THE EFFECTS OF ECONOMIC FACTORS ON
KUALA LUMPUR STOCK EXCHANGE COMPOSITE INDEX

A thesis submitted to the Graduate School of Universiti Utara Malaysia
in partial fulfilment of the requirement
for the Master Degree of Science (Management)

BY
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1998

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ABSTRAK

ABSTRACT

An economic climate is a major factor in determining the primary trend of a stock market. The stock market, on the other hand, is often regarded as a reliable barometer of a country’s economy. In this study, Multivariate Time-Series Regression model are used to examine empirically the impact of foreign exchange rates, interest rate and inflation rate on Kuala Lumpur Stock Exchange Composite Index (CI). Pearson Correlation Matrices and Scatter Plots indicate that multicollinearity and heteroscedasticity exist among the selected currencies and independent variable. The finding in three-factor test using Multivariate Time-Series Regression with Autoregressive Moving Average technique indicates that coefficient of exchange rates and interest rate are significant, however, the coefficient of inflation rate is not significant. This study also indicates that both exchange rates and interest rate are negatively related to CI. This indicates that foreign exchange rates and interest rate do significantly and negatively affected the CI.
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LIST OF ABBREVIATIONS

AIC
Akaike Information Criterion

ALR
Average Lending Rate

AR
Autoregression

ARMA
Autoregressive Moving Average

CDS
Central Depository System

CHF
Swiss Franc

CI
Kuala Lumpur Stock Exchange Composite Index

CPI
Consumer Price Index

CRSP
University of Chicago Center for Research in Security Prices

DM
German Mark

DW
Durbin-Watson

Forex
Foreign Exchange Rates

GDP
Pound Sterling

GLS
Generalized Least Squares

HK$
Hong Kong Dollar

IFS
IMF’s International Financial Statistics

IMF
International Monetary Fund

KLSE
Kuala Lumpur Stock Exchange

MA
Moving Average

MCD
Malaysian Central Depository Sdn. Bhd.

MERM
Multilateral Exchange Rate Model
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<td>OLS</td>
<td>Ordinary Least Squares</td>
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<td>$$</td>
<td>Singapore Dollar</td>
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<td>SDR</td>
<td>Special Drawing Right</td>
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<td>SEE</td>
<td>Standard Error of Estimation</td>
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CHAPTER ONE
INTRODUCTION

1.1 Problem Statement

An economic climate is a major factor in determining the primary trend of a stock market. As such, the stock market is often regarded as a reliable barometer of a country’s economy, and the stock prices are deemed as a reflection of future expectations concerning the economics well being of the country. Due to this factor, it is necessary to know the cause and effects of economic variables and their relationship with stock market performance.

In Malaysia, stock market contributes to the best allocation of capital resources among numerous users. The roles of the stock market are mainly to facilitate and encourage the mobilization of funds, direct them towards efficient economic activities, provide adequate liquidity for investors and encourage the creation of large-scale enterprises.

The Kuala Lumpur Stock Exchange Index (CI) is the most popular indicator of the Kuala Lumpur stock market performance. The CI represents share prices of 100 corporations. These companies are chosen because their operations cover a broad spectrum of economic performance in Malaysia and more significantly reflect stock market activities with fair accuracy.
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