Does Economic Policy Uncertainty Affect the Composite Stock Price Index? Evidence from Seven Asian Countries

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ABSTRACT

Economic Policy Uncertainty (EPU) is one of the crucial factors affecting investors' decisions to invest in global capital markets. This study aims to analyze the movement of the Composite Stock Price Index (CSPI) due to the influence of EPU, covering seven Asian countries, including Hong Kong, Japan, Pakistan, China, India, South Korea, and Singapore. The data used is monthly panel data from January 2010 to January 2025, employing the Feasible Generalized Least Squares (FGLS) method based on Cross-Section SUR (PCSE). The primary independent variable studied is EPU, with control variables including interest rates, inflation, and exchange rates. The analysis shows that EPU has a significant positive effect on the CSPI, indicating that an increase in global EPU can trigger a shift in investment to developing countries and sectors that are safe or resistant to uncertainty shocks. Meanwhile, interest rates and inflation indicate a significant negative impact on the CSPI, consistent with the theory that stock market performance is negatively affected by rising capital costs and declining purchasing power. Conversely, the exchange rate shows a significant positive impact on the CSPI, where the appreciation of the domestic currency increases investor confidence and improves export competitiveness. This study emphasizes the urgency of stabilizing the aggregate economy and managing perceptions in the face of economic policy uncertainty as a tactic to maintain investor interest in the stock market, thereby promoting sustainable economic development through long-term investments.

1.Introduction

Investment is a fundamental aspect for companies, especially with the rapid development of the capital market, which acts as one of the main sources of company capitalization. The investment intermediary that is currently considered the most profitable is in the form of shares. Stocks represent the capital contributed or the ownership of investors in the value of a company. According to a study conducted by (Asmoro et al., 2022), stocks account for the largest share of a company's capital, reaching 75%, while other sources of capital such as debt contribute only 25%, and retained earnings contribute a smaller share of 10%. According to a report released by the Chartered Financial Analyst Institute in February 2025, stock investments are the most profitable source of income for an investor, as evidenced by the comparison of equity returns to bond returns of 100:56, meaning that stocks account for nearly half of an investor's profits when compared to other investment forms such as pure bonds (Pham et al., 2025). This indicates a positive feedback loop where companies can enhance productivity through optimal capitalization, and investors also benefit from the capital market.

The capital market is an investment venue that can generate high returns but also carries high risks. Stock prices can fluctuate unpredictably depending on market conditions and the economy of the issuing country, so investors must be cautious in managing their investments (Fatah & Usman, 2024). One indicator that can assist investors in making investment decisions in the capital market is the Composite Stock Price Index (CSPI). The CSPI provides a chronological overview of stock price movements (Hasanudin, 2025). The existence of the CSPI assists investors in determining their investment decisions, whether to buy or sell stocks based on the stock prices listed on the stock exchange. Below is the CSPI for 7 Asian countries from 2010 to 2025.

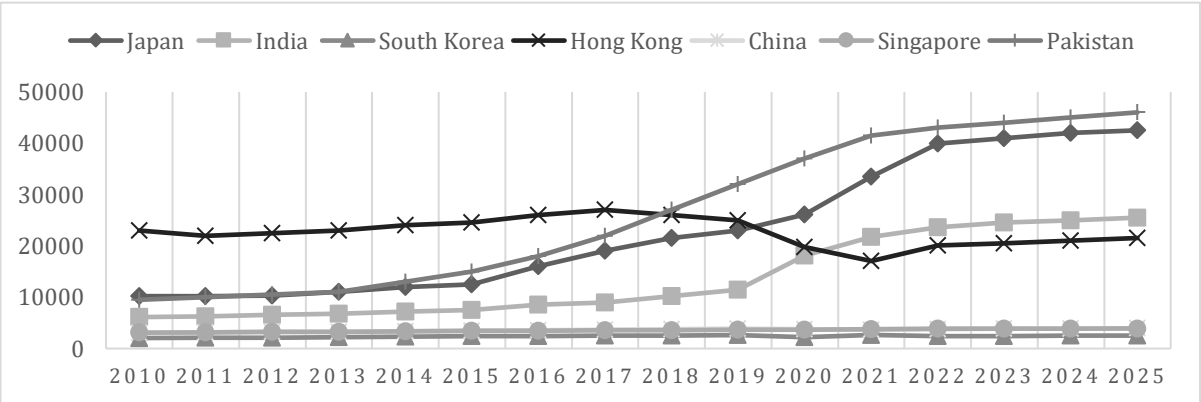

Figure 1. Composite Stock Price Index of Seven Asian Countries 2010-2025
Source: id.investing.com (data processed)

Based on the graph above, it can be seen that there were movements in the CSPI in seven Asian countries between 2010 and 2025, showing fluctuations. Pakistan, Japan, and India experienced a sharp upward trend starting in 2015. In Hong Kong, the CSPI showed an upward trend but dropped significantly in 2021 before eventually rising again from 2022 to 2025. Meanwhile, South Korea, Singapore, and China saw the CSPI remain

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relatively stagnant each year. This indicates that the CSPI in South Korea, Singapore, and China is more stable than in other countries, and the most volatile CSPI is in Hong Kong.

The fluctuations in the CSPI in the seven Asian countries show diverse trends, with some countries experiencing increases, increases and decreases, and others with stagnant CSPI. The fluctuating changes in the CSPI reflect the varying impacts of external influences. One factor that can influence CSPI fluctuations is economic policy uncertainty (EPU). EPU is an index that describes the condition of economic policies whose implementation is uncertain based on data from news articles (Johana & David, 2025). EPU can have a negative impact on the CSPI or cause it to decline. When global economic policies are uncertain, especially uncertainty in capital market trade policies, investors are hesitant to invest because of the risk of loss. The decline in investor confidence to invest amid high EPU can be seen when investors rush to sell back the shares they have purchased (panic selling) to avoid investment losses (Gui et al., 2024). However, EPU can also have a positive effect on the increase in the CSPI, as investors prefer to shift their investments to developing countries and industries that are more resilient to crises, such as energy, health, and basic goods, when there is uncertainty in global economic policy (Nida & Andriasari, 2024). This drives an increase in stock market activity, which ultimately strengthens the rise in the CSPI.

EPU can also influence macroeconomic variables such as interest rates, inflation, and exchange rates, which can ultimately impact the CSPI. The following graph illustrates the relationship between EPU and macroeconomic variables.

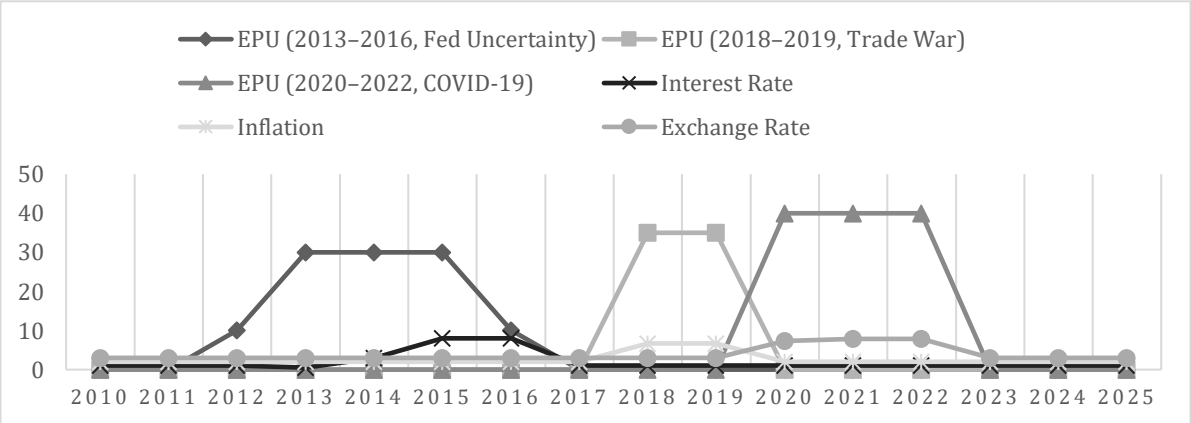

Figure 2. Correlation and Impact of EPU on Interest Rates, Inflation, and Exchange Rates in Seven Asian Countries

Source: www.policyuncertainty.com, id.investing.com, dan Oficial Website 7 Asian Countries (data processed)

Based on the representative graph above, three periods of EPU increases with a continuously rising trend can be seen. During the first period (2013–2016), the dark blue line indicates a sharp increase in EPU due to the introduction of uncertain policies by the Federal Reserve, specifically the tapering of Quantitative Easing (QE) or the reduction of Quantitative Easing (Amico & Feldman, 2024). This led to an increase in US yields, prompting Asian investors to withdraw their funds and shift their investments to the US, as it was perceived to offer higher yields, which were considered more profitable. The purple line shows the response of some Asian countries to this EPU by raising interest

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rates to stabilize domestic investment, such as Japan, which increased its interest rate from 0.1% to 0.5%, India, which raised its interest rate from 7.5% to 8%, and South Korea, which also took precautions by increasing its interest rate from 2.5% to 3%.

In the second period (2018-2019), the red line shows the increase in EPU caused by the US-China trade war. One of the trade wars was the tit-for-tat tariffs on core commodities, which disrupted supply chains and increased import costs (Celestin, 2025). This uncertainty led companies to raise product prices to compensate for costs, ultimately causing inflation. The light blue line shows the impact of this EPU on several Asian countries, with inflation in Pakistan rising from 3.1% in 2017 to 6.7% in 2019. Singapore, as a country dependent on international trade, also saw inflation rise from 1.8% in 2017 to 2.6% in 2019. In the third period (2020-2022), the green line shows an increase in EPU due to the COVID-19 pandemic. The pandemic caused economic policy uncertainty, particularly fiscal policy, with many countries implementing lockdowns, which disrupted international trade such as exports and imports, and led to a sharp decline in FDI (Koçak & Tüzemen, 2022). This inevitably led to a decline in foreign exchange reserves and could cause severe effects such as currency depreciation. The orange line shows the impact of EPU on exchange rate weakening in several Asian countries, such as China, where the domestic exchange rate against the USD weakened from 6.9 in 2019 to 7.3 in 2020, and Hong Kong, where it weakened from 7.75 in 2019 to 7.85 in 2020. Thus, the EPU has proven to influence macroeconomic variables. Fluctuations in the EPU and macroeconomic variables will have varying effects on the CSPI. The table below shows the impact of the EPU, interest rates, inflation, and exchange rates on the CSPI.

Table 1. Impact of the EPU, interest rates, inflation, and exchange rates on the CSPI

Variable	Type of Influence	Reason	Impact on CSPI
EPU	Positive	In certain situations, an increase in EPU from abroad (such as from the US) can encourage foreign investors to shift their investments to emerging markets such as Indonesia in order to diversify risk.	↑
	Negative	High EPU indicates uncertainty in economic policy, which can reduce investor confidence and increase market volatility.	↓
Interest Rates	Positive	An increase in interest rates can attract bond investors, strengthen the rupiah, and boost confidence in overall economic stability.	↑
	Negative	High interest rates make capital costs more expensive for companies, hinder business growth, and reduce the appeal of stock investments.	↓
Inflation	Positive	Consistent or slightly rising inflation indicates economic growth, which can support the performance of the consumer sector and industry.	↑
	Negative	Significant price increases reduce people's purchasing power and increase corporate spending, thereby reducing profits.	↓
Exchange Rate	Positive	The strengthening of the rupiah against the US dollar reduces spending on imported goods and increases profits for companies that depend on imports.	↑

Variable	Type of Influence	Reason	Impact on CSPI
	Negative	The depreciation of the rupiah exchange rate increases the burden of foreign currency loans and import costs, reduces net profits, and encourages capital outflows.	↓

Source: (Zhang et al., 2023)

Based on table 1, EPU, interest rates, inflation, and exchange rates have both positive and negative effects on the CSPI. EPU has a positive impact on the CSPI when foreign investors move their funds to emerging markets, but has a negative impact when it creates uncertainty in domestic policy. Interest rates and inflation have a dual effect, that is they can contribute positively if they attract investors through high interest rates or increase corporate profits, and conversely, they have a negative effect if they suppress purchasing power or increase production costs. The rupiah exchange rate has a positive impact on the CSPI when it strengthens, as it reflects economic stability, but has a negative impact when the rupiah weakens against the US dollar. These various influences and impacts indicate the need for research related to the influence of EPU, interest rates, inflation, and exchange rates on the CSPI in order to obtain a clear relativity of influence. The acquisition of clear influence trends through this research is expected to assist in the formulation of policies in order to maintain the stabilization of the CSPI, thereby creating profitable and sustainable investments for a country's economic development.

Previous research by (Deflyanty, 2023) examined the effect of EPU on stock indices for the period 2015-2022 in five ASEAN countries and concluded that EPU and stock indices are significantly correlated. In this study, the analysis was conducted in seven developed and developing countries in Asia, resulting in more reliable results because it examined the impact of EPU in various countries with diverse economic structures. A study conducted by Kolaski et al., (2023) explains the theory of meta-analysis, namely that research with a broader scope will produce more accurate analyses, particularly in studies examining influence, where the relativity of influence will be clearer, more reliable, and more generalizable. Previous research conducted by Raihan et al., (2023), which only examined Indonesia for the period 2016 to 2021, showed that EPU consistently had a negative effect on the CSPI. This study, which has a broader scope covering seven countries from 2010 to 2025, found that EPU can have a positive effect on the CSPI under certain conditions, thus providing a basis for studies on investment tactics management between countries.

The novelty of this research can be seen in two key aspects. First, the study does not merely examine the impact of EPU on the CSPI in general terms, but also analyzes EPU and key macroeconomic factors, namely inflation, exchange rates, and interest rates, to explain how the CSPI moved in seven Asian countries. Research using simultaneous methods tends to be rare, given that previous studies have mostly been limited to analyzing the relationship between EPU and the CSPI partially without including macroeconomic variables as control variables. Second, this study uses long chronological data (2010-2025) on a monthly basis and analyzes across countries, thereby producing differentiation and stability tests that can strengthen the results. This study contributes to the development of research related to stock market conditions affected by EPU by

adding the perspective of macroeconomic transmission, namely interest rates, inflation, and exchange rates that directly affect the CSPI. This expands the literature by analyzing the transmission of macroeconomic policy to the CSPI, whereas most studies only focus on the impact of EPU on the CSPI. Second, this study presents evidence from various countries in Asia that shows variations in the level of response of the CSPI to EPU shocks, thereby contributing to comparative literature that is important for understanding differences in Asian capital markets. Third, this study emphasizes the importance of macroeconomic policy stability in maintaining the attractiveness of the domestic capital market, which theoretically can strengthen the discussion on financial market integration, global risks, and measures to reduce policy uncertainty.

Financial literature explains that the impact of economic policy uncertainty on stock markets operates through changes in macroeconomic expectations and cross-country investor portfolio allocation (Alok et al., 2022), but this framework has not been tested jointly in the context of key macro variables, as in Zhao & Park (2024), which only analyzed the direct impact of EPU on stock markets. Empirically, Nguyen (2025) also focused on the direct relationship between EPU and financial markets in China without incorporating interest rates, inflation, and exchange rates into a unified model. Thus, this study makes a strong and clear contribution by jointly integrating EPU and macroeconomic transmission to explain the dynamics of CSPI across Asian countries.

2. Literature Review

Signaling Theory, according to Gomez, (2025), states that external signals, such as EPU spikes, can influence capital management and thus play an important role in how investors perceive market risk. Another study conducted by Andersson, (2024) shows that an increase in EPU causes a shift towards quality, namely the transfer of capital to emerging markets with solid fundamentals, which in turn increases foreign capital flows and strengthens domestic stock indices.

Economic Policy Uncertainty (EPU) does not always have a negative impact, but can also have a positive effect on the increase in the stock index, namely the CSPI, through changes in investment tactics. A study conducted by Nur et al., (2022) shows that when global EPU rises, aggressive investors tend to be happy because they can take advantage of the situation to make profits more quickly amid increased market volatility. On the other hand, foreign investors will tend to shift their investments to developing countries and sectors that are considered more stable, such as the defensive sector (OECD, 2024). The transfer of funds will trigger an increase in stock demand, which can spur price increases that ultimately have a positive impact on the CSPI.

Based on the Modern Portfolio Theory concept described by Jacob et al., (2024), macroeconomic factors such as interest rates, inflation, and currency exchange rates are key factors in creating an optimal investment portfolio. Research conducted by Garnia et al., (2021) reveals that in Indonesia, high interest rates have a negative effect on the CSPI because they increase capital costs and reduce people's purchasing power, while the strengthening of the rupiah supports the CSPI by lowering import costs and improving

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export margins. On the other hand, high inflation causes the CSPI to decline because it reduces purchasing power and burdens companies' operating costs (Hafifa et al., 2025).

Macroeconomic variables can also affect the CSPI, including interest rates, inflation, and exchange rates. A study conducted by Sia & Puah, (2025) shows the negative effect of interest rates on the CSPI because an increase in interest rates will increase the burden of loan investments, which will ultimately reduce the attractiveness of investment. On the other hand, a study by (Sumantri, 2020) found that inflation has a negative effect on the CSPI, because when prices increase continuously, it will reduce demand, thereby weakening purchasing power and reducing company profits, which ultimately weakens stock price. A study conducted by (Larasati & Simamora, 2025) shows that exchange rate appreciation has a positive impact on the CSPI, where a strong exchange rate can reduce import costs, strengthen the competitiveness of domestic companies, and foster investor confidence.

Based on Signalling Theory, an increase in Economic Policy Uncertainty (EPU) serves as external information that changes investors' risk perceptions and triggers adjustments to portfolio allocation strategies. When EPU increases, some investors respond by fleeing to quality, shifting capital to markets and sectors with stronger fundamentals, thereby increasing capital inflows and domestic stock demand, which ultimately drives up the CSPI. This mechanism is reinforced by aggressive investors who take advantage of volatility to gain short-term profits. However, the magnitude of EPU impact on the CSPI is conditional on macroeconomic factors, as explained in Modern Portfolio Theory, where high interest rates and inflation increase the cost of capital and suppress stock performance, while currency appreciation strengthens corporate competitiveness and boosts investor confidence, thereby amplifying the positive effect of EPU on the CSPI.

3. Research Method

This study uses a quantitative method with monthly panel data from January 2010 to January 2025 in seven Asian countries, namely Hong Kong, Japan, Pakistan, China, India, South Korea, and Singapore. The sample used consists of 1,267 observations obtained from 181 months (monthly range January 2010 - January 2025) multiplied by the 7 countries studied. The model in this study uses a dependent variable, namely the composite stock price index (CSPI), with the main independent variable being economic policy uncertainty (EPU). This study also uses control variables, namely interest rates, inflation, and exchange rates. The following are details and sources of data used in this study.

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Table 2. Variable descriptions and data sources

Variable	Descriptions	Source
CSPI	A statistical measure that describes the price movements of all global stocks	https://id.investing.com/
EPU	An index reflecting economic policy uncertainty measured based on the frequency of news reports.	https://www.policyuncertainty.com/
Interest Rate	The percentage of the benchmark interest rate set by the monetary authorities	Official website of the central banks of the 7 countries studied.
Inflation	Continuous increase in the prices of goods and services based on the Consumer Price Index	Official website of the central banks of the 7 countries studied.
Exchange Rate	The amount of domestic currency needed to obtain one unit of foreign currency.	https://id.investing.com/

Source: author's processing

Model selection in this study followed standard procedures in panel data analysis. The Chow test was first applied to determine the most appropriate specification between the Common Effect Model (CEM) and the Fixed Effect Model (FEM). If the Chow test indicated a preference for the FEM, the Hausman test was subsequently employed to compare the FEM with the Random Effect Model (REM) and identify the optimal model. Conversely, when the Chow test results favored the CEM, the analysis proceeded with the Breusch–Pagan Lagrange Multiplier test to evaluate the suitability of the REM relative to the CEM and select the best-fitting model.

The next test is to examine the residual variance-covariance structure and analyze whether there is cross-sectional correlation or not (Feng et al., 2021). If the model selected previously is CEM or FEM, then the residual variance-covariance structure and cross-sectional correlation will be tested. However, when the model selected is REM, the next test is the classical assumption test. The residual variance–covariance structure is first examined using the Lagrange Multiplier (LM) test, while cross-sectional dependence is assessed through the Breusch–Pagan Lagrange Multiplier test. When the LM test indicates that the residual variance–covariance matrix is homoscedastic, estimation is conducted using the Ordinary Least Squares (OLS) approach. In contrast, if heteroscedasticity is detected, the Breusch–Pagan Lagrange Multiplier test is subsequently applied to evaluate the presence of cross-sectional correlation. If no cross-sectional dependence is identified, the appropriate estimation technique is Generalized Least Squares (GLS). However, when cross-sectional correlation is present, Feasible Generalized Least Squares (FGLS) is employed. After determining the estimation method, classical assumption testing is performed. For OLS estimation, a complete set of classical assumption tests is required, including normality, heteroscedasticity, multicollinearity, and autocorrelation tests. Meanwhile, when GLS or FGLS is used, classical assumption testing is limited to normality and multicollinearity tests. This can be done because

GLS/FGLS estimation is robust to autocorrelation and heteroscedasticity constraints (Bai et al., 2021).

After the model meets the classical assumption evaluations, regression analysis is performed to gather the research results. The outcomes of the panel data regression analysis are shown through various measures, such as the F-test to check the collective significance of the explanatory variables, the t-test to evaluate the individual impact of each independent variable, and the coefficient of determination to gauge how well the model fits by showing the percentage of variation in the dependent variable that is accounted for by the independent variables. The research model used in this investigation is displayed as follows.

$$LOGYCSPI = \alpha 0 + \beta 1X1EPU_{it} + \beta 2X2INTERESTRATE_{it} + \beta 3X3INFLATION_{it} + \beta 4X4EXCHANGERATE_{it} + \varepsilon_{it} \quad \text{.....(1)}$$

Description:

LOGYCSPI	= Logarithm of CSPI
X1EPU	= Main independent variable EPU
X2INTERESTRATE	= Interest rate
X3INFLATION	= Inflation
X4EXCHANGERATE	= Exchange rate

4. Results and Discussion

This section aims to interpret the panel data regression results in explaining how economic policy uncertainty and key macroeconomic variables, namely interest rates, inflation, and exchange rates, affect the dynamics of the composite stock price index across seven Asian countries, drawing on financial theory and prior empirical evidence.

Model Used in the Research

Table 3. Chow Test

Effects Test	**Statistic**	**d.f**	**Prob.**
Cross-section F	2187.890406	(6,1256)	0.0000
Cross-section Chi-square	3089.121725	6	0.0000

Source: author's processing

Between the Common Effect Model (CEM) and the Fixed Effect Model (FEM), the Chow test was used to identify which model was best. The cross-section Chi-square statistic, which is lower than the 0.05 significance level, is 3089.121725 with a p-value of 0.0000, according to the results shown in the above table. Because of this outcome, H1 is accepted. The Chow test's decision rule states that if H1 is accepted, the FEM is chosen, but if H0 is accepted, the CEM is preferred. Consequently, it may be said that the Fixed Effect Model is better suited for this investigation than the Common Effect Model.

Tabel 4. Hausman Test

Test Summary	**Chi-Sq. Statistic**	**Chi-Sq. d.f.**	**Prob.**
Cross-section random	24.082666	4	0.0001

Source: author's processing

The Hausman test was utilized to identify the better fitting model between the Random Effect Model (REM) and the Fixed Effect Model (FEM). The table presented above indicates that the cross-section random statistic is 24.082666 with a p-value of 0.0001, which falls below the 0.05 significance level. This result suggests that H1 is supported. Based on the rules for interpreting the Hausman test, if H0 is accepted, it implies the REM is appropriate, whereas acceptance of H1 indicates the FEM is preferable. Therefore, it can be inferred that the Fixed Effect Model is the more favored and fitting model in comparison to the Random Effect Model for this analysis.

The outcomes of both the Chow and Hausman assessments show that the Fixed Effect Model (FEM) is reliably chosen in the two model selection methods. This reliability suggests that the FEM is the most suitable option, as it has backing from multiple statistical evaluations. As a result, the Lagrange Multiplier test, which compares the Random Effect Model (REM) with the Common Effect Model (CEM), is unnecessary. The Lagrange Multiplier test is only needed when the Hausman test prefers the REM. Given that the Hausman test in this analysis favors the FEM, the study will continue with the Fixed Effect Model for estimating the panel data regression.

Panel Data Regression Model Estimation Methods Used in Research

Table 5. Heteroscedasticity Test

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	0.048044	0.006513	7.377000	0.0000
X1_EPU	4.93E-05	2.95E-05	1.674211	0.0943
X2_INTERESTRATE	0.005760	0.000825	6.979974	0.0000
X3_INFLATION	0.001123	0.000723	1.552657	0.1208
X4_EXCHANGERATE	3.89E-05	5.55E-06	7.004394	0.0000

Source: author's processing

The heteroscedasticity test was conducted using the Glejser method by regressing the independent variables against the absolute residuals. Heteroscedasticity occurs when most of the partial t-significance is < 0.05 and the F-test significance is < 0.05. The results in the table above show that most of the partial t-significance is > 0.05 or accepts H0, and the F-test significance is 0.0000 < 0.05 or accepts H1, so the model has a heteroscedasticity problem or is heteroscedastic.

Table 6. Autocorrelation Test

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	0.015334	0.003188	4.809565	0.0000
RESID02(-2)	0.038588	0.028547	1.351730	0.1767
RESID02(-1)	0.920626	0.028318	32.51037	0.0000
X1_EPU	-8.06E-05	1.44E-05	-5.585388	0.0000
X2_INTERESTRATE	-8.82E-05	0.000399	-0.220973	0.8251
X3_INFLATION	0.000521	0.000351	1.483764	0.1381
X4_EXCHANGERATE	-2.58E-06	2.68E-06	-0.963340	0.3356

Source: author's processing

The autocorrelation test was performed using the Breusch–Godfrey LM serial correlation procedure, which involves regressing the residuals on all explanatory variables as well as the first and second lags of the residuals. The results show that most partial t-statistics are insignificant at the 5 percent level, suggesting acceptance of the null

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hypothesis in individual tests. However, the F-test reports a significance value of 0.0000, which is below the 0.05 threshold, leading to rejection of the null hypothesis. These results indicate the existence of serial correlation, meaning that the model does not meet the assumption of no autocorrelation.

After testing for heteroscedasticity and autocorrelation, it turns out that there are problems of homoscedasticity and non-autocorrelation violations in the model. Therefore, the model must be corrected through Cross Section SUR (PCSE) calculations, which make the model immune or robust to violations of the assumptions of heteroscedasticity and serial autocorrelation. The results of the heteroscedasticity test explain that the residual variance-covariance structure is heteroscedastic, therefore the Breussch-Pagan Lagrange Multiplier test is needed to analyze the presence or absence of cross-sectional correlation.

Tabel 6. Breussch-Pagan Lagrange Multiplier Test

Test	Statistic	d.f	Prob.
Breusch-Pagan LM	780.8382	21	0.0000
Pesaran scaled LM	116.1655		0.0000
Bias-corrected scaled LM	116.1460		0.0000
Pesaran CD	18.90569		0.0000

Source: author's processing

Based on the table above, the significance value of the Breusch-Pagan Lagrange Multiplier test is 0.0000 < 0.05, indicating that there is cross-sectional dependence. The Breusch-Pagan Lagrange Multiplier test stipulates that if no cross-sectional correlation is found, then the estimation method chosen is Generalized Least Square. Conversely, if the Breussch-Pagan Lagrange Multiplier test finds cross-sectional correlation, then the appropriate estimation is Feasible Generalized Least Square (FGLS). The results in the table and interpretation show that the model has cross-sectional correlation, so the appropriate estimation method used is FGLS. Thus, the appropriate estimation method used in this study is Feasible General Least Square (FGLS) with Cross Section SUR (PCSE) estimation coefficients.

Classical Assumption Tests

The classical assumption tests required in this study are only normality and multicollinearity tests. This is because the estimation method used in this study is FGLS, which is robust to heteroscedasticity and autocorrelation problems.

1. Normality Test

   This study uses the FGLS estimation method because FGLS utilizes error covariance estimation to overcome autocorrelation and heteroscedasticity. The assumption of normality is not crucial as long as the sample size is large enough because the asymptotic distribution of the estimator will remain close to a normal distribution. The sample used in this study is a large sample of 1267 samples, therefore the Central Limit Theorem (CLT) applies. According to the Central Limit Theorem, a sufficiently large sample can be regarded as normally distributed since the sampling distribution of the mean converges toward a normal distribution as the sample size increases (Gujarati & Porter, 2013). Thus, inferences based on OLS (such as t-tests or F-tests) remain asymptotically valid based on the central limit theorem.

2. Multicollinearity Test

Table 7. Multicollinearity Test

Variable	X1_EPU	X2_INTERESTRATE	X3_INFLATION	X4_EXCHANGE RATE
X1_EPU	1.000000	0.020082	0.007282	0.040608
X2_INTERESTRATE	0.020082	1.000000	0.755464	-0.090141
X3_INFLATION	0.007282	0.755464	1.000000	-0.070579
X4_EXCHANGE RATE	0.040608	-0.090141	-0.070579	1.000000

Source: author's processing

The multicollinearity test is considered satisfied when the correlation among independent variables does not indicate a strong relationship, namely when the correlation coefficients remain below 0.9 or above negative 0.9 (Audigé, 2005). Based on the table above, the correlation test results among the independent variables indicate that none of the correlation coefficients exceed 0.9 or fall below negative 0.9, suggesting the absence of strong correlations. Therefore, the model does not suffer from multicollinearity and satisfies the multicollinearity assumption.

Statistical Hypothesis Test

Table 8. Panel Data Regression Estimation Results Using the FGLS SUR (PCSE) Method

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	3.757445	0.021532	174.5087	0.0000
X1_EPU	0.000250	5.25E-05	4.751747	0.0000
X2_INTERESTRATE	-0.013519	0.002055	-6.579280	0.0000
X3_INFLATION	-0.003661	0.001357	-2.697954	0.0070
X4_EXCHANGERATE	0.001168	8.41E-05	13.88929	0.0000

Source: author's processing

Based on the table above, the F-test value is 3292.114 with a p-value of 0.000000. The p-value of 0.000000 is less than 0.05. This indicates that the main variable, EPU, and the control variables, including interest rates, inflation, and exchange rates, jointly affect the movement of the CSPI in seven Asian countries. The adjusted R-square value in the table above is 0.962958 or 96.29%. This indicates that the main independent variable, EPU, and the control variables, interest rates, inflation, and exchange rates, contribute 96.29% to the movement of the CSPI in 7 Asian countries. Meanwhile, the remaining 3.71% is influenced by other independent variables outside the scope of this study.

Based on the table above, the t-test (partial test) results explain the individual effects of the independent variables on the dependent variable. The coefficient of EPU is 0.000250, indicating that a one-point increase in EPU is associated with a 0.000250 percent rise in the CSPI. The probability value for EPU is 0.0000, which is below the 0.05 significance level, suggesting that EPU has a statistically significant positive impact on the CSPI in seven Asian countries. The interest rate variable has a coefficient of −0.013519, meaning that a one percent increase in interest rates leads to a 0.013519 percent decline in the CSPI. With a significance value of 0.0000, which is less than 0.05, interest rates are found to have a significant negative effect on the CSPI in the seven Asian economies. Inflation also shows a negative relationship with the CSPI, as indicated by its coefficient

of −0.003661. This implies that a one percent increase in inflation reduces the CSPI by 0.003661 percent. The associated p-value of 0.0071 is below 0.05, confirming that inflation has a significant negative influence on the CSPI in the sampled countries. Furthermore, the exchange rate coefficient of 0.001168 suggests that an increase of one unit in the domestic currency per USD is linked to a 0.001168 percent increase in the CSPI. The exchange rate variable is statistically significant, with a probability value of 0.0000, indicating a significant positive effect on the CSPI across seven Asian countries. Overall, these findings support all of the proposed research hypotheses.

The estimation results show that differences in coefficient magnitudes reflect different macroeconomic transmission channels to CSPI movements. Interest rates have the greatest economic impact (−0.013519), indicating that interest rate hikes directly increase capital costs and lower the valuation of risky assets, thereby putting significant pressure on the stock market. Inflation also has a negative impact (−0.003661), but with a smaller magnitude, indicating that its influence works indirectly and gradually through increased cost uncertainty and reduced purchasing power. The relatively small EPU coefficient (0.000250) indicates that economic policy uncertainty does not trigger a large stock market response in the short term, but it still plays a role as a determining factor in investor expectations when uncertainty increases continuously. Meanwhile, the positive exchange rate coefficient (0.001168) shows that the appreciation of the domestic currency against the USD tends to increase the CSPI through increased investor confidence and macroeconomic stability. The adjusted R-square value of 96.29% indicates that the variation in CSPI movements in seven Asian countries can largely be explained by the combination of EPU, interest rates, inflation, and exchange rates in the model, while the role of other factors is relatively limited.

Discussion

The following discussion explains how economic policy uncertainty and key macroeconomic factors affect the movement of CSPI in seven Asian countries through investor response, capital flow dynamics, and changes in sectoral performance, with reference to cross-country empirical evidence and the context of regional financial market developments.

1. The Effect of Key Independent Variables (EPU) on the CSPI in 7 Asian Countries

EPU can surge significantly, especially when influential countries announce policies that lack clarity in the long term. such as the United States imposing an increase in import tariffs on steel and aluminum from China, which initially stood at 3.1% in 2017 to 18.3% in May 2019, with long-term uncertainty regarding the mechanism and duration of the policy (Caldara et al., 2020). This phenomenon has caused a sharp increase in EPU in affected countries. A case study was conducted in Hong Kong, where 40% of the increase in Hong Kong's EPU was caused by spillover from regulatory uncertainty abroad, particularly in influential countries such as the United States and China (Kan et al., 2020). This increases stock volatility, which in turn triggers aggressive investors to become more active in the stock market. Aggressive investors are those who are willing to take on significant risks in order to reap quick profits amid sharp fluctuations in stock prices.

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Another case study found that Japan was also affected by policy uncertainty, with the Japanese EPU rising due to the postponement of consumption tax and external pressure from US trade regulations (Arbatli et al., 2022). This has made aggressive investors even more active through the potential to utilize leverage effects during high volatility caused by falling stock prices amid uncertainty and asymmetric volatility, where negative news causes higher stock volatility. Risk-taking or aggressive investors will optimize this potential opportunity by buying when prices fall sharply or when EPU increases with high stock volatility and selling when prices rise.

When there is an increase in EPU in developed countries, investors tend to shift their funds to developing countries for reasons of better risk diversification and as a precautionary measure, that is allocating funds to places that are considered relatively safer for investment. A study in Pakistan analyzed that a global increase in EPU, particularly in developed countries, could increase domestic stock market profits by 0.69% due to investors' assumption that shifting funds to developing countries would be better than investing in developed countries experiencing uncertainty (Hussain et al., 2023). A study in India in 2023 also noted that despite economic policy uncertainty, the Indian stock market continued to soar, with foreign investors purchasing up to USD 1.5 billion in stocks over a two-month period (IEP, 2025). This shows that India, as an emerging country, is considered a more stable investment alternative when EPU in developed countries is increasing. On the other hand, a study in Singapore shows that the inflow of short-term foreign capital in Singapore increases when there is global uncertainty (IMF, 2020). This means that Singapore is considered more prepared for uncertainty shocks, so that investment remains stable. The inflow of foreign investment can increase stock prices, which in turn increases the CSPI.

In the short term, EPU can actually stimulate growth in sectors that are considered safe, such as commodities and energy. A study in China found that when economic policy uncertainty increases, returns on energy sector stocks actually show an increase of up to 7% in just 12 months (Gui et al., 2024). This is because investors feel safer investing in real assets such as oil and coal than in equity funds amid soaring global EPU. In addition, the pharmaceutical and banking sectors in China have also experienced an increase in stock market returns amid high EPU due to their perceived resilience to policy fluctuations and the existence of government support and regulations that fully support these sectors. A South Korean study also explains that the basic necessities and health sectors actually grew amid soaring economic policy uncertainty due to stable demand as basic human needs and materials (Cho et al., 2024). In addition, South Korea also continues to strive to support the improvement of defensive sectors so that they continue to generate profits in the stock market amid the turmoil of rising global EPU. This phenomenon explains that when EPU is high, investors will shift to sectors that are relatively safe in value and have short-term stability. With the large amount of funds received by these sectors, stock prices in these sectors can increase, and ultimately raise the CSPI as an index of price movements recorded in the stock market.

This discussion is consistent with Signalling Theory Gomez (2025) which views economic policy uncertainty as external information that shapes investors' risk perceptions and responses. An increase in EPU encourages investment strategy adjustments through portfolio reallocation and increased market activity, which can have

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a positive impact on the CSPI. The increase in EPU creates uncertainty in the investors' home countries, encouraging cross-border capital movements as a rational response to reduce risk. Within the framework of international financial integration, this capital shift occurs because stock markets across countries are interconnected, so that policy shocks in one country directly affect global portfolio allocation decisions. This mechanism of capital transmission and reallocation confirms that changes in stock market activity and indices in the destination country are a direct consequence of global financial market integration under economic uncertainty (Haddad, 2023).

2. The Effect of Control Variables (interest rates, inflation, and exchange rates) on the CSPI in 7 Asian countries

An increase in interest rates will have a negative effect or may lower the CSPI because interest rates can increase the burden of investment in the form of borrowing costs, thereby reducing investor interest in investing in the stock market. A study in South Korea explains that an increase in short-term interest rates will have a negative effect on the KOSPI (Korea Composite Stock Price Index), because domestic investors will relatively withdraw their investments from stocks and switch to low-risk assets (An, 2023). A study in Japan shows that when the Bank of Japan implemented interest rate hike regulations in 2024 after years of using negative interest rates (-0.1%), small to medium-sized companies began to feel the pressure of increased interest costs, which ultimately led to downward pressure on the Nikkei index (BOJ, 2024). A study in China explains that the increase in 10-year bond yields has caused a significant decline in the daily return on the Shanghai Composite Index (Zhang, 2024). This happened because investors assumed that rising capital costs would cause a decline in stock valuations. Thus, an increase in interest rates could cause a decline in the CSPI because it could reduce incentives for investment (increased investment costs) and could weaken corporate productivity due to higher interest costs, resulting in a decline in purchasing power. Overall, an increase in interest rates could cause a decline in stock market valuations.

High inflation will have a negative impact, namely a decline in the CSPI, because continuous increases in the prices of goods and services can lead to a decline in purchasing power and a decrease in public consumption. Declining public consumption will have an impact on companies' revenues, which in turn can reduce companies' profits or profitability, making stock prices less attractive to investors (Suteja & Abas, 2018). High inflation will also cause an increase in raw material and operational costs for companies, which can further reduce their profit margins. All of these factors will relatively reduce investor confidence, causing most investors to withdraw their investments from the stock market, which will result in a decline in the CSPI. A study in Pakistan in 2024 outlined the results of an analysis that an average annual inflation rate of 6.5% could sharply cause a decline in the PSX stock index (Devi, 2024). In addition, the inflation rate is the most crucial factor that can negatively affect stock index returns, reducing them by 0.42 points for every 1% increase in inflation (Devi, 2024). A study in Hong Kong shows that the sharp rise in inflation after the Covid-19 pandemic

ISSN (print) 1858-165X | ISSN (online) 2528-7672

significantly reduced the HangSeng Index, especially in the property and consumption sectors (HKMA, 2021). This occurred because investors had estimated that people's purchasing power would decline sharply. Therefore, high inflation can adversely affect the CSPI by lowering corporate profitability and diminishing investor confidence, which ultimately leads to weaker investor sentiment.

A strengthening exchange rate can indicate the macroeconomic stability of a country. This can boost investor confidence, which can increase foreign capital inflows and stock purchases, thereby boosting the CSPI. A strengthening exchange rate can also reduce import costs, thereby boosting profitability and increasing stock prices. A strong exchange rate indicates stable and effective inflation control and reflects favorable external conditions, thereby boosting investor confidence and sentiment in the stock market. A study conducted in India found that when the rupee exchange rate against the US dollar increased by 1%, it had a positive impact on an increase of more than 0.5% in stocks, the Nifty 50 index (Victor et al., 2021). A study in Singapore shows that the strengthening of the domestic currency by 3.6% in the past year has contributed to an increase in foreign capital inflows into the stock market, thereby strengthening the stock index (Teng, 2024). Thus, exchange rate appreciation contributes significantly to the increase in the CSPI through strengthening corporate competitiveness, stabilizing the macroeconomy, and increasing investor confidence and sentiment.

This discussion is in line with Modern Portfolio Theory as proposed by Jacob et al. (2024), which asserts that investor asset allocation decisions are influenced by changes in returns and risks arising from macroeconomic conditions. Rising interest rates and inflation increase risk and lower expected stock returns, thereby encouraging a shift in portfolios away from risky assets, while a strengthening exchange rate improves companies' fundamentals and increases the attractiveness of stocks in investment portfolios. Changes in interest rates, inflation, and exchange rates affect the CSPI through the mechanisms of capital costs, purchasing power, and shifts in investment preferences in the stock market. Within the framework of open finance theory and international capital market integration, increases in interest rates and inflation put pressure on stock valuations through increased production costs and reduced profit expectations, while exchange rate appreciation encourages capital inflows and strengthens investor sentiment (Purnamasari et al., 2025). Therefore, CSPI dynamics reflect the market's response to the interaction of macroeconomic policies and investor behavior in an interconnected global financial system.

5. Conclusion

EPU appreciation has a significant positive impact because it diverts investment flows to more resilient emerging markets, while interest rates and inflation have a significant negative impact because they reduce investment attractiveness and profit margins. Exchange rates have a significant positive impact because domestic currency appreciation increases investor confidence and export competitiveness. These findings have direct implications for monetary authorities and financial market supervisors. The positive impact of EPU on the CSPI requires central banks to develop communication strategies and stabilization instruments that can turn uncertainty into a catalyst for

ISSN (print) 1858-165X | ISSN (online) 2528-7672

capital inflows. The negative impact of interest rates on the CSPI underscores the need for monetary authorities to maintain credibility and transparency in setting policy interest rates so that adjustments do not weaken the attractiveness of domestic investment. The negative impact of inflation demonstrates the importance of close cooperation between monetary and fiscal authorities to maintain price stability and thus protect purchasing power and corporate performance. Meanwhile, exchange rate appreciation that strengthens the CSPI requires the central bank to implement adaptive exchange rate policies to maintain export competitiveness while increasing global investor confidence.

The limitations of this study are that the variables used are still relatively simple and do not take into account important factors such as the role of institutional investors, liquidity, and hedging instruments, which have a significant impact on market sensitivity to EPU and macroeconomic variables. This limitation makes the findings of this study more indicative than conclusive. Therefore, further research is urgently needed, adding structural variables and dynamic models so that the results are truly more meaningful, accurate, and relevant for policy-making in the face of increasing global uncertainty and current conditions.

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