and attract investment. In contrast, Boadi and Amegbe (2017) found that VA has a negative impact on equity indices in both high-income and lower-middle-income countries. Their interpretation implies that increasing civil liberties and democratic engagement may introduce policy uncertainties or regulatory interventions that deter investors in certain economic groups. Similarly, a substantial inverse association between VA and stock market success was shown by Modugu and Dempere (2020), who focused on the Gulf Cooperation Council (GCC) nations. They contend that extending civil liberties could upset the perceived stability and predictability of the market environment in areas where markets are often impacted by centralised authority. These contradictory results suggest that VA's impact on financial performance can vary depending on the situation and be impacted by larger political and economic systems.

According to Kaufmann et al. (2011), Political Stability and Absence of Violence/Terrorism (PV) evaluates the likelihood of political violence or governmental instability. In general, empirical research indicates that political stability and stock market performance are positively correlated. Alim et al. (2024), for example, discovered that political stability in Pakistan considerably boosts stock market returns and lowers volatility. The study highlights how a secure political environment reassures investors, lowers risk premiums, and

fosters sustainable market activity. Similarly, Mai et al. (2023) concluded that political stability in Pakistan boosts investor confidence and facilitates foreign capital inflows, both of which are crucial for stock market development. These findings emphasise the importance of a stable political climate in enhancing investor trust and supporting robust market performance, especially in emerging economies.

Rule of law (RL) refers to the efficacy of judicial institutions, the protection of property rights, and the application of the law (Kaufmann et al., 2011). Savari et al.'s (2023) research shows that gains in regulatory quality and the rule of law have a beneficial impact on stock market returns in Iran and a few other emerging nations. Khan and Siddiqui (2017) support this approach, finding a direct positive correlation between RL and stock market performance. They contend that institutional integrity and law enforcement improve investor protection and lower transaction risks. However, Jumaah et al. (2023) offer a counter perspective, noting a negative effect of RL on market performance. This could suggest that stringent legal environments, particularly if coupled with rigid compliance requirements or overregulation, might hinder entrepreneurial freedom or increase operational costs for firms, thereby deterring investment.

Government Effectiveness (GE) assesses the legitimacy of government policies, the independence of the bureaucracy from political influences, the ability of civil servants, and the quality of public services (Kaufmann et al., 2011). According to Hooper et al. (2009), countries with effective institutional frameworks and well-executed governmental programs typically see better stock market returns. Similarly, Low et al. (2015) highlighted that GE plays a more significant role in reducing equity market risk in developing economies compared to developed ones, as weaker institutions in emerging markets often result in greater financial uncertainty and volatility. Moreover, Destek et al. (2023) discovered that while government effectiveness negatively impacts real Gross Domestic Product (GDP), it significantly contributes to economic growth in the Middle East and North Africa (MENA) region. Governments that lack effectiveness may implement inconsistent or poorly designed policies, creating an unpredictable economic environment. This uncertainty can discourage both domestic and foreign investment, ultimately hindering GDP growth.

Regulatory Quality (RQ) The ability of a government to develop and implement efficient laws and rules that support the expansion of the private sector, uphold economic stability, and improve market efficiency (Kaufmann et al., 2011). Using a pooled mean group model, Umar and Nayan (2018) empirically examined the impact of regulatory quality on the growth of African stock markets between 1996 and 2016. Their findings suggest that effective rules have a positive impact on the development of the stock market. Savari et al. (2023) also found that improving RQ had contributed to higher stock market returns. A well-structured regulatory framework, particularly in the economic and financial sectors, enhances investor trust and confidence by ensuring that business and trade laws are transparent, consistent, and easy to interpret. This reduces the risk of regulatory ambiguity and multiple interpretations of the same rule, creating a more stable and predictable investment environment (Savari et al., 2023). Stock market performance is improved by a robust regulatory framework backed by accountability in governance and an effective administrative system (Manasseh et al., 2017). By minimising unpredictability and ensuring fair market practices, an efficient regulatory system creates a stable and attractive environment for investors, ultimately leading to better stock market performance.

Control of corruption is the degree to which elites and commercial interests capture control of the state and exploit public authority for their own benefit, including both major and minor forms of corruption (Bolgorian, 2011). Corruption is a global problem that hinders economic growth and discourages investment (Bolgorian, 2011). Studies conducted in Tunisia highlight how poor institutional quality and the perception of corruption negatively affect

business performance, causing instability that impedes economic growth (Kırşanlı, 2023). These results demonstrate how urgently governance reforms are needed to fortify institutions and fight corruption, which will ultimately create a more favorable business climate. Hassouna and Lewaaelhamd (2025), investor confidence, which is essential for preserving a company's market value, can be seriously damaged by the perception of corruption. Investors may consider companies to be high-risk investments when corruption is perceived as pervasive, which could result in a drop in market capitalisation and stock prices (Hassouna & Lewaaelhamd, 2025). In a similar vein, Kurniawati and Achjari (2022) discovered that companies that operate in areas where corruption is seen to be prevalent typically have lower accounting quality, which can lead to exaggerated profit reports and a skewed portrayal of financial health.

Theoretical Framework

Institutional Theory, has been published by Meyer & Rowan (1977), highlighted how institutional factors influence organisational behaviour (Pamela, 1999). According to Scott et al. (2005), institutions are robust social structures that use cultural-cognitive, normative, and regulative components to give social life stability and purpose. This idea was used by Jumaah et al. (2023) in their study to investigate how governance quality affects ASEAN stock market performance. Institutional Theory posits that institutions (comprising rules, norms, cultures, laws, and regulations) are fundamental in shaping economic behaviours and outcomes. In the context of stock markets, this theory suggests that a robust institutional and regulatory environment is crucial for market existence and efficiency. Effective governance structures can enhance investor trust, thereby influencing their participation levels and impacting overall market performance. Applying Institutional Theory enables an examination of how the relationship between monetary policy and stock market performance is moderated by differences in institutional quality, such as regulatory frameworks, rule of law, and governance effectiveness. As an illustration of the significance of institutional quality in financial markets, Jumaah et al. (2023) found that governance measures such as political stability and accountability had a beneficial impact on stock market performance.

Asset Pricing Theory has been developed through contributions from various economists, with foundational models like the Capital Asset Pricing Model (CAPM) introduced by William F. Sharpe (1964) (Sharpe, 1964). Using this hypothesis, Bui (2015) investigated how changes in the stock market and monetary policy are related. The theory of asset pricing looks at how the intrinsic risks and expected returns are used to determine the value of securities. It implies that monetary policy can affect enterprises' cash flows and the discount rates used for those cash flows, which in turn can affect stock prices. Bernanke and Kuttner (2005) elaborated that expansionary monetary policy enhances firms' access to credit, enabling them to undertake profitable projects, thereby increasing expected cash flows. Conversely, contractionary policy restricts credit access, potentially reducing cash flows and increasing economic volatility. The application of asset pricing theory makes it easier to comprehend how monetary policy influences stock market performance. This theory clarifies the direct routes of monetary policy transmission to stock prices by analysing how shifts in the money supply and interest rates affect the cash flows of businesses and the returns that investors need. Bui (2015) emphasized that monetary policy has a substantial impact on stock prices by influencing investor discount rates as well as the anticipated cash flows of businesses.

Hypothesis Development

Monetary Policy and Stock Market Performance

Several studies have examined the link between monetary policy and stock market performance and have come to different conclusions. Monetary policy significantly influences stock market performance, with interest rate changes impacting asset prices and investment decisions. Juhro et al. (2021) found that contractionary monetary shocks lower real stock values, while financial markets react differently to global risks and policy expectations. Ooi and Lau (2020) showed that gradual U.S. interest rate hikes positively affect ASEAN equity and currency markets, while bond markets benefit more from stable expectations. Sharif et al. (2025) highlighted the interconnectedness of monetary policy and stock markets, emphasising its crucial role in economic growth and investor confidence. King (2023) further demonstrated that risk premiums, cash flow expectations, and monetary interventions shape stock prices, preventing severe market downturns. Another study conducted by Alugbuo and Chika (2020) indicated that lending interest rates and the wide money supply have a significant impact on stock market performance in Nigeria than consumer price indexes and Treasury bill rates. Thus, the following research hypothesis was developed:

H₁: Monetary policy significantly affects the stock market performance.

Institutional Quality, Monetary Policy and Stock Market Performance

It is also anticipated that the relationship between monetary policy and stock market performance will be moderated by institutional quality. The way that institutional quality, especially in ASEAN, moderates the relationship between monetary policy and stock market performance is not well supported by empirical data. Therefore, the impact of monetary policy on stock market outcomes can be either strengthened or weakened by the quality of the institutions (Hooper et al., 2009; Khan et al., 2023). Using the dynamic system generalised method of moments (GMM), Ali et al. (2022) found that the relationship between resource rent and stock market performance is positively moderated by institutional quality. It has been demonstrated that the negative impacts of fiscal policy on financial development are mitigated by institutional quality (Okine et al., 2023). According to the findings, governments might slash taxes and possibly boost the economy by reducing spending, all the while offering incentives and easing the tax burden on the manufacturing and industrial sectors. Additionally, Hunjra et al. (2020) discovered that the detrimental effects of financial development, energy consumption, and economic expansion on environmental sustainability are mitigated by institutional quality. Islam et al. (2020) found that the relationship between financial development and foreign direct investment is significantly influenced by the moderating function of institutional quality. These observations emphasise how crucial institutional changes are to guaranteeing that financial progress successfully converts into more investment. Thus, the following research hypothesis was developed:

H₂: Institutional quality strengthens the relationship between monetary policy and stock market performance.

Research Framework

According to the earlier research, Lin et al. (2021) discovered that institutional quality significantly and favorably impacted Malaysia's stock market performance. However, only one country is the subject of the scant study that explicitly examines the direct impact of institutional excellence. In order to investigate the connection between monetary policy and the stock market, Ugurlu-Yildirim et al. (2020) used just one technique, the non-linear autoregressive distributed lag (NARDL) approach. The study found that, both in the short and

long term, investor sentiment and monetary policy uncertainty have a considerable and dramatic impact on the stock market. Previous studies mainly focus on countries with similar monetary policy frameworks, limiting the understanding of diverse policy regimes (Iddrisu et al., 2016). Cross-sectional dependence test results suggest high correlation across panels, indicating a lack of research on economies with distinct monetary strategies. In ASEAN, where monetary policies vary, the impact on stock market performance remains underexplored. Furthermore, previous research looks at how monetary policy affects inflation and economic growth, but it ignores how institutional quality influences stock market results. By examining the relationship between institutional quality and the impact of monetary policy on ASEAN stock market performance, this study fills these gaps.

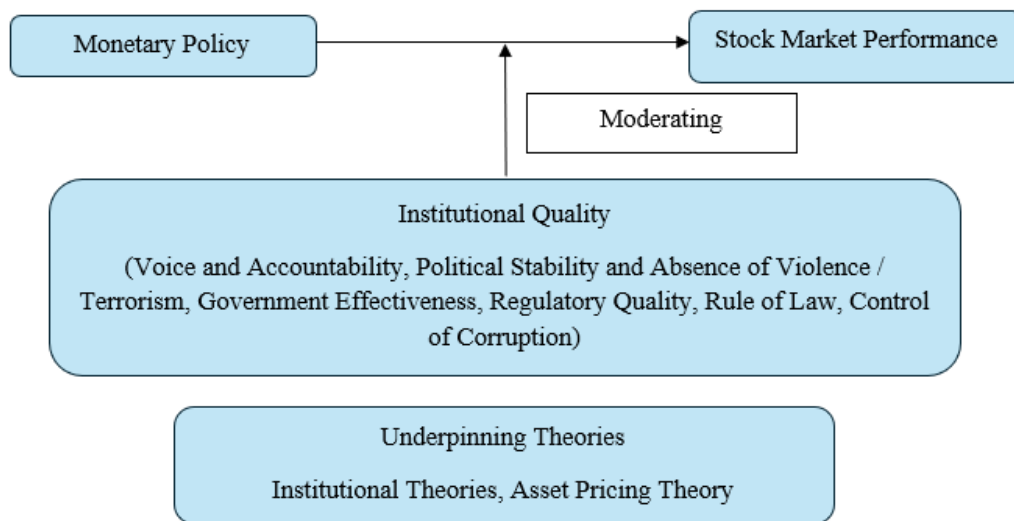


Figure 3: Research Framework

METHODOLOGY

Sample and Methodology

This study focuses on the ASEAN countries and is selected due to their active stock markets and represents diverse monetary policy regimes, ranging from inflation targeting frameworks to interest rate management. This study adopts a quantitative research design, relying on quantifiable data and statistical techniques to test hypotheses and assess connections between variables. The data used in this study are secondary in nature, gathered from credible sources such as the World Bank Database, International Monetary Fund (IMF) and CEIC database. The utilisation of secondary data guarantees that credible macroeconomic indicators and consistent time-series information are available throughout the ASEAN countries. The study comprises 10 10-year samples with an annual period from 2015 to 2023, allowing it to represent long-term economic patterns and record the influence of important global events such as the COVID-19 pandemic in 2020.

Dependent Variables

The dependent variables for this research focus on stock market performance in ASEAN countries. Stock market performance reflects the annual return of each country's main stock market index, indicating the market behaviour. To measure the stock market performance, this research will use the stock market return by calculating the percentage changes in the stock market performance index (Kelvin, 2019). Stock market performance index will be collected

from the stock exchanges through CEIC, including the Jakarta Stock Exchange Composite Index (JCI), Laos Stock Exchange Index, Cambodia Stock Exchange Index, Ho Chi Minh Stock Exchange index (HOSE), Kuala Lumpur Composite Index (KLCI), Straits Times Index (STI), Stock Exchange of Thailand (SET), Yangon Stock Exchange Index, and the Philippines Stock Exchange Index (PSEI). Notably, Brunei Darussalam is excluded from the sample as it does not have an active stock market. The annual return on these indices reflects the overall direction and health of each country's stock market.

Independent Variables

Monetary policy, which refers to the measures used by a nation's central bank to affect economic activity through interest rate and liquidity control, is the independent variable. The GDP growth rate, interest rate, and inflation rate are the three main macroeconomic indicators that make up the independent variables. The GDP growth rate, which is calculated as the yearly percentage change in real Gross Domestic Product, is used to quantify overall economic activity and expansion (Suhaibu et al., 2017). The interest rate, which influences the cost of borrowing and investing, is the policy or lending interest rate that is determined by the central bank of each nation (Alugbuo & Chika, 2020). Finally, price stability and purchasing power are reflected in the inflation rate, which is determined by the annual percentage change in the Consumer Price Index (CPI) (Bengana et al., 2024).

Moderator Variables

The moderating variable is institutional quality, which influences the strength and credibility of a country's policies, environment and governance. It is measured using selected indicators from the World Bank's Worldwide Governance Indicators (WGI), including voice and accountability, political stability and absence of violence or terrorism, government effectiveness, regulatory quality, rule of law, and control of corruption. This study employs Principal Component Analysis (PCA) to construct a composite Institutional Quality Index by combining six governance indicators. PCA reduces dimensionality and captures the most significant common variation among these indicators, allowing the first principal component to represent the overall institutional quality across ASEAN countries.

Data Analysis and Diagnostic Test

This study uses a variety of statistical methods to investigate the connection between ASEAN stock market performance, institutional quality, and monetary policy to meet its goals. Descriptive analysis, multiple regression analysis, and Pearson's correlation analysis are the three primary techniques used in the analysis. The purpose of descriptive analysis is to give a broad picture of the data's properties, including each variable's mean, standard deviation, minimum, and maximum values. The linear relationship between variables, namely between monetary policy indicators, institutional quality, and stock market performance, is examined using Pearson's correlation analysis (Kuzey et al., 2020). Before regression analysis, the correlation coefficient, which ranges from -1 to +1, helps identify any multicollinearity problems by indicating the direction and intensity of the link.

Full Model 1

$$SMP_{it} = \beta_0 + \beta_1 GDP_{it} + \beta_2 INTR_{it} + \beta_3 INF_{it} + \varepsilon_{it}$$

Whereby,

SMP = Stock Market Performance

GDP = GDP growth rate

$INTR$ = Interest Rate
 INF = Inflation Rate
 β_0 = Constant
 ε_{it} = Error Term of the model

Full Model 2

$$SMP_{it} = \beta_0 + \beta_1 GDP_{it} + \beta_2 INTR_{it} + \beta_3 INF_{it} + \beta_4 IQ_{it} + \beta_5 (GDP * IQ)_{it} + \beta_6 (INRT * IQ)_{it} + \beta_7 (INF * IQ)_{it} + \varepsilon_{it}$$

Whereby,
 SMP = Stock Market Performance
 GDP = GDP growth rate
 $INTR$ = Interest Rate
 INF = Inflation Rate
 IQ = Institutional Quality
 β_0 = Constant
 ε_{it} = Error Term of the model

Both fixed effects and random effects models will be used to account for unobservable heterogeneity across nations due to the panel form of the data (ASEAN countries across time). The random effects model makes the assumption that these variations are random and unrelated to the explanatory variables, whereas the fixed effects model takes into consideration country-specific factors that can affect the dependent variable. To decide which of the fixed and random effects models is best, the Hausman Test will be used. Furthermore, diagnostic tests like the serial correlation, heteroscedasticity, and normality tests will be used to make sure the regression results are reliable and valid. In addition to ensuring that the assumptions of classical linear regression are met, these tests aid in identifying possible problems in the model.

EMPIRICAL FINDING AND DISCUSSION

Descriptive Analysis

This section presents the descriptive statistics of all variables used in the study to provide a general overview of the data characteristics. It includes the number of observations, mean, standard deviation, minimum, and maximum values for each variable, allowing for a better understanding of their distribution, central tendency, and variability.

Table 1: Descriptive Statistical Analysis

Variables	Obs	Mean	Std.Dev	Min	Max
SMP	79	0.537	18.681	-57.222	89.124
GDP	81	3.945	4.116	-12.016	9.691
INTR	81	8.292	3.651	3.06	16
INF	81	4.016	5.749	-1.139	31.23
IQ	81	0	2.163	-3.987	5.107

The descriptive results highlight noticeable variation across the economic indicators examined. Stock Market Performance (SMP) shows a high level of volatility, with values ranging from a low of -57.222 to a high of 89.124, and a relatively low average of 0.537, indicating frequent fluctuations in market activity. The Gross Domestic Product (GDP) records an average of 3.945,

with a broad spread from -12.016 to 9.691, suggesting alternating periods of economic decline and growth. Interest rates (INTR) average 8.292 and fall between 3.06 and 16, reflecting a generally high and unstable interest rate environment. Inflation (INF) also exhibits substantial variation, with a mean of 4.016 and a maximum value of 31.23, signalling occasional spikes in price levels. Meanwhile, the IQ variable is likely a standardised measure of economic or institutional quality, centred around zero with moderate dispersion, indicating relatively balanced but varying conditions across the dataset.

Pearson Correlation Coefficient

This section presents the correlation matrix to examine the strength and direction of the linear relationships between the key variables in the study. The analysis helps to identify potential associations among GDP, interest rate, inflation, institutional quality, and stock market performance. The correlation matrix reveals key interactions among the variables. A moderately strong and statistically significant positive relationship is observed between interest rates and inflation ($r = 0.449$, $p < 0.01$), which is consistent with traditional economic expectations that higher inflation prompts an increase in interest rates. In contrast, a notable negative correlation exists between interest rates and IQ ($r = -0.6560$), suggesting that as borrowing costs rise, economic or institutional quality tends to decline. Other correlations, such as between SMP and GDP ($r = 0.1780$) or SMP and inflation ($r = 0.1639$), are relatively weak and not statistically significant. These results imply that, within this sample, the stock market is not strongly tied to the broader macroeconomic variables under review.

Table 2: Matrix of Correlation

Variables	SMP	GDP	INTR	INF	IQ
SMP	1.0000				
GDP	0.1780	1.0000			
INTR	-0.1325	0.0451	1.0000		
INF	0.1639	-0.0161	0.449**	1.0000	
IQ	0.0375	-0.0317	-0.6560**	-0.4010**	1.0000

**significant at 0.01(2-tailed)

Regression Analysis

After conducting the Breusch-Pagan LM test and the Hausman test, the results indicated that the Pooled OLS (POLS) model was more appropriate than the Fixed or Random Effects models for this study. Diagnostic tests were performed to ensure the reliability of the POLS estimation. The multicollinearity test showed no severe correlation among the independent variables. Additionally, heteroskedasticity and serial correlation were detected, and therefore, robust standard errors were applied to correct for these issues. As a result, the final regression results are based on the POLS model with heteroskedasticity- and autocorrelation-consistent standard errors.

Table 3: Regression Result for Monetary Policy, Institutional Quality and Stock Market Performance

Variables	(Model 1)	(Model 2)
GDP	0.853 (0.520)	0.731 (0.495)
INTR	-1.391* (0.643)	-0.160 (0.342)
INF	0.914	1.216**

	(0.580)	(0.473)
IQ		-7.255**
		(2.556)
GDPIQ		0.334
		(0.182)
INTRIQ		1.036**
		(0.378)
INFIQ		-0.0162
		(0.0760)
Constant	4.907	-0.962
	(5.965)	(3.875)
Observations	79	79
R-squared	0.114	0.187
F-statistics	8.204	26.000
Prob > F	0.008	0.000

Robust standard errors in parentheses

*** p<0.01, ** p<0.05, * p<0.1

Two models were estimated to empirical results on how monetary policy affects stock market performance in ASEAN countries. Model 1 captures the direct relationship between monetary indicators and stock market performance, while Model 2 examines the moderating role of institutional quality. In Model 1, the regression shows that the interest rate (INTR) has a statistically significant and negative impact on stock market performance, with a coefficient of -1.391 and significance at the 10% level. This indicates that when interest rates increase, stock market returns tend to decline. This finding is consistent with Asset Pricing Theory, which suggests that higher interest rates raise the discount factor used by investors, reducing the present value of future cash flows and, consequently, stock prices (Sharpe, 1964; Fama, 1970). The inflation rate (INF), with a coefficient of 0.914, is positive but not statistically significant at conventional levels in Model 1. This suggests a possible, though inconclusive, trend where moderate inflation may be linked to improved market returns, potentially reflecting underlying economic growth and demand. The GDP growth rate (GDP) of 0.853 in model 1 shows a positive relationship with stock market performance, though it is not statistically significant. Nonetheless, this trend implies that higher economic growth tends to support stronger market returns, consistent with findings by Jain (2024) and Jamaludin et al. (2017).

In Model 2, a linear regression analysis was performed to assess the moderating role of institutional quality in the relationship between monetary policy and stock market performance. The results indicate that Model 2 with interaction terms is better than Model 1, given that its R-squared value is 0.187 compared to an R-squared value of 0.114 for Model 1, which implies that approximately 18.7% of the variation in stock market performance can be explained by Model 2. Additionally, Model 2 was statistically significant overall, with an F-statistic value of 26.000 and a p-value less than 0.001. The inclusion of institutional quality as a moderator greatly enhanced the model's predictive strength and further confirms the argument that the relationship between monetary policy and stock market performance is influenced by institutional quality.

Among the main effects, the inflation rate (INF) exerts a positive and statistically significant effect on stock market performance (SMP), evidenced by a coefficient of 1.216 and a p-value of 0.033, which is critical at the 5% significance level. In this regard, the ASEAN region demonstrates the notion that moderate inflation levels indicate strong economic performance, which in turn stimulates stock market investments. Meanwhile, GDP is found to have a small positive impact on SMP, but it is not influential at any significance level. The

independent effect of interest rates (INTR) is statistically negligible, as evidenced by its coefficient of 0.160 and a p-value of more than 0.05. This shows that interest rates alone do not consistently have a detrimental impact on SMP. Moreover, at the 5% significance threshold, the sole impact of the institutional quality index (IQ) on SMP is significant and negative, with a coefficient of 7.255. This supports Habib et al. (2023), who noted a negatively correlated relationship between institutional quality and stock returns in emerging and developing economies. Their study concluded that underdeveloped or overly stringent institutions with inefficiencies and high transaction costs may diminish investor participation and market efficacy. This supports the interpretation that while tighter regulatory environments may improve stability in the market, they could also potentially depress market reactions, resulting in lower stock market returns.

Conversely, the interaction term between interest rate and institutional quality (INTRIQ) is positive and statistically significant, with a coefficient of 1.036 and a p-value below 0.05. This proves that in nations with superior institutions, the adverse effect of rising interest rates on stock market performance may be mitigated or even turn positive, possibly due to investors' confidence in the effectiveness and stability of the country's monetary policy. Besides, the GDPIQ interaction has a positive coefficient of 0.334 and a p-value of 0.104, indicating that IQ could marginally strengthen GDP's link to market performance, but the moderating influence is not significant. The interaction term of INFIQ is negligible and statistically insignificant, with a 0.016 coefficient and a very high p-value of 0.836, meaning IQ does not moderate the effect of INF on SMP.

Additional Test

The regression results for this additional test reveal how the relationship between key macroeconomic indicators and stock market performance evolved before, during, and after the COVID-19 pandemic, with a specific focus on the moderating role of institutional quality in Model 2. We noted that this analysis is derived from a relatively small sample size, especially the data for during COVID and after COVID, in which results from small samples are subject to greater variability and a larger margin of error. These findings should be viewed as indicative rather than definitive, and we recommend caution when making strategic decisions based solely on this data. Further research with a larger sample is recommended to validate these initial insights.

Table 4: Regression Results in Different Periods for Monetary Policy, Institutional Quality and Stock Market Performance

Variables	Before Covid		During Covid		After Covid	
	Model 1	Model 2	Model 1	Model 2	Model 1	Model 2
GDP	-0.191** (-0.0895)	-0.0925 (-0.0839)	1.739** (-0.734)	-0.0765 (-0.0478)	0.761 (-1.456)	-0.00962 (-0.016)
INTR	-0.109** (-0.0535)	0.130*** (-0.0465)	0.799 (-1.453)	0.0608 (-0.0829)	-2.577* (-1.215)	-0.0672** (-0.0329)
INF	0.118 (-0.0841)	0.0928 (-0.0796)	-0.888 (-2.059)	0.187 (-0.18)	1.526*** (-0.436)	0.0104 (-0.0163)
IQ		-0.793*** (-0.174)		-0.773** (-0.33)		-0.0839 (-0.289)
GDPIQ		0.0485* (-0.0284)		0.0154 (-0.017)		0.0185** (-0.00834)
INTRIQ		0.134*** (-0.0281)		0.169** (-0.0576)		0.0646* (-0.0348)

INFIQ		-0.00882 (-0.0375)		-0.0113 (-0.0619)		-0.0251** (-0.0123)
Constant	9.102*** (-0.358)	7.261*** (-0.301)	-2.579 (-7.12)	7.058*** (-0.591)	5.032 (-10.62)	7.914*** (-0.496)
Observations	44	44	18	18	18	18
R-squared	0.261	0.583	0.2	0.713	0.481	0.4128
Number of Countries	9	9	9	9	9	9
F Statistics/ Chi2	8.52	40.84	2.89	3.54	4.33	32.1
Prob>F/ Prob>Chi2	0.000	0.000	0.073	0.035	0.023	0.000

Robust standard errors in parentheses

*** $p < 0.01$, ** $p < 0.05$, * $p < 0.1$

Before COVID (2015–2019), Model 1 shows that both GDP (-0.191 , $p < 0.05$) and interest rate (-0.109 , $p < 0.05$) had significant negative effects on stock market performance, while inflation was not significant. In Model 2, the interaction term GDPIQ is positive and significant (0.0485 , $p < 0.1$). Since the direct effect of GDP is negative in Model 1, a positive moderation implies that institutional quality enhances the negative effect of GDP, making it more harmful to stock performance. Similarly, INTRIQ is positive and significant (0.134 , $p < 0.01$), and because the direct effect of INTR is negative, this moderation also enhances the negative impact of interest rates. The interaction INFIQ is not significant. Thus, before COVID, institutional quality softened the adverse effects of both GDP and interest rate on stock performance. This suggests that stronger institutions may have reinforced structural or policy-related rigidities during periods of macroeconomic strain.

During COVID (2020–2021), Model 1 shows that GDP had a positive but not significant effect, while INTR and INF remained statistically insignificant. In Model 2, the interaction term INTRIQ is negative and significant (-0.169 , $p < 0.01$). Since the direct effect of INTR is positive, this positive moderation implies that institutional quality enhances the positive effect of interest rate, essentially strengthening any stabilising role interest rate might have had during COVID. GDPIQ and INFIQ are insignificant in this period, suggesting no strong moderation effect from institutional quality on GDP or inflation. This may reflect stricter policy enforcement or constrained monetary flexibility in well-governed economies during times of uncertainty.

After COVID (2022–2023), Model 1 shows that interest rate has a significant negative effect (-2.577 , $p < 0.05$), while GDP and inflation are insignificant. In Model 2, GDPIQ is positive and significant (0.0185 , $p < 0.05$), indicating that institutional quality enhances the positive effect of GDP on stock market performance. This may suggest that post-pandemic, stronger institutions helped translate economic growth into better market performance. Even though GDP was not significant in Model 1, this moderation suggests that in the presence of strong institutions, GDP growth contributes more effectively to stock performance. INTRIQ is also positive and significant (0.0646 , $p < 0.1$); since the direct effect of INTR is negative, this implies that institutional quality enhances the negative impact of interest rates. In contrast, INFIQ is negative and significant (-0.0251 , $p < 0.05$), and since inflation's direct effect was positive, the negative moderation reduces the positive impact of inflation on stock market performance in the post-COVID period.

Overall, institutional quality does not have a uniform effect; instead, its moderating role varies depending on both the macroeconomic condition and the period. It may either intensify or dampen the influence of key economic variables, underscoring its strategic importance in shaping market outcomes during stable periods, crises, and recovery phases.

CONCLUSION AND RECOMMENDATIONS

The regression results show that institutional quality significantly moderates the impact of interest rates on stock market performance. Specifically, the negative impact of rising interest rates on the stock market is exacerbated by stronger institutional environments, as evidenced by the positive coefficient of INTRIQ (1.036, $p < 0.05$). This means that in countries with high institutional quality, interest rate increases cause stock markets to react more strongly. This study examined how GDP, interest rate, and inflation influenced stock market performance across three periods, including before, during, and after COVID-19, with institutional quality as a moderator. Before COVID-19, GDP and interest rates had significant negative effects, and institutional quality further intensified these impacts. During COVID-19, no macroeconomic variables were directly significant, but institutional quality weakened the stabilising role of interest rates. After COVID-19, interest rates remained a negative factor, while institutional quality enhanced GDP's positive effect, amplified the negative impact of interest rates, and reduced the positive effect of inflation, indicating increased market sensitivity to price changes in stronger institutional environments.

While the findings are insightful, the study also has limitations. One limitation is the relatively small sample size of 79 observations, which may reduce the statistical robustness of some results and limit broader generalisations. Furthermore, the study excludes Brunei due to the absence of an active stock market, and it does not fully account for informal institutional factors such as culture, norms, or informal governance practices that could also influence financial outcomes. Another limitation lies in the potential risk of endogeneity, as the study does not address reverse causality, where monetary policy may respond to stock market fluctuations. Additionally, the use of Principal Component Analysis to create a composite institutional quality index may obscure the individual impacts of its underlying dimensions, such as political stability or the rule of law, which could offer more nuanced insights.

Despite these limitations, the study contributes meaningfully to existing literature by providing empirical evidence on how institutional quality moderates the relationship between monetary policy and stock market performance in ASEAN countries. It bridges two important theoretical frameworks, including Institutional Theory and Asset Pricing Theory. This gives us a more complete picture of how governance structures and macroeconomic policy work together to affect financial markets. Moreover, the study delivers practical guidance for policymakers and financial regulators by emphasising the importance of institutional reforms and policy transparency in fostering market stability and economic resilience across emerging economies.

The findings of this study have several important implications for policymakers, investors, and financial regulators, particularly within the ASEAN context. First, the evidence that institutional quality significantly moderates the impact of interest rates on stock market performance suggests that monetary policy does not operate in isolation. In countries with stronger institutional frameworks, interest rate changes tend to trigger more pronounced stock market reactions. This indicates that well-functioning institutions improve policy transmission but may also increase market sensitivity. Policymakers in high-institutional-quality environments should therefore consider the potential volatility in financial markets when implementing rate adjustments, especially during periods of economic recovery or uncertainty. Second, the results highlight the evolving role of institutional quality across different economic phases. While institutions intensified negative macroeconomic impacts before COVID-19, their moderating role became more complex during and after the crisis. This suggests that institutional reforms should be tailored not only to strengthen governance structures but also to

ensure flexibility and adaptability in crisis response mechanisms. For investors, understanding the interaction between macroeconomic indicators and institutional strength is crucial for risk assessment and portfolio allocation.

Based on the results, several recommendations emerge for policymakers and regulators in ASEAN. First, there is a pressing need to strengthen institutional frameworks, including enhancing regulatory quality, judicial independence, transparency, and anti-corruption measures. These reforms are essential not only for building investor trust but also for improving the overall credibility and effectiveness of monetary policy. Second, central banks should carefully calibrate their monetary interventions, taking into account the strength of institutional quality within their jurisdictions. Abrupt adjustments in interest rates, especially in environments with weak institutions, may lead to heightened financial market volatility and reduced investor confidence.

In conclusion, further research on this study should consider expanding the dataset to include more recent years and a broader set of countries, including those with emerging or less developed stock markets. Employing advanced econometric techniques such as the Generalised Method of Moments (GMM) could help address endogeneity concerns and improve causal inference. Finally, disaggregating the components of institutional quality, such as rule of law, voice and accountability, or regulatory effectiveness, may offer deeper insight into which governance factors most strongly influence monetary policy outcomes.

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