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Effect of Macroeconomic Variables On Stock Price in Nepal

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Abstract

This study explores how variations in major macroeconomic indicators affect stock market performance in Nepalese stock market. This study examines how macroeconomic factors, such as inflation rate, exchange rate and market capitalization, affect the price of shares in Nepal. Secondary time-series data from FY 2000 to FY 2024 were used in the analysis. This study analyzed descriptive statistics, correlation analysis, multiple regression analysis, ANOVA, and beta analysis. The findings provide evidence that the major variable affecting stock price is market capitalization. The findings offer important insights policymakers, investors, and for future research into the Nepalese financial market.

Keywords: exchange rate, inflation rate, market capitalization, stock price

1. Background

The economic liberalization of the 1980s significantly affected Nepal's financial system and placed greater emphasis on the relationship between financial markets and the real economy (Karki, 2017). The relationship between the Nepal Stock Exchange and its macro-economic environment indicators is important for development of policies based on knowledge, development of investment strategies and financial evaluation (Thapa & Adhikari, 2025). Although a large number of literatures exists that examines the relationship between stock exchanges and the macro-economic environment in developed countries and developing countries, few studies exist which examine the relationship within the Nepalese context with an emphasis on recent time frames and a variety of factors (Karki, 2018). A cointegration relationship can be used to show that an inefficiency exists in both the short run and long run for the Nepalese stock market, allowing for the identification of predictable deviations from equilibrium (Karki, 2018; Khatri, 2019). The importance of identifying which macroeconomic factors have effects on stock price volatility in emerging markets such as Nepal derives from the unique features of their financial systems and their susceptibility to exogenous shocks (Khatri, 2019). This study is a research investigation that is analyze how macroeconomic factors (inflation, exchange rate, and market capitalization) impact stock prices in Nepal. The study uses time-series analysis that have been used less frequently than other statistical methods.

2. Literature Review

Arbitrage Pricing Theory have identified several macro-economic risk factors including money supply, interest rates, inflation and exchange rates as being significant determinants of stock returns (Khatri, 2019). In the case of the Nepalese Stock Market, several other macro-economic factors have also been studied. Some studies suggest that there exists a long run relationship between the variables of broad money supply, interest rates, and the exchange rate and the NEPSE Index (Devkota & Dhungana, 2019). These results indicate the necessity of studying the stock market through a multi-factor model.

2.1 Stock Price

The stock price is recognized through the aggregation of all possible future cash flows associated with each respective stock, and all are impacted significantly by macroeconomic factors. Therefore, as well as being influenced by exchange rate, money supply, and inflation, macroeconomic factors also impact the overall fundamental characteristics that determine the intrinsic value of a stock (Rakhal,

2018; Ojha, 2021). As interest rates rise, the cost of capital increases for businesses, thereby decreasing the expected profitability of a business and ultimately the value of its shares (Karki, 2018). Increased money supply creates increased economic and commercial activities which can lead to higher business earnings and therefore greater stock values (Khatri, 2019).

2.2 Inflation Rate

There are various reasons for inflation, such as demand and supply of money, change in production, cost of distribution, or even policies such as taxes on products (Setiawan et al., 2019). Inflation occurs due to a lax monetary policy (Samadi et al., 2012). Stock prices respond to inflation through several channels, notably through their effect on corporate profitability, the discount rate, and investor confidence (Utomo et al., 2019; Chauhan et al., 2024), and in doing so they may influence expectations about future cash flows (Hardi et al., 2023). If the expected rate of return is increased in response to this inflation, then it would likely increase the discount rate associated with stocks and therefore decrease their value (Hardi et al., 2023). The reason for this is the inverse relationship between inflation and real output, and therefore reduced corporate profitability and cash flow due to decreased economic activity (Kasongwa & Minja, 2022). This may make the stock less attractive unless there is an equivalent increase in the rate of growth of cash flows (Ghazo et al., 2020).

2.3 Exchange Rate

Stock prices are influenced by changes in exchange rates through the influence on the profitability of corporations that have international operations and through the valuation of foreign investment, as it influences the overall outlook and capital inflow in the market. A devaluation of a nation's currency may decrease the return on stocks for foreign investors and make an asset less attractive (Alqaralleh et al., 2021). A decreasing value of a nation's currency may increase the competitiveness of companies whose primary function is to export. This may lead to higher profitability and increased returns on stocks (Karaömer & Güzel, 2024). Exchange rate fluctuations may also affect the cost of importing raw materials used by domestic companies and consequently affect production costs and stock valuations (Barakat et al., 2015). The ability of a multinational company to remit profits back home may be significantly affected by exchange rates and thus its earnings, and subsequently its stock price (Upadhyaya et al., 2018). Foreign investors are discouraged from investing in foreign companies with volatile exchange rates, and this discouragement will affect the stock prices of international companies that conduct business in multiple currencies (Trecy et al., 2024).

2.4 Market Capitalization

Market capitalization is an important factor used to represent the entire value of a company's outstanding shares. Macro-economic factors have a direct effect on a firm's profitability, growth and the discount rate applied to its future cash flow, which are all very important when calculating a firm's market capitalization (Ikhsan et al., 2022). An example of this would be if the economy was expanding there would be an increase in earnings for corporations, and positive views from investors. Therefore, the corporation's market capitalization would decrease (Ghazanvi & Akram, 2025).

3. Conceptual Framework

The conceptual framework of this model provides a general description of how the changes to these variables will relate to the movements in the stock market of Nepal. Thus, it addresses research gaps and can be used as a base for future studies based on empirical evidence. The paradigm also assesses the potential impact of political stability, government policies, and global economic conditions on these linkages, thereby offering a comprehensive perspective on the factors that influence stock prices in the developing market. The following research framework is proposed.

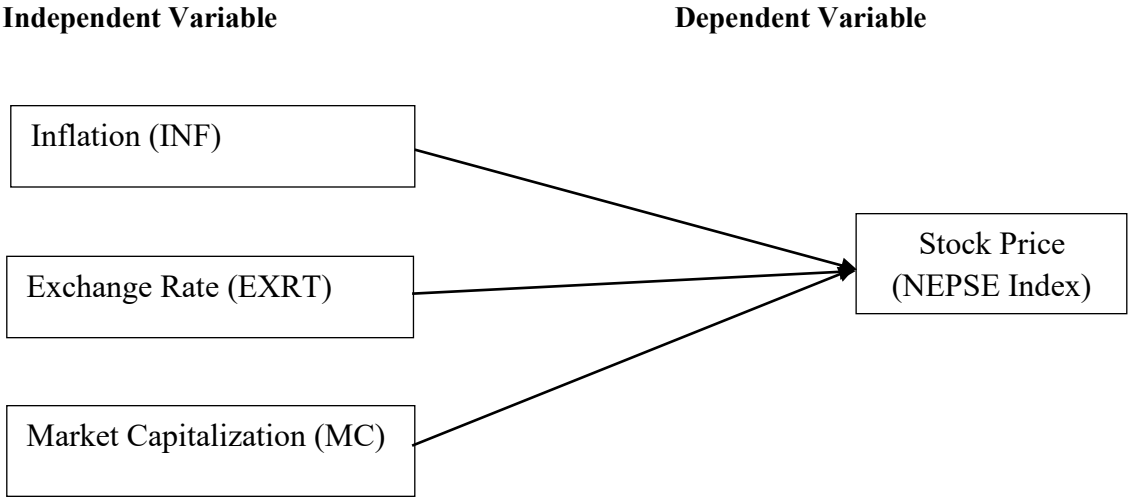


Figure 1. Proposed Model

4. Research Hypothesis

4.1 Inflation and Stock Price

Researchers have proposed a unidirectional relationship between the inflation rate and stock prices, suggesting that inflation influences stock prices, whereas stock prices do not impact inflation (Talla, 2013). The study conducted by Phuyal (2016) examined the long-term equilibrium relationship between selected macroeconomic indicators, specifically interest rates, inflation rates, remittances, and stock prices, in the emerging Nepalese Stock Exchange. While the exchange rate is linked to the stock market, other indicators do not show such a connection (Gurloveleen & Bhatia, 2015). Furthermore, the study found that the Stock Market Index (SMI) is positively correlated with inflation and an increase in the broad money supply (Shrestha & Subedi, 2014). An inverse relationship between stock prices and inflation has been identified (Naik & Padhi, 2012), with the inflation rate being negatively related to stock prices (Gunu & Irdis, 2009). Based on this, we propose the following hypothesis:

H1: Inflation rate significantly effects on stock price.

4.2 Exchange Rate and Stock Price

The findings demonstrate that the exchange rate has a significant and beneficial long-term effect on stock markets, while inflation exerts a minor and negative long-term influence (Karki, 2018). The exchange rate has a significant and beneficial long-term effect on stock markets, whereas inflation exerts a minor and negative long-term influence (Mohanty et al., 2023). Interest and inflation rates have a significant positive impact on stock market indices (Rakhal, 2018). There were no statistically significant positive or negative correlations between the Consumer Price Index (CPI), interest rates, exports, and currency exchange rates and the KSE Index (Rafay et al., 2014). However, exchange rates have a negative impact on stock returns, although interest rates are not significant in predicting long-term returns on the NSE (Setiawan et al., 2019). Based on the above discussion, we propose the following hypothesis:

H2: The exchange rate significantly effects on stock price.

4.3 Market Capitalization and Stock Price

A decline in the total market capitalization can also cause a fall in the overall share price. Market capitalization as an indicator of aggregate stock price movements. It can indirectly influence the valuation of each individual stock. Changes in market

capitalization can provide investors with information about their own investments as well as the liquidity of individual stocks. This will ultimately have an effect on whether stock prices are efficient (Memon et al., 2024). Stock prices can also be affected by a reduction in market capitalization due to lower investor confidence and/or a weak economy that could result in a reduction in investor confidence (Wafi & Merlinda, 2023). Larger market capitalizations can attract foreign investment and lead to higher stock prices as well as increased demand for the local currency (Ararso, 2024). Based on above review, we propose the following hypothesis:

H3: Market capitalization significantly effects on stock price.

5. Research Methodology

This study adopts a positivist research philosophy. The deductive method logically conforms best to the views and demands of the positivist research philosophy. This study employed a descriptive and explanatory research design.

This study uses time-series data of macroeconomic indicators and the stock market index for analysis. The sample was selected for the period FY 2000 through FY 2024 because this time frame represents a full cycle of Nepal's stock market development, with an emphasis on economic growth and significant political and structural changes in the country. A 25-year time horizon offers sufficient observations to perform a reliable time series analysis and enables the assessment of both short-term volatility and long-term trends. This study is empirical research based on secondary data. The sources of data were the NEPSE and NRB websites. After all data had been collected, then mean, standard deviation (SD), coefficient of variation (CV) and trend analyses were completed, as well as correlation analysis, ANOVA and beta analysis with the help of SPSS software version 20. Additionally, diagnostic testing (Variance Inflation Factor) was done to check for multicollinearity among the independent variables. This may affect the reliability of the regression coefficient. It can provide assurance that all data produced are valid and applicable.

5.1 Model Specification

A regression model was drafted to test the hypothesis that there is a significant relationship between macroeconomic variables and stock price. The model included in key macroeconomic factors including inflation, exchange rates, and market capitalization, as well as financial sector. The following econometric model was utilized in this study:

$SP = \beta_0 + \beta_1 INFR_t + \beta_2 EXRT_t + \beta 3 MS_t + e_t \ldots (1)$

Where:

SP = Stock Price (NEPSE Index),

INF = Inflation

EXRT = Exchange Rate

MC= Market Capitalization

Likewise, β0 can be seen as the constant of the model; while β1, β2, and β3 represent the coefficients of the independent variables; and finally, et, denotes the stochastic error term which is the factor accounting for the impact of other variables that have been left out of the model.

6. Results

6.1 Trend Analysis

This study examines trends in share prices alongside macroeconomic variables, including inflation rate, exchange rate and market capitalization.

Figure 1. *Trend of Stock Price*

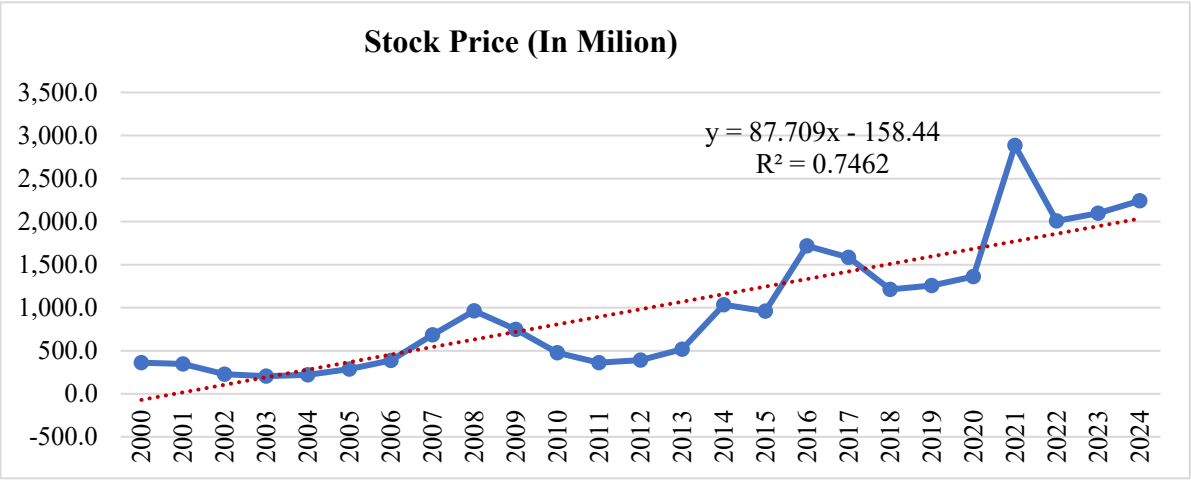


Figure 2. *Trend of Inflation Rate (INFR)*

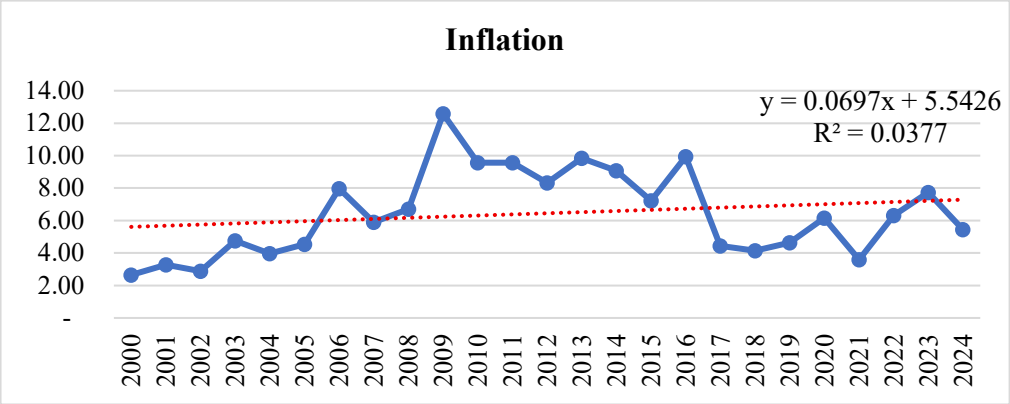


Figure 3. *Exchange Rate*

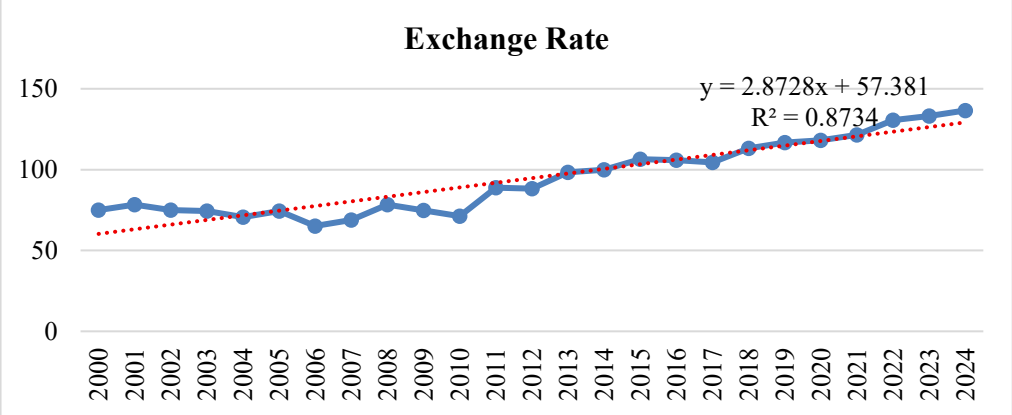
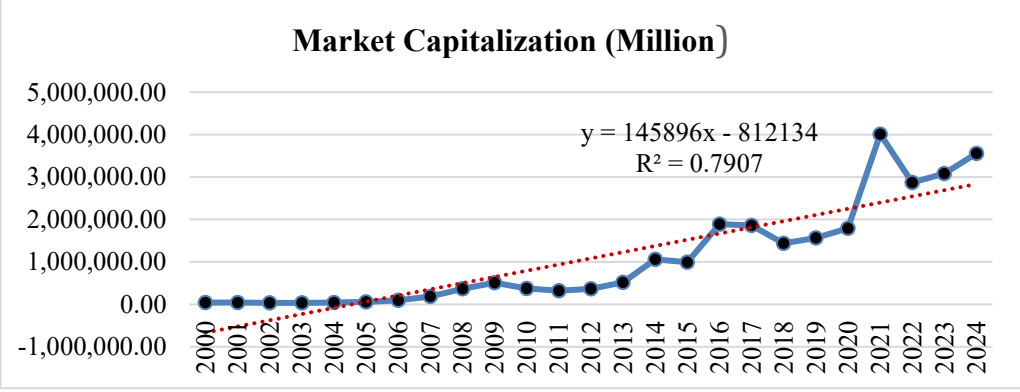


Figure 4. *Market capitalization*



Source: *Nepal Rastra Bank, 2025*

The graph shows 2000–2024 stock price increases. After no major changes, it slowly rose, fell between 2009-12, then rose again in 2013. The stock price peaked several times, including 2021. The linear trend line (y = 87.709x – 158.44) shows an average yearly stock price growth of 87.7 million, with R^2 = 0.7462. This fits well and lets the model explain most of the variation. Similarly, Figure 2 illustrates macroeconomic volatility by showing inflation changes since 2000. From 2000 to 2009, inflation was 2–5%. In 2009, inflation was 12.6%. After 2009, inflation decreased and fluctuated until 2016. It declined to 4% in 2017-18. After 2019, inflation climbed slightly until 2023 and decreased in 2024. While the Linear Trend Line (y=0.0697x+5.5426) shows inflation rate increases, the low R^2 (.0377) reveals exogenous factors drive inflation rather than regular trends. Inflation has no long-term structure and is highly unpredictable. Also, Figure 3 shows the 2000–2024 foreign currency rate rise. The domestic currency devalues constantly. Early foreign currency rates were 70-80 units. Foreign exchange dropped in 2006. After that, exchange rates rose gradually in 2007. The improvements continued from 2010 to 2015 and peaked in 2024. The linear trend line (y= 2.8728x+ 57.381) demonstrates 2.87-unit annual foreign exchange growth. R^2 =.8734 indicates a good fit. Domestic currency has been falling for a long period, possibly due to economic causes.

Finally, the graph shows from 2000 to 2006, capitalization was modest and stable. Capitalization rose moderately from 2007 to 2010, with small dips and spikes from 2011 to 2013. A strong rise after 2014 and a massive 2016–2017 spike. Market correction in 2018–2019 lowered capitalization. Capitalization peaked in 2021, suggesting investor optimism. It climbed again in 2024 after dipping in 2022. The linear trendline y=145896x−812134 shows an annual rise of 145,896 million units. The R^2 value of.7907 suggests a strong link between time and investment in Nepal. Nepalese capital markets are maturing and expanding, as shown by short-term highs and lows and long-term growth.

6.2 Descriptive Statistics

The descriptive statistics for the dependent and independent variables are presented below.

Table 1. *Descriptive Statistics of Study Variables*

	Min.	Max.	Mean	SD	CV	N
Stock Price (In Million)	204.9	2883.4	981.76	747.24	76.11	25

Inflation	2.6	12.6	6.44	2.65	41.10	25
Exchange Rate	65	137	94.68	22.70	23.97	25
Market Capitalization (Million)	34704	4010957.8	1,084,519.88	1,207,523.74	111.34	25

Table 1 shows that stock prices fluctuated significantly; at its lowest point, the stock price was Rs. 204.9, and at its highest point, it was Rs. 2883.4. The average stock price was Rs. 981.76, million and the stock prices had an exceptionally large standard deviation of Rs. 747.24. The coefficient of variation for stock prices was 76.11%, which also reflected significant variability as well as instability in stock prices. Also, inflation rates varied from 2.60% to 12.60%, averaged 6.44%, and had a standard deviation of 2.65. The C.V. for inflation was 41.10%, suggesting moderate variability but overall stability. The exchange rates ranged from 65 to 137 and had an average of 94.68. The exchange rates had a standard deviation of 22.70. The C.V. for the exchange rate was 23.97%, indicating relative stability. Similarly, market capitalization showed the most variability, ranging from Rs. 34,704 to over Rs 4 million. The mean was approximately Rs. 1.08 billion. The standard deviation was approximately Rs. 1.21 billion. The C.V. for market capitalization was 111.34%, which also indicated extreme variability and unstable market conditions.

Stock prices and market capitalization were by far the most variable and exhibited a greater degree of volatility. This reflected the sensitivity and instability of these two areas of the economy. Both inflation and the exchange rate have shown more stability than the other three measures of economic activity during the same time frame.

6.3 Correlation Analysis

Table 2. *Correlation Analysis of Study Variables*

	SP	In	ER	MC
1) Stock Price	1			
2) Inflection	-.041	1		
3) Exchange Rate	.863**	-0.03	1	
4) Market Capitalization	.979**	-0.061	.909**	1

** Correlation is significant at the 0.01 level (2-tailed).

Table 2 displays the relationship between stock price and inflation, exchange rate and market capitalization are -.041, .863 and .979 respectively. There is positive and significant relationship between stock price and exchange rate and market capitalization. But, stock price is insignificant and negatively correlated with inflation.

6.4 Regression Analysis

Table 3. *Model Summary*

R	R Square	Adjusted R Square	Std. Error of the Estimate
.982a	0.964	0.959	151.3893

Table 3 presents the model summary of the multiple regression analysis assessing the influence of specific macroeconomic variables on share prices. The multiple correlation coefficient (R = .928) signifies a robust positive association between share price and the total predictors of real GDP, inflation, money supply, and exchange rate. The coefficient of determination (R^2 = .861) indicates that 86.1 percent of the fluctuation in share prices is accounted for by these macroeconomic variables.

Table 4. *ANOVA Analysis*

	Sum of Squares	df	Mean Square	F	Sig.
Regression	12919441.69	3	4306480.563	187.902	.000b
Residual	48129.56	21	22918.727		
Total	13400734.96	24			

a. Dependent Variable: Stock Price

b. Predictors: (Constant), Exchange Rate, Inflation Rate, Market capitalization

The results of the ANOVA test for the multiple regression model illustrate the effects of several macroeconomic variables on share prices. Since the p-value of the F-statistic for the ANOVA test is less than 0.01 (.000), it indicates that the overall goodness of fit of the regression model is good enough to be considered statistically valid.

Table 5. *Coefficient Analysis*

	Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Collinearity Statistics	
	B	Std. Error	Beta			Tolerance	VIF
(Constant)	684.746	259.888	-	2.635	0.015	-	-
Inflation	6.704	11.713	0.024	0.572	0.573	0.992	1.008
Exchange Rate	-5.312	3.278	-0.161	-1.62	0.12	0.172	5.098
Market Capitalization	0.001	0.000	1.128	11.307	0	0.172	5.014

a Dependent Variable: Stock Price

Table 5 represents the findings of the multiple regression analysis for the effect of inflation, exchange rates, and market capitalization on stock price in Nepal. The results show a significant positive correlation between market capitalization and stock price (B= 0.001; β= 1.128; t(23) = 11.307; p <.001). This implies that market capitalization will directly affect stock prices. Although inflation had a positive correlation with stock prices (B= 6.704; β= 0.024; t(23) = 0.572; p=.573), it was not statistically significant over the study period. A negative correlation was found between exchange rates and stock prices (B= −5.312; β=−0.161; t(23) = −1.620; p=.120), although not significant at a 0.05 level. Finally, the equation's constant (B= 684.746; t(23) = 2.635; p=.015) represents the stock price base when controlling for other variables. The multicollinearity diagnostic tests yielded tolerances of 0.172-0.992 and VIFs of 1.008-5.098. These results show there is no multicollinearity in data sets. The research hypothesis H1 and H2 were rejected and H3 was accepted. Therefore, these results provide evidence that the major variable affecting stock price is market capitalization, while inflation and exchange rates were not found to have a statistically significant impact on the model.

7. Discussion

The research shows that market value was the biggest factor contributing to stock prices in Nepal, as does established financial theory, where the relationship is positive for a firm's market capitalization and its stock price (Robbetze & Niet, 2025). Nevertheless, the study also shows that inflation and exchange rate changes do not affect stock prices in Nepal. This contrasts previous studies that indicate that both are significant to how stock exchanges function (Hardi et al., 2023). It is possible that this difference results from the unique aspects of the Nepalese financial market; for example, the way investors view the market and the overall structure of the market may be more influential on the value of stocks than traditional exogenous macro-economic factors (Karki, 2024). Therefore, understanding the characteristics of the Nepalese financial market and the ways in which investors behave in this environment are critical to understand why the relationships observed existed. The lack of significance of the two macroeconomic indicators (inflation and exchange rates) may be due to the methodology used or the time frame examined in this study.

Therefore, continuing to study these relationships through the use of alternative statistical models or by increasing the size of the data set will be a good approach. While the results provided show a statistically insignificant negative correlation between the inflation rate and the NEPSE Index, there is evidence in prior studies that a similar type of relationship exists, and further research has shown that the effect of inflation on the stock market may be smaller than originally believed and/or influenced by other macroeconomic variables (Adhikari et al., 2024). These findings contrast with other studies that have shown a significant inverse relationship between inflation and stock market performance in other developing countries (Devkota & Dhungana, 2019). therefore, an evident requirement to produce a more sophisticated methodology for analyzing macroeconomic matters in developing countries and the structural anomalies of each respective domestic market, which may influence how macroeconomic metrics relate to equity valuations (Putra & Sugiyanto, 2021). Although other research has established a positive association between exchange rates and stock prices (Hardi et al., 2023), this study found a negative relationship in Nepal (albeit statistically non-significant), indicating a divergence which could be attributed to the laws regulating foreign investment in Nepal and the degree to which it is reliant upon international financial systems (Devkota & Panta, 2018). Some of the research that indicates no long-term relationship exists between inflation/exchange rates/interest rates and stock markets support the idea that short-term fluctuations in these metrics are not necessarily translated into enduring impacts on the performance of

equity markets (Trecy et al., 2024). It should therefore be acknowledged as important, to consider the regulatory context of a country when researching associations between macro-economic variables and equity markets (Karki, 2017).

8. Conclusion

This study addressed the macroeconomic determinants of stock market prices in Nepal. It can be that the stock price is influenced by market capitalization in Nepal. The uniqueness of the sensitivity of the Nepali stock market is shown as an example of how local factors may influence stock prices rather than larger scale macro-economic influences. These findings also reinforce the importance of prudent monetary policy and currency management by the Nepal Rastra Bank to create an equitable and attractive equity market environment. The results of this research offer several important points for consideration to policymakers, investors, and for future research into the Nepalese financial market. Policymakers are better able to develop regulations to stabilize and grow markets by taking into account these unique sensitivities. Investors should take note of the need for granular, firm-specific information and knowledge of specific nuances in the domestic market as opposed to a general macroeconomic view when making investments in Nepal.

Conflict of Interest: The authors declare no specific financial support and no known competing non-financial interests.

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