CHAPTER 1
INTRODUCTION

1.1 Introduction

This section explains the introduction to this study. In this section, each component of the study is discussed, starting with the background of study, problem statement, research objective, research question, significance of the study, scope of the study, and limitations of the study. Finally, the section explains the definition of the key terms used in this research, including inflation, interest rate, exchange rate, money in circulation, and stock return.

1.2 Background of Study

The stock market of a nation plays a vital part in industrial growth and adds to the country's economic success and development. Investment is a method of investing a particular quantity of money or other resources now in order to reap huge rewards afterwards (Tandelilin, 2010: 2). People can invest by buying shares of companies listed on the stock market. In common sense, all investors want to make as much profit as possible. To avoid losses, all investments must therefore be carefully planned. Investors who want to purchase stocks in a company must ensure that the target company is healthy, that it can grow, and that the company can generate profits for its shareholders through dividends or capital gains.

Each investment instrument has different potential risks. But the higher the potential return, the greater the potential risk of the instrument. The same is true in the stock market. Stock investment risk is classified into two types: non-systematic risk and systematic risk. Micro factors are associated with non-systematic risk. This risk may be reduced by carefully choosing and diversifying assets to meet the microenvironment of the organisation. Company risks include, for example, the amount of debt (financial risk) and the nature of the business (business risk). And systemic risk linked to a country's macroeconomic conditions. If a country is struggling economically, its companies will not perform well.

Companies in currently contemporary economic period do require more funding to enhance their operational effectiveness. Offering the public ownership of the company on the stock market is one method businesses get money. Making the appropriate stock investment selections is essential for achieving the anticipated returns because investing in stocks carries a considerable amount of risk. The outcome of an investor's decision when identifying a profitable investment is influenced by the investor's ability to understand and predict future macroeconomic conditions.

Economic development may be expedited through the stock market by diversifying risk, improving the liquidity of financial assets, and making wise investments. However, there are also circumstances that prevent better investments from being made, and those forces are economic constraints. These economic dynamics have a considerable impact on the stock market, both positively and negatively. When economic factors have a favorable effect on the stock market, investors may become billionaires; when economic factors have a negative impact on the stock market, investors lose money. Economic considerations influence stock market results.

National inflation, interest rates, exchange rates, and money in circulation may all be used to analyses economic statistics for any country. The stock market is claimed to be a reflection of the economy, and macroeconomic indicators are utilized to determine stock market prices. The primary goal of this research is to assess the influence of macroeconomic factors on stock market returns, such as inflation, interest rates, exchange rates, and money in circulation.

Based on the issues raised above, this study investigates many characteristics that influence stock returns in blue-chip businesses, namely the IDX30 index posted on the Indonesia Stock Exchange. Inflation, interest rates, exchange rates, and money in circulation are examples of these elements. As a result, the issue in this study is the impact of inflation, interest rates, exchange rates, and money in circulation on stock returns.

1.2.1 Background of Stock Return

According to Carlo (2014), as cited in Sugiharti & Wardati, E. (2019), stock returns consist of two main components. In other words, a capital gain favorable to the investor can be acquired at a selling price greater than the secondary market purchase price. As a result, dividend payments and share price appreciation account for any income or profit received by shareholders. There are various elements that can only impact the price of a stock. Stock returns are influenced by both macro and micro variables. Inflation, interest rates, exchange rates, and money in circulation are all factors to consider.

Micro factors are those that occur inside the organization. Internal conditions provide information in the form of financial and non-financial data. To estimate stock return profiles, two forms of analysis are used: fundamental information and technical information (Nuryanto et al., 2014, as referenced in Sugiharti & Wardati, E., 2019). Internal firms can provide basic information such as sales dividends, company growth rates, financial attributes, and company size. Technical knowledge outside of the organization, such as economics, politics, and finance.

Understanding stock returns from stock investments is very important. The definition of stock return is the difference between the selling price of shares and the buying price of shares plus dividends. Stock returns can be positive or negative. The positive case means making a profit or getting capital gains, and the negative case means experiencing a loss or capital loss. Investors who buy and invest in shares on world stock exchanges are very confident about the risks and uncertainties of the future. There are technical ways that investors can use to get the best results, but the game of the exchange is very dependent on luck.

Dividends are ignored when calculating stock returns in stock trading practices. Stock returns are identified gains and losses in capital. First, identify the type as follows:

1. Revenue Realization

   Quoting from Indonesia Stock Exchange, realized profits are profits calculated based on historical data. Historical data itself is a summary of price movements of certain issuers listed and traded on the Indonesia Stock Exchange (IDX).

2. Expected Return

   The investor's own expectations or estimates are used to calculate expected return. Of course, this expected return is not necessarily the case. The components in it are:

   - Capital gain: an increase in share price that benefits investors.
   - Capital Loss: Unlike capital gain, a capital loss is a decline in the price of a stock that results in a loss for the investor.
   - Yield: a component of income that reflects the income or cash flow of an investment over a period of time.

1.2.2 Background of Inflation

Inflation is defined as a continuous upward trend in overall prices. One or two types of commodity price hikes cannot be considered inflation unless they affect most other commodity price hikes. In general, there are three sorts of inflation theories; each type reveals distinct aspects of the inflation process, and none of them is a complete inflation theory that addresses all major aspects of the inflation process. The three theories are quantitative theory, Keynesian theory, and structuralist theory.

Fahlevi, M. (2018) According to several inflation studies in developing countries, inflation is driven not only by monetary phenomena but also by structural and cost phenomena. This is because the economic structure of developing countries is still based on agriculture. Therefore, external factors such as sudden seasonal changes, external relations problems due to natural disasters, economic impacts such as deterioration of trade conditions due to natural disasters, etc., may cause price fluctuations in the domestic market, such as foreign debt and foreign exchange rates.

Stable inflation is a prerequisite for sustainable economic growth, which ultimately helps improve national welfare. The importance of managing inflation is to consider the negative impact of high and uncertain inflation on the socioeconomic conditions of a society. Inflation reduces income, lowers productivity, and affects stock prices. High inflation will reduce demand. A decrease in demand reduces a company's revenue and affects the revenue it receives.

Inflation reflects the overall price trend. Inflation is associated with a reduction in both consumer and company buying power. Widjojo et al. conducted research on the link between inflation and stock yields. We discovered that the greater the inflation rate, the lower the firms' profit level. Declining corporate earnings are bad news for stock market investors and might lead the firm's share price to fall. According to Utami and Rahayu (2003), the influence of inflation on stock prices is that more inflation leads to lower stock yields. This work was inspired by Adams et al. Inflation has a significant negative influence on stock yields, according to our findings. High inflation in real estate firms may reduce company profits and affect stock returns.

According to data from the Central Bureau of Statistics (BPS), CPI inflation for December 2022 was 0.66% (mtm), 5.51% (year-over-year) for 2022, and 1.87% (year-over-year) for 2021. Beyond the target of 3.0+1%, primarily the impact of fuel price adjustments in September 2022. Various monthly trends show that inflation is getting back under control and that inflationary pressures are building after rising crude oil prices. It continues to decrease and is below the original estimate. Managed CPI Inflation is also driven by close policy synergies between central and local governments, the Bank of Indonesia, and various strategic partners to contain inflation, including ongoing fuel price adjustments to contain inflation. Although it cannot escape the impact of the future, the Bank of Indonesia will continue to strengthen its response policy, continue to reduce inflation, and ensure that source inflation remains in the range of 3.0 ± 1%. In this regard, coordination of central and regional inflation management teams (TPIP and TPID) continues through programmes to strengthen the National Food Inflation Management Movement (GNPIP) in various regions.

CPI inflation for December 2022 is strongly influenced by seasonal patterns at the end of the year. Core inflation rose to 0.22 percent (mtm) from 0.15 percent (mtm) the previous month, mainly due to housing contract products. The volatile food group's inflation rate was 2.24% (mtm), higher than last month's year-end seasonal pattern of deflation of 0.22% (mtm). The managed price group recorded inflation of 0.73% (mtm). This is up from inflation of 0.14% (mtm) the previous month, and follows a pattern of price hikes by beverage companies and seasonal empty travel demand. Christmas and New Year’s transport cigarette filters, cigarette crack.

Inflationary pressures in 2022 that are lower than previous forecasts are expected to have a positive impact on the inflation outlook for 2023, returning to the 3.0+1% target. The core inflation rate in 2022 remained low at 3.36% (year-over-year) due to the reduced ripple effect of fuel price adjustments and the lack of strong demand-side inflationary pressures. Unstable food inflation in 2022 will be contained at 5.61% (year-on-year) due to the synergy and adjustment of inflation containment policies by TPIP and KNK, ensuring supply availability, smooth distribution, price stability, and effective communication. On the other hand, price inflation, controlled by fuel price adjustments and transportation rate cuts, was also lower than expected at 13.34% (year-over-year).

In February 2023, the consumer price index (CPI) inflation rate was 5.47% (year-on-year). Last month, the consumer price index edged up from 5.28% (year-over-year) due to the erratic food inflation of 7.62% (YoY). Core inflation fell to 3.09% (year-on-year), which reduced supply and reduced inflation enough to dampen import inflationary pressures and increase demand. Inflation was controlled through Bank Indonesia's monetary policy response and close coordination between Bank Indonesia and the governments (central and regional) in various regions. Bank Indonesia expects that the core inflation rate will remain in the range of 3.0±1% in the first half of 2023 and the CPI inflation rate will return to the target of 3.0±1% in September 2023. Bank Indonesia continues to strengthen cooperation with the government (central and local) to curb inflation, including the celebration of national religious holidays (HBKN).

1.2.3 Background of Interest Rates

The interest rate is a reference rate that reflects the Bank of Indonesia's monetary policy stance, which is determined and released. The government controls local money flows by raising BI rates. High interest rates are a negative signal for stock prices, and rising interest rates lead to higher interest rates needed to invest in stocks. Because interest rates are high, investors can shift their investments away from equities and into other types of investments such as savings and term deposits.

Various studies on the link between interest rates and stock prices have yielded conflicting results. Granger (1993) argued that interest rates negatively affect stock prices, however utilizing the Arima analytic model, Moku (1993) discovered no significant association between these two variables The substantial influence of interest rates on stock prices, as Granger points out, suggests a negative link between interest rates and stock prices. Low interest rates reduce borrowing costs because they boost investment and economic activity and cause stock prices to rise.

On March 15-16, 2023, the Board of Directors of Bank Indonesia (RDG) resolved to keep a BI7DRR (Bi 7-Day Reverse Repo Rate) of 5.75%, a deposit interest rate of 5.00%, and a loan interest rate of 6.50%. This move is consistent with a pre-emptive and forward-looking monetary policy tone designed to assure ongoing declines in inflation expectations and future inflation. If Bank Indonesia maintains the BI7DRR at 5.75%, beginning inflation will be about 3.0 ± 1% in the first quarter of 2023, with consumer price index (CPI) inflation targeting 3.0 ± 1% in the second quarter. The policy of rupiah exchange rate stability will also be tightened in order to contain imported inflation and mitigate the impact of global financial market uncertainty.

1.2.4 Background of Exchange Rates

Foreign exchange (FOREX) is defined as a foreign currency or payment instrument used to perform or fund financial and commercial transactions on an international scale based on the official exchange rates of central banks (Hamdy, 2001 as cited in Fahlevi, M., 2019). There are two types of currencies in circulation across the world: hard currencies and soft currencies. Depreciation, appreciation, decline, and revaluation are the four causes of exchange rate fluctuations. Currency is a commonly recognized form of payment. When the problem crosses borders, it gets much more complicated. This is because cross-border transactions are feasible when a currency travels from one country to another. A currency exchange rate is a component of the currency exchange process. Foreign currency refers to genuine foreign currency in the form of bank balances and promissory notes.

The exchange rate is an essential currency indicator since variations in the exchange rate can impact a country's stock market as well as its fiscal policies. An exchange rate is the cost of one standard currency relative to another. The nominal exchange rate is the cost of local currency in foreign currency units. This interpretation was chosen because exchange rate research most frequently employs it.

Accordingly, an increase in the exchange rate indicates appreciation, whereas a decline in the rate indicates depreciation. Ma and Kao discovered that local currency appreciation (strengthening) had a negative impact on domestic stock price movements in export-dominant economies and a positive impact on domestic stock price movements in import-dominant economies utilizing data from six nations. Ajayi and Mougu are also utilizing an error correction model (ECM) to investigate the link between exchange rates and floating stock indexes in eight industrialized countries: Canada, France, Germany, Italy, Japan, the Netherlands, the United Kingdom, and the United States. The findings demonstrate that the stock index and currency rate pairings for each nation are combined.

Rupiah exchange rate coincides with Bank Indonesia's stabilization efforts amid continued uncertainty in global financial markets. On March 15, 2023, the Indonesian Rupiah exchange rate depreciated slightly by 0.75% compared to the end of February 2023, in line with the weakness of almost all world currencies due to increased uncertainty in global financial markets. On March 15, 2023, the rupiah exchange rate increased by 1.32% compared to the end of December 2022, while the Indian rupee appreciated by 0.16%, while the Thai baht and Malaysian ringgit depreciated by -0.04% and -1.80%. Bank Indonesia estimates the rupiah's high exchange rate domestic economic growth, low inflation, current account surplus, along with attractive earnings prospects for domestic financial assets. Bank Indonesia will maintain its rupiah exchange rate stability policy in order to prevent import inflation and the impact of global financial market concerns on the rupiah exchange rate.

1.2.5 Background of Money in Circulation

Cambridge theory emphasizes the function of money as a medium of exchange since money is a prerequisite for liquidity transactions. This theory says that money is used as a store of wealth because it has the liquidity to be easily exchanged for commodities. Cambridge theory emphasizes behavioral factors that link the demand for money and the volume of transactions. Money demand is not only affected by transaction volume and national institutional factors. It can also be influenced by people's expectations of future interest rates, wealth, and community

(Boediono, 1994, as cited in Amri, 2021). Keynesian theory is based on Cambridge theory, which expresses a different view from classical monetary theory. These divides highlight another role of money: that of a store of value and a means of exchange. Keynes's theory is also known as the liquidity-first theory (Boediono, 1994, as citied in Amri, 2021).

According to Kistianingsih (2019), money in circulation is positively correlated with economic growth in Indonesia. Government policies in regulating money in circulation and economic growth have a long-term steady link. Based on Keynes' concept that financial supply has a positive influence on output and growth, economic growth grows when a society's money in circulation increases. If the supply of social money is large, the central bank will extend its policy of lowering interest rates. Such a situation encourages investment among the elderly and creates an increase in outcomes that stimulates economic growth.

Liquidity in the banking system and economy is sufficient to support sustained credit growth. In February 2023, the Liquidity to Third Party Funds Ratio (AL/DPK) was classified as high at 29.09%. This allocation is consistent with Bank Indonesia's accommodative liquidity policy and supports the availability of funds for banks to lend to or credit the business community. Economic liquidity sufficient to support economic activity was reflected in the short-term (M1) and long-term (M2) money supply, which increased by 6.6% (YoY) and 7.9% (YoY) respectively in February 2023. On financial markets, Indonesian interest rates remain low at 5.53% as of March 15, 2023. Short-term SBN yields are up 50 basis points compared to end-December 2022, while long-term SBN yields remain subdued. Monthly deposit rates were also low at 4.12% in February 2023, but 15 basis points higher than December 2022. Bank Indonesia will continue to provide sufficient liquidity to maintain financial system stability and support Indonesia's sustained credit growth.

1.3 Problem Statement

Investment is the long-term placement of money in one or more assets with the goal of generating income or growing the value of the initial investment (capital). The objective is to maximize projected return while staying within each investor's risk tolerance (Jogiyanto, 2017). However, there are many factors to consider when choosing which stocks to invest in. Investors gain predicted returns through numerous ways, including their own research of stock trading behavior or the advice of brokers, traders, investment managers, and other capital market professionals.

Equity investing is considered attractive to investors because it can offer attractive returns and is easy to trade. on the other hand, Stock prices are highly volatile and vary on a regular basis. According to Tandelilin (2014), capital market movements are tied to changes in numerous macroeconomic factors. Price variations are determined by the strength of supply and demand; if supply exceeds demand, the share price rises; conversely, if supply exceeds demand, the stock price falls. (Wahyuni, 2021) says that investors with experience investing in the market are always looking for information about the companies they are buying stocks from before investing. The rise and fall of stock prices can be influenced by many factors, and in the study of Suriyani & Sudiartha (2018), microeconomic factors are factors that exist within a company, and macroeconomic factors are factors that exist outside a company. According to Ang (2012), external factors that affect investment returns are the same as the development of the industrial sector, and also the influence of economic conditions. According to Ang (2012), the examination of economic circumstances is the foundation of securities analysis, and if economic conditions are bad, outstanding stock returns are likely to reflect a commensurate fall. However, if the economy is doing well, the stock market will do well as well.

Stock market price fluctuations are a systematic risk that must be faced by investors. Systemic risk cannot be controlled because it is related to changes in macroeconomic fundamentals and will affect market capital and the national economy. When undertaking stock trading operations in a country, investors must pay attention to changes in monetary circumstances and macroeconomic indicators such as inflation, interest rates, exchange rates, and the amount of money in circulation.

1.4 Research Question

The research conducted within this paper aims to solve the following research questions**:**

RQ1 : What is the effect of the inflation towards the stock returns?

RQ2 : What is the effect of the interest rates towards the stock returns?

RQ3 : What is the effect of the exchange rates towards the influence stock returns?

RQ4 : What is the effect of the money in circulation towards the stock returns?

1.5 Research Objective

1.5.1 General Objective

The general objective of this research is to examine macroeconomic factors affected towards the stock returns.

1.5.2 Specific Objective

The specific objective of the research presented in this paper:

1. To examine of the inflation affected towards the stock returns.
2. To examine of the interest rates affected towards the stock returns.
3. To examine of the exchange rates affected towards the stock returns.
4. To examine of the money in circulation affected towards the stock returns.

1.6 Significance of the Study

A capital market investment is an investment in financial assets with the expectation of a return on the securities acquired. High returns will attract investors to buy these shares. The concept applies in investing activities: the larger the projected profit, the higher the risk, and the lower the expected profit, the lower the risk (high risk, high return, and low risk, low return). There are several significances of study from this research are:

1.6.1 Student

This study is designed to expand knowledge, insight, and information on the Indonesian Stock Exchange, particularly stock returns.

1.6.2 Investor

Investors place a high value on stock market performance. The capacity of an investor to comprehend and forecast future macroeconomic conditions influences the outcome of his or her judgements in choosing lucrative assets. Markets are influenced by macroeconomic variables such as inflation, interest rates, exchange rates, and money in circulation. This study assists investors by offering experimental evidence on inflation, interest rates, exchange rates, and money in circulation to assist them in making the best stock investments and achieving the expected returns.

1.6.3 Other Parties

The results of the research are expected to add references, information, and insights to support further research related to stock returns or as library materials and sources of knowledge.

1.7 Scope of Study

This study focuses only on how inflation, interest rates, exchange rates, and money in circulation affect return stocks. This study only examines companies that are included in the IDX30 index category on the Indonesia Stock Exchange for the 2018-2022 period, a total of 30 companies. Purposive sampling methods were used to identify samples in this study. Therefore, in order to determine the sample for this study, the researchers established criteria for selecting samples whose data met the needs of the study. According to the criteria, 26 companies were selected as the research sample. This research employs two theories: signal theory and agency theory. This research is classified as quantitative since it involves the computation of research data in the form of numbers, with panel analysis serving as a data gathering instrument. Then the analysis technique is multiple linear regression.

1.8 Definition of the Key Terms

1.8.1 Stock Return

The difference between the sale price, or current price, and the purchase price, or beginning of the period, is the stock return. The difference between the amount received and the amount spent is the return (Brigham and Houston, 2012). Based on the aforementioned definition, the return on a stock is the return on investment in the form of profits gained when the stock is purchased and sold in the capital market.

1.8.2 Inflation

Inflation is defined as a constant growth in an economy (Jhingan, 2002, as cited in Egbunike, C. F., and Okerekeoti, C. U. (2018). The inflation rate based on the price index measures the change in the average price level (Akers, 2014).

1.8.3 Interest Rates

Interest rate is the price to be paid to convert one rupiah now into one rupiah in the future (Boediono, 1996, as citied in Suharyanto, & Zaki, A., 2021).

1.8.4 Exchange Rates

According to (Salvatore, 1997 as cited in Akbar, A. B., 2019), the exchange rate is the price of one currency vs another or the value of one currency versus another. Foreign currency appreciation refers to an increase in the domestic exchange rate, whereas foreign currency depreciation refers to a reduction in the domestic exchange rate. The exchange rate is the price at which two (two) different forms of currency are exchanged, at which point the value or price is compared. The exchange rate is the value comparison (Nopirin, 2009: 163, as cited in Sugiharti & Wardati, E., 2019).

1.8.5 Money in Circulation

Money in Circulation is the amount of currency circulating in society which is controlled by the authorities to stabilize the national economy, because excess or shortage of money in circulation will have an impact on the people's economy and companies listed on the Indonesian stock exchange.

1.9 Summary

The introduction provides information about the research topic and the importance of research. The research background provides an overview of the research topic and an introduction to the ideas used in the research. the research problem, research objective, research question, significance of the study, scope of study, limitations of the study, and definition of key terms. As a consequence, the reader will be able to better understand the reason behind this study. This thesis consists of three chapters with each chapter being detailed as follows:

Chapter 1 Introduction

This chapter contains information on the background of the research, the research problem, research objectives, research questions, significance, and limitations of the research, the definition of key terms, and the structure of the proposal.

Chapter 2 Literature Review

This chapter includes the review of experts' theoretical underpinnings that are relevant to the topic's research, an empirical literature review, research framework, and the research hypotheses.

Chapter 3 Research Methodology

This chapter explains the research methodology, including the research paradigm, research method, research design, research process, sampling procedure, research instrument development, data collection method, data analysis techniques, and summary.

Chapter 4 Data Analysis

In Chapter 4 the description includes: data analysis and finding that discusses about the finding by researchers.

Chapter 5 Conclusion

In Chapter 5 the description includes: the conclusions, limitations, and recommendations made related to data analysis and discussion of existing problem.