

Macroeconomic Shocks and Market Persistence: A VECM Approach to the Indonesian Financial Sector

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Abstract

Research Originality: This study offers fresh insights by analyzing how inflation, exchange rates, and economic growth affect Indonesia's IDX Finance sector, addressing a key gap in understanding the market's internal dynamics.

Research Objectives: This study quantifies the impact of inflation, exchange rates, and economic growth on the Indonesian IDX Finance sector.

Research Method: This study uses 62 monthly observations and a VECM to analyze short- and long-run relationships among variables.

Empirical Results: Long-run VECM estimates reveal that the Consumer Price Index (CPI) and Exchange Rate (ER) exert significant positive pressures on IDXFİNANCE, suggesting that moderate inflationary environments often catalyze credit expansion and heightened demand for financial intermediation. Conversely, Economic Growth (EG) exhibits a statistically negligible long-term impact.

Implications: The findings indicate that IDX Finance is largely driven by its own past dynamics rather than by external macroeconomic shocks. As a result, internal market trends provide more reliable short-term predictions than traditional economic indicators, especially when the sector's persistence is taken into account.

Keywords:

Indonesian financial sector; inflation; exchange rate; economic growth

How to Cite:

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INTRODUCTION

Macroeconomic conditions play a fundamental role in shaping financial market dynamics, particularly in emerging economies where financial systems are more vulnerable to external and domestic shocks. Fluctuations in inflation, interest rates, exchange rates, and economic growth directly influence the profitability, risk exposure, and investor sentiment of the banking sector (Mouna & Anis, 2016; Verma & Bansal, 2021). As banks constitute the backbone of financial intermediation, understanding how macroeconomic variables affect banking stock performance is critical for ensuring financial stability and sustainable economic growth.

Indonesia represents one of Southeast Asia's largest and most dynamic emerging economies. Its banking sector serves as a central pillar of economic development, facilitating capital allocation, supporting business expansion, and promoting financial inclusion (Boachie et al., 2023). The performance of listed banking institutions—reflected in the bank sector index—acts as a forward-looking indicator of financial sector health and market expectations (Habib et al., 2025). However, Indonesia's exposure to commodity price volatility, capital flow reversals, exchange rate fluctuations, and global financial uncertainty heightens the banking sector's sensitivity to macroeconomic disturbances. Goh et al. (2025) show that stock price predictions are reasonably accurate and that the error may be attributable to stochastic macroeconomic conditions.

Drawing on Kumar et al. (2024) on the nexus between monetary stability and growth in developing contexts, this research addresses the persistent challenges of financial fragility and inflationary pressures. The impact of inflation on corporate valuation remains a subject of significant debate. While Baek et al. (2024) and Isma et al. (2023) posit that inflation erodes firm value, Truong (2025) extends this argument, suggesting that such detrimental effects persist across both short- and long-term horizons. In the Indonesian context, Anas et al. (2022) identify supply-side shocks—predominantly fluctuations in energy and food prices—as the primary drivers of price instability. Seasonal demand surges further compound these pressures during religious and year-end festivities, which Hosen (2024) identifies as critical cyclical determinants of domestic inflation.

The exchange rate constitutes a key macroeconomic determinant of inflation in Indonesia. Hudaya and Firmansyah (2022) emphasize that exchange rate volatility increases economic uncertainty and may weaken macroeconomic stability, particularly in sectors highly exposed to international trade. Due to Indonesia's dependence on imported intermediate goods and raw materials, movements in the rupiah—especially against the US dollar—can transmit external shocks into the domestic economy.

The broader implications of exchange rate movements on equity markets yield heterogeneous findings in the literature. While Goh et al. (2024) and Šimakova (2017) observe a consistent inverse relationship between currency value and stock market performance, Ahmadzai et al. (2024) provide evidence of a positive influence. These conflicting results underscore the complexity of the exchange rate's role in shaping financial market dynamics, underscoring the need for further empirical investigation within the Indonesian financial sector.

Similarly, Rasbin et al. (2021) find that fluctuations in the rupiah's exchange rate exert a statistically significant effect on domestic price levels, especially during periods of economic turbulence. Currency depreciation increases the cost of imported goods, thereby elevating overall inflation and potentially dampening macroeconomic performance (Ohakwe & Wu, 2025). Their findings underscore the importance of coordinated monetary and fiscal policies to mitigate the adverse effects of exchange rate volatility on price stability. Nasreen et al. (2020) demonstrate that economic growth and institutional quality are positively linked to financial development, indicating that robust institutions and sustained economic expansion contribute to more developed and resilient financial systems. Similar conclusions are reached by Okeke et al. (2024) and Nalliboyina and Chalam (2023), who argue that strong institutional frameworks, combined with consistent economic growth, enhance the depth and stability of financial systems.

Indonesia's economic trajectory reflects substantial structural transformation, evolving from a post-independence developing economy into a prominent emerging market (Imanuella et al., 2025). Bachtiar et al. (2023) note that the country's growth pattern has not been linear, with significant slowdowns during the 1997–1998 Asian Financial Crisis and the 2008 global financial crisis. Nevertheless, Indonesia has demonstrated considerable resilience, supported by its natural resource endowment, agricultural base, and progressive industrialization. Over the long term, economic performance has exhibited a steady upward trend. However, scholars highlight the critical influence of global economic dynamics, domestic political stability, and institutional reforms in shaping this growth path (Serbina et al., 2024). The policy adjustments implemented in the aftermath of the Asian Financial Crisis played a crucial role in restoring macroeconomic stability (Makin, 2019). Kohler and Stockhammer (2022) argue that fiscal consolidation, monetary restructuring, financial sector reforms, and trade liberalization collectively established the institutional and macroeconomic foundations necessary for sustained post-crisis expansion.

A critical lacuna exists in the current discourse: the disproportionate focus on aggregate stock market indices at the expense of sector-specific analysis. While the banking industry constitutes the backbone of the Indonesian financial system and serves as the primary conduit for monetary policy transmission, limited empirical attention has been directed toward the IDXFINANCE index within a VECM framework. Understanding the dynamic sensitivities of the banking sector is paramount, given its systemic role in capital allocation and its unique exposure to interest rate volatility and credit risk—factors that are often obscured in diversified market studies.

This research contributes to the macro-financial literature by shifting the analytical lens from market-wide aggregates to a targeted sector-specific evaluation. By isolating the Indonesian banking sector, this study provides a more precise mapping of how economic growth, inflation, and exchange rate dynamics permeate the financial core of an emerging Southeast Asian economy. The novelty of this work lies in its ability to capture the long-run equilibrium and short-run error correction mechanisms unique

to a bank-dominated financial system undergoing rapid structural transformation and global integration. Consequently, this study offers updated, empirically rigorous evidence that is vital for both portfolio managers and idiosyncratic risk monitoring by monetary authorities.

The research specifically aims to quantify the impact of inflation, interest rates, exchange rates, and economic growth on banking stock performance; investigate the short-run and long-run relationships between these macroeconomic variables and the sector index; and provide practical policy and investment recommendations to enhance financial stability and support effective macroeconomic management. By focusing on a sector-specific index, the study not only fills a critical gap in the literature but also provides actionable insights to guide financial decision-making in Indonesia and other emerging markets with similar structural characteristics.

METHODS

The data used in this study consists of secondary data covering the Exchange Rate, Gross Domestic Product (GDP), Consumer Price Index (CPI), and the IDX Finance index for the period 2021–2026. The selection of the 2021–2026 period is strategically designed to capture the Indonesian financial sector's performance during a critical phase of structural transformation and global macroeconomic realignment. Unlike previous decades, this timeframe encompasses the post-COVID-19 recovery trajectory, allowing the VECM model to account for the transition from emergency liquidity measures to a more normalized monetary environment. This period is particularly significant for Indonesia as it highlights the “new normal” of fiscal-monetary coordination and the resilience of the banking sector amidst fluctuating global commodity prices and inflationary pressures. These data were obtained from TradingView and Bank Indonesia. This research applies a quantitative approach using time-series secondary data. The IDX Finance (IDXF) index is treated as the dependent variable, while the Exchange Rate (ER), Consumer Price Index (CPI), and Economic Growth (EG) serve as independent variables. The analysis is based on 62 observations. Monthly data is the ideal middle ground for observing how markets react to external shocks without the excessive volatility (noise) of daily or weekly data.

To examine the dynamic interactions among the variables, this study utilizes the Vector Error Correction Model (VECM). This framework is particularly suitable for assessing both short-term dynamics and long-term equilibrium within cointegrated, non-stationary time series. The estimation followed a rigorous diagnostic hierarchy – stationarity analysis: unit root tests were conducted to confirm that the variables were integrated of order I (1); lag of selection: the optimal lag structure was identified using the AIC, SC, and HQ information criteria to ensure model parsimony and residual stability; and cointegration testing: the Johansen procedure was applied to verify the existence of a stable long-term nexus, justifying the VECM specification.

The robustness of the model was assessed using several diagnostic tests, including

the serial correlation test, heteroskedasticity test, and stability test, to ensure that the residuals satisfy the classical assumptions. In addition, t-statistics were employed to assess the short-run significance of each macroeconomic variable. In contrast, the statistical significance of the error correction term indicates the presence of long-run causality.

To gain deeper insight into the dynamic relationships among the variables, Impulse Response Function (IRF) and Variance Decomposition (VD) analyses were also conducted. The IRF analysis demonstrates how shocks to one variable influence other variables over time. In contrast, the VD analysis quantifies the extent to which variations in each variable are attributable to shocks originating from other variables in the system. These approaches provide a more comprehensive understanding of the dynamic interactions within the Indonesian financial sector.

RESULTS AND DISCUSSION

Empirical results demonstrate that inflation serves as a primary determinant of banking sector performance across both short- and long-term horizons. While controlled inflationary environments may catalyze expansionary opportunities, the persistence of this relationship highlights the imperative for price stability as a prerequisite for sustained market confidence. Concurrently, the IDXFINANCE index shows high elasticity to exchange rate fluctuations, suggesting that currency stabilization is a fundamental pillar of financial market resilience. Interestingly, the long-run estimates reveal a decoupling between aggregate economic growth (EG) and sectoral equity returns. This relative insulation implies that the banking industry is structurally shielded from transitory shifts in aggregate output, potentially because the sector relies on internal credit mechanisms and institutional maturity rather than on immediate GDP fluctuations.

This study primarily utilizes the Augmented Dickey-Fuller (ADF) test to examine the presence of a unit root. The ADF test expands the basic Dickey-Fuller equation by incorporating lagged differences of the dependent variable to account for potential higher-order serial correlation in the error terms.

Table 1. Unit Root Test

Variables	Level	t-Statistic	Prob
CPI	I(0)	-3.14	0.03
EG	I(1)	-7.63	0.00
ER	I(1)	-7.31	0.00
IDXFinance	I(1)	-7.27	0.00

Source: Authors' own work

Based on the Augmented Dickey-Fuller (ADF) test results at the level form with an intercept in Table 1, the Consumer Price Index (CPI) variable is found to

be stationary. The ADF test statistic is -3.1377 , which, in absolute terms, exceeds the MacKinnon critical value at the 5% significance level (-2.9100). This result is supported by a probability value of 0.0289 ($p < 0.05$), leading to the rejection of the null hypothesis (H_0) that indicates the presence of a unit root. Therefore, the CPI variable can be considered stationary at the level, meaning that the data can be used directly in subsequent econometric analysis without differencing and without the risk of spurious regression.

Furthermore, a stationarity test at the first-difference level was conducted for the Economic Growth (EG) variable. The ADF test results show a t-statistic value of -7.6263 , which is significantly smaller (more negative) than the MacKinnon critical values at the 1% (-3.5440), 5% (-2.9108), and 10% (-2.5930) significance levels. In addition, the obtained p-value is 0.0000 ($p < 0.01$), indicating that the null hypothesis of a unit root can be rejected at all significance levels. Therefore, the EG variable is considered stationary in first differences, or integrated of order 1, $I(1)$. This result indicates that the data stabilize after a single differencing and are therefore suitable for cointegration analysis and other dynamic estimation models.

The Exchange Rate (ER) variable was also tested for stationarity in first differences. The results of the Augmented Dickey-Fuller test show a t-statistic value of -7.3056 , which is significantly lower than the critical values at the 1% (-3.5440), 5% (-2.9108), and 10% (-2.5930) significance levels. With a probability value of 0.0000 , the null hypothesis indicating the presence of a unit root can be strongly rejected. Thus, the ER variable is considered stationary in first differences, or integrated of order 1, $I(1)$. This condition confirms that, after differencing, the data are stable and can be used in the research model without causing spurious regression. A similar result is observed for the IDXFİNANCE variable, which becomes stationary after first differencing. Based on the ADF test results, the t-statistic value obtained is -7.2668 , which is significantly lower than the MacKinnon critical values at the 1% (-3.5440), 5% (-2.9108), and 10% (-2.5930) significance levels. The probability value of 0.0000 ($p < 0.01$) indicates that the null hypothesis of a unit root can be rejected. Therefore, the IDXFİNANCE variable is considered stationary in first differences, or integrated of order 1, $I(1)$. This result implies that, after differencing, the data exhibit stable means and variances over time, thereby meeting the requirements for further analysis using dynamic econometric models such as the Vector Error Correction Model (VECM).

The Granger Causality test is conducted to examine the bidirectional relationship and the direction of predictive influence among variables in the short run (see Table 2). Based on the test results at a 5% significance level ($\alpha=0.05$), several key findings are identified as follows: First, the relationship between CPI and ER: There is a unidirectional causality where CPI influences ER (Prob. $0.0097 < 0.05$). Conversely, ER does not significantly influence CPI. This indicates that changes in the domestic inflation rate signal movements in the exchange rate during the observation period. Second, the relationship between ER and EG: A unidirectional causality is detected where ER influences EG (Prob. $0.0410 < 0.05$). This suggests that fluctuations in the

exchange rate have a predictive role for economic growth (EG). Third, Relationship between IDXFİNANCE and EG: At the 10% significance level, there is an indication of causality from IDXFİNANCE to EG (Prob. 0.0602). However, under the stricter 5% significance level, this relationship is not statistically significant. Fourth, other variables: No bidirectional causality (feedback mechanism) is found among the remaining variable pairs. Most variables show p-values above 0.05, meaning that the null hypothesis cannot be rejected; therefore, there is no significant short-run causal relationship among those variable pairs.

Table 2. Granger Causality Test

Null hypotheses	F-Satistic	Prob.
EG \nrightarrow CPI	0.80	0.37
CPI \nrightarrow EG	0.08	0.78
ER \nrightarrow CPI	0.07	0.79
CPI \nrightarrow ER	7.15	0.01
IDXFİNANCE \nrightarrow CPI	0.20	0.65
CPI \nrightarrow IDXFİNANCE	1.85	0.18
ER \nrightarrow EG	4.37	0.04
EG \nrightarrow ER	0.19	0.67
IDXFİNANCE \nrightarrow EG	3.67	0.06
EG \nrightarrow IDXFİNANCE	2.05	0.16
IDXFİNANCE \nrightarrow ER	0.02	0.89
ER \nrightarrow IDXFİNANCE	0.57	0.45

Source: Authors' own work

Table 3. Cointegration Test

Hypothesize	Eigenvalue	Trace Statistic	Prob.
None *	0.44	109.14	0.00
At most 1 *	0.40	75.24	0.00
At most 2 *	0.32	44.84	0,00
At most 3 *	0,30	21.66	0,00

Source: Authors' own work

Cointegration testing was conducted to assess the existence of a stable long-term relationship among the variables used in this study, namely CPI, EG, ER, and IDXFİNANCE (see Table 3). The analysis applied two approaches: the Trace Test and the Maximum Eigenvalue Test. First, the results of the Trace Test indicate that the Trace Statistic values for the hypotheses None, At most 1, At most 2, and At most 3 are all higher than their corresponding critical values at the 5% significance level. Moreover, the p-values for each hypothesis are 0.0000 ($p < 0.05$), supporting the rejection of the

null hypothesis. Second, the Maximum Eigenvalue Test yields results consistent with those of the Trace Test. The Max-Eigen Statistic values for each hypothesis also exceed the 5% critical values, confirming cointegration among the variables.

Table 4. VECM Long Run

Variable	t-statistics
IDXFinance	1
CPI	1.69
EG	-0.68
ER	6.43
C	-408.37

Source: Authors' own work

CPI shows a significant positive long-run relationship with (IDXFİNANCE), with a coefficient of 1.69. This indicates that higher inflation tends to be accompanied by higher levels of financial sector indices. The coefficient for EG is negative (-0.68); however, the t-statistic is relatively small (-0.68, below 2.0). Therefore, this variable is not statistically significant in explaining the long-term movement of the financial sector index. ER exhibits a significant positive relationship, with a coefficient of 6.43. This suggests that, in the long run, appreciation or changes in the exchange rate contribute positively to the financial sector index's performance. The Vector Error Correction Model (VECM) estimates the short-run relationships among variables, as indicated by the coefficients of the variables in their first-difference form. Based on the estimation results, the equation for the change in the financial sector index shows that only the inflation variable, proxied by the Consumer Price Index (CPI), has a significant short-run effect. This is indicated by a t-statistic value of 2.281, which is greater than the critical value of 1.96 at the 5 percent significance level. The CPI coefficient is positive at 8.772585, indicating that a short-run increase in inflation will lead to an increase in the financial sector index. This condition suggests that changes in the economy's price level can influence the financial sector's performance in the short term.

Table 5. VECM Short Run

Model	IDXFinance	CPI	EG	ER
CountEq1	-2.22	-0.57	0.61	-4.38
IDXFinance	-1.52	0.96	-1.36	2.92
CPI	2.28	0.11	-0.04	-1.22
EG	-0.34	-0.11	-4.1	-0.12
ER	0.62	0.59	-0.93	0.65
C	-0.25	-0.21	-0.05	-0.21

Source: Authors' own work

Meanwhile, the variables of economic growth (EG) and exchange rate (ER) do not show a significant effect on the financial sector index in the short run. This can be observed from the t-statistic values of each variable, which are smaller than the critical value of 1.96. Therefore, it can be concluded that fluctuations in economic growth and the exchange rate do not directly affect the short-term movement of the financial sector index. In the equation for the change in inflation, the estimation results indicate that none of the independent variables in the model—namely, the financial sector index, economic growth, and exchange rate—have a significant short-run effect. This is indicated by t-statistic values below the 5 percent critical value. These findings suggest that other factors outside the research model more strongly influence short-run changes in inflation.

Furthermore, the estimation results for the change in economic growth indicate that none of the variables has a significant short-run effect. The financial sector index, inflation, and the exchange rate do not show any meaningful influence on economic growth. This implies that short-run dynamics of economic growth are not directly affected by the variables included in the research model. In the equation for the change in the exchange rate, the estimation results show no significant short-run relationship between the financial sector index, inflation, economic growth, and the exchange rate. All variable t-statistics are below the critical value, indicating they are not statistically significant. Therefore, it can be concluded that short-run changes in the exchange rate are not directly influenced by the variables included in the model. Overall, the VECM estimation results indicate that, in the short run, only inflation has a significant effect on the financial sector index. In contrast, the short-run relationships among the other variables are not statistically significant.

Figure 1. Impulse Response

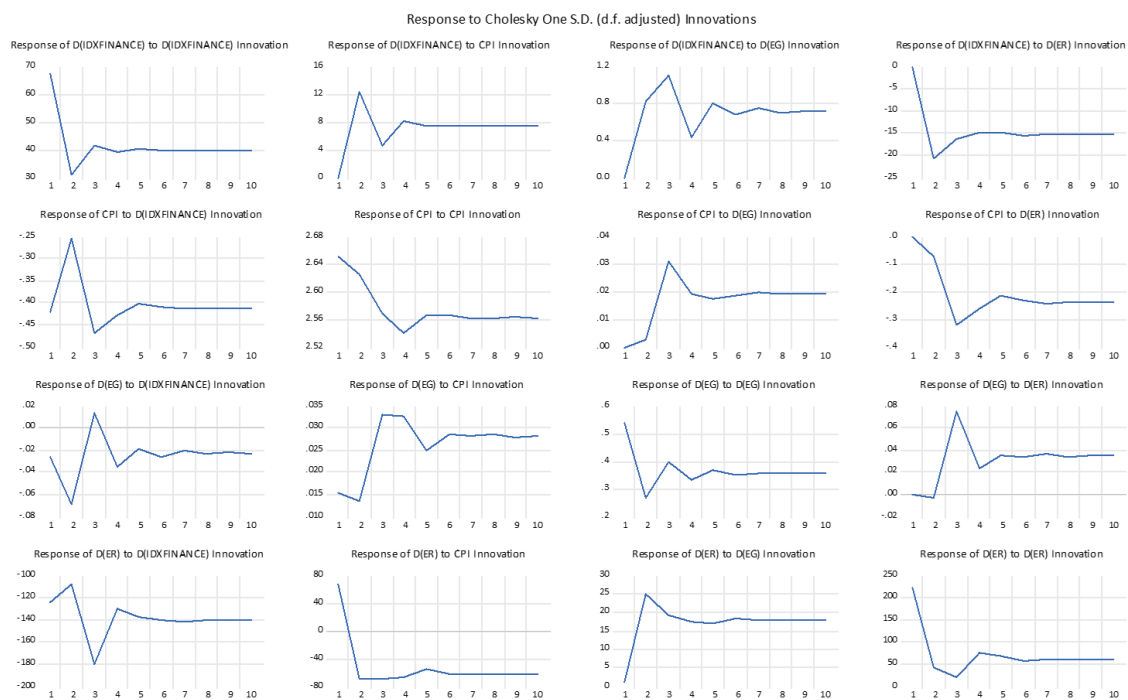


Figure 1 illustrates the dynamic response of IDXFİNANCE to macroeconomic shocks. A standard deviation shock to the CPI triggers a sustained positive reaction, peaking in the second period; this suggests that moderate inflation is perceived as a signal of credit demand and economic expansion. Conversely, Exchange Rate innovations exert significant downward pressure, with a sharp negative response from the second period through the tenth, highlighting how Rupiah volatility drives risk aversion. Finally, Economic Growth shocks provide a stable, positive impetus; following initial fluctuations, the index maintains a consistent upward trajectory, confirming the long-term link between real-sector productivity and financial performance.

Figure 2. Variance Decomposition

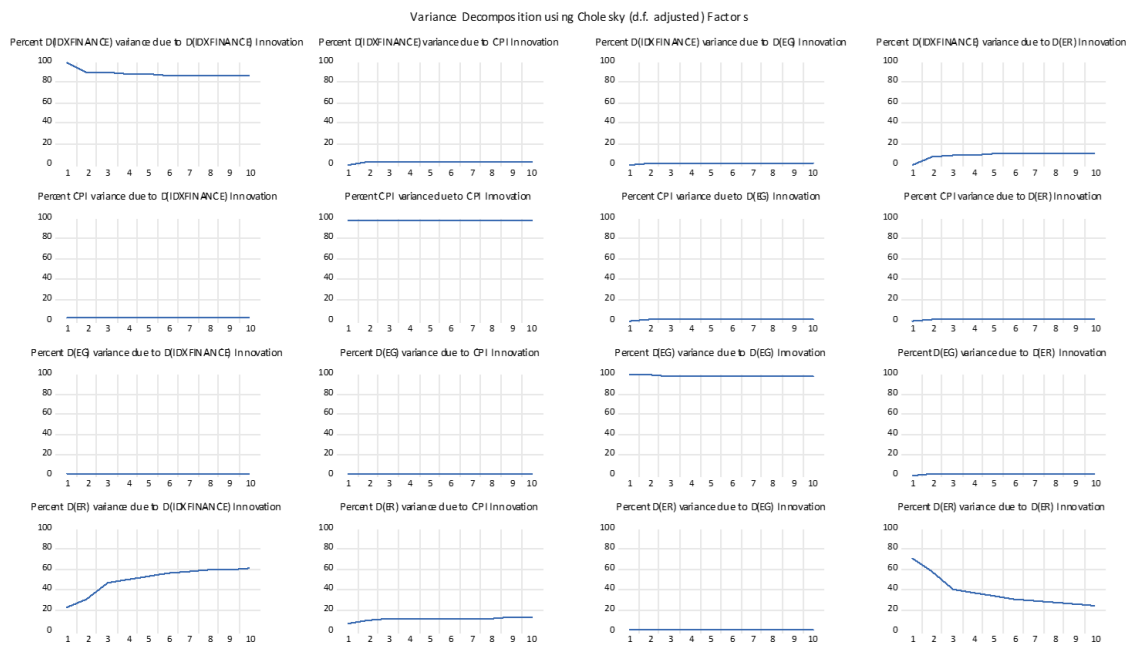


Figure 2 shows that IDXFİNANCE variance is predominantly driven by its own shocks, which account for over 80% of the fluctuations through the tenth period. This high degree of self-explanation suggests the index is relatively exogenous and remains largely insulated from immediate macroeconomic volatility. Among external factors, the Exchange Rate is the most influential, though its contribution remains marginal compared to CPI and Economic Growth. These results imply that market-specific dynamics, rather than broader macroeconomic shocks, are the primary drivers of Indonesian financial sector performance.

The preliminary diagnostic tests provide critical insights into the data’s stochastic properties. The stationarity tests reveal that while the Consumer Price Index (CPI) is integrated of order I(0), Economic Growth (EG) and the Exchange Rate (ER) are integrated of order I(1), and IDXFİNANCE is integrated of order I(0). The fact that these series achieve stationarity only after first differencing is consistent with the evidence provided by Anas et al. (2022) and Baek et al. (2024). Such findings reinforce the

common characteristic of emerging market variables following stochastic trends, thereby justifying the application of differencing techniques to eliminate the risk of spurious regression and ensure the robustness of the VECM estimates.

The Granger causality analysis identifies several distinct unidirectional transmission channels within the system. Notably, a significant causal relationship exists between the Consumer Price Index (CPI) and the Exchange Rate (ER), indicating that domestic inflationary pressures serve as a leading indicator of currency fluctuations. This finding aligns with the established literature on emerging economies, where currency values frequently respond to inflationary signals to maintain purchasing power parity (Hudaya & Firmansyah, 2023; Olamide et al., 2022; Yildirim & Ivrendi, 2016). Furthermore, the unidirectional causality extending from ER to Economic Growth (EG) highlights the pivotal role of exchange rate stability in forecasting aggregate output. This relationship corroborates the assertions of Rasbin et al. (2021) and Okeke et al. (2024), who posit that currency market volatility significantly influences the real economy through its impact on trade competitiveness and production costs. Finally, a marginal causal link is observed from IDXFİNANCE to EG (significant at the 10% level), providing tentative evidence that the banking sector acts as a catalyst for economic expansion. This supports the theoretical framework of financial intermediation as a driver of growth, as discussed by Boachie et al. (2023).

Cointegration analysis confirms a stable long-term relationship among CPI, EG, ER, and IDXFİNANCE. This finding supports earlier studies that emphasize the interdependence between macroeconomic variables and financial sector indicators. For example, Mouna & Anis (2016) and Verma & Bansal (2021) highlight the long-run sensitivity of stock indices to inflation, interest rates, and exchange rate movements in emerging markets, while Goh et al. (2024) similarly identify sustained macro-financial linkages in Southeast Asian stock indices. The VECM results indicate that, in the long run, CPI and ER exert significant positive effects on IDXFİNANCE, whereas EG has a negative but statistically insignificant effect. The positive relationship between inflation and the banking sector index aligns with the findings of Truong (2025) and Isma et al. (2023), who argue that moderate inflation can signal economic expansion, increased lending activity, and demand for banking services. Likewise, the positive impact of ER corroborates the findings of Ahmadzai et al. (2024) and Šimakova (2017), who document that currency appreciation can boost investor confidence and stock market performance in emerging economies. The insignificant long-term effect of EG suggests that short-term fluctuations in economic growth may not directly translate into sectoral stock performance, echoing the findings of Kumar et al. (2024) and Nasreen et al. (2020), who note that growth impacts are often mediated by institutional quality and financial development.

In the short run, only CPI has a statistically significant effect on IDXFİNANCE, highlighting the banking sector's sensitivity to inflationary signals. This finding supports Hosen (2024) and Anas et al. (2022), who emphasize that banking stock returns react promptly to changes in the price level. The impulse response function further illustrates

that CPI shocks generate sustained positive effects on IDXFİNANCE, whereas ER shocks elicit negative responses. This reflects short-term market uncertainty driven by currency volatility, consistent with observations by Ohakwe & Wu (2025). Variance decomposition results indicate that the banking sector index is largely driven by its own shocks, with macroeconomic variables contributing a smaller share of the variability. Among them, ER exerts the most notable influence, though still limited, in line with Hudaya & Firmansyah (2023) and Saeed & Klugah (2025), who stress that internal market dynamics often dominate external macroeconomic shocks in emerging markets.

In aggregate, these findings establish that inflationary pressures and exchange rate dynamics are the primary catalysts of banking sector performance in Indonesia across both short- and long-term horizons. While the financial sector exhibits notable resilience to transitory fluctuations in aggregate economic growth, maintaining macroeconomic equilibrium—specifically by mitigating price and currency volatility—remains a fundamental prerequisite for sustaining financial market confidence (Aladwani, 2025; Irani et al., 2025; Nowzohour & Stracca, 2020). By synthesizing these empirical results, this research confirms the distinctive sensitivity of the IDXFİNANCE index to macroeconomic shocks, thereby addressing a critical lacuna in the extant literature that has historically prioritized aggregate market indices or firm-level metrics over sector-specific analysis (Boachie et al., 2023; Goh et al., 2024, 2025; Ahmadzai et al., 2024). Ultimately, these insights offer a robust framework for policymakers and institutional investors aiming to safeguard systemic stability and optimize portfolio management within the volatile landscape of emerging Southeast Asian economies.

CONCLUSION

The analysis reveals a nuanced relationship between key macroeconomic variables and the IDX Finance sector's performance, with inflation emerging as the most influential factor. The Consumer Price Index (CPI) shows a positive impact on the financial sector, indicating that inflation plays a critical role in shaping market dynamics. Exchange rate (ER) movements also exhibit a positive relationship with the IDX Finance index, although their impact is weaker than that of inflation. In contrast, economic growth (EG) shows an insignificant relationship with the financial sector index. These findings suggest that, within the observed period, financial sector performance in Indonesia is more sensitive to inflationary pressures and exchange rate fluctuations than to aggregate economic growth. The results address the study's objectives by clarifying both the short-run and long-run effects of macroeconomic indicators on banking sector performance, highlighting that CPI and ER are key determinants. In contrast, EG appears less influential in driving sectoral market outcomes.

Based on these findings, several policy implications emerge. First, inflation's significant role in shaping IDX Finance's performance underscores the importance of maintaining price stability through effective monetary policy. Policymakers should

monitor inflation trends closely and implement measures to mitigate excessive volatility, thereby supporting investor confidence and financial sector stability. Second, although the direct impact of exchange rate fluctuations is moderate, policymakers should ensure that currency management policies, such as foreign exchange interventions or hedging frameworks, protect the financial sector from potential external shocks. Finally, financial institutions and investors should consider market-specific dynamics alongside macroeconomic fundamentals when making strategic decisions, as the banking sector's sensitivity to inflation and exchange-rate movements underscores the need for risk-aware asset allocation and proactive financial planning. While this study provides updated evidence on the macro-financial nexus, the scope is limited to four key macroeconomic indicators. Future research should expand this analytical lens to include the impact of fiscal policy interventions, global liquidity conditions, and investor sentiment. Furthermore, investigating the role of institutional quality as a mediating factor could provide a deeper understanding of why real-sector growth exhibits limited direct influence on sectoral market outcomes in emerging economies.

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