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Foreign Direct Investment in Asean: The Moderating Role of Regulatory Quality on Macroeconomic Factors and Political Stability

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ABSTRACT: This study examines the determinants of Foreign Direct Investment (FDI) inflows in developing ASEAN countries, focusing on interest rates, exchange rates, inflation, and political stability, with regulatory quality as a moderating variable. Employing a quantitative, causal-comparative design, the study utilizes panel data from eight ASEAN countries (Malaysia, Thailand, Vietnam, Myanmar, Indonesia, Laos, the Philippines, and Cambodia) spanning the period from 2003 to 2023, sourced from the World Bank and the Worldwide Governance Indicators. Chow and Hausman tests indicate that the Fixed Effects Model provides the best fit for the data. The results indicate that interest rates have a negative and significant impact on FDI inflows, suggesting that higher borrowing costs deter foreign investors. Exchange rates exert a positive and significant influence, suggesting that currency depreciation enhances investment attractiveness. Inflation is found to be insignificant, indicating that investors can tolerate moderate inflation. Political stability shows a positive and significant effect, underscoring its crucial role in reducing investment risk and enhancing investor confidence. Furthermore, regulatory quality significantly moderates the effects of interest rates, exchange rates, and political stability on FDI. Strong regulatory frameworks can cushion the impact of adverse macroeconomic conditions and strengthen investment security. These findings extend institutional theory and emphasize the importance of macroeconomic, political, and regulatory stability in attracting FDI.

Keywords: ASEAN, Exchange Rate, Interest Rate, Inflation, Political Stability, Regulatory Quality, Foreign Direct Investment.

INTRODUCTION

Amid today's economic globalization, cross-border capital movements are now regarded as a decisive driver shaping the patterns of national growth and overall development dynamics (Merian & Aimon, 2024). Among these investments, Foreign Direct Investment is identified as a major type that has drawn worldwide attention, especially within developing economies. Within such economies, FDI assumes a pivotal function because knowledge, technology, and management practices are transmitted from foreign corporations to local firms, raising productivity and

reinforcing competitive strength across industries in process (Wilantari et al., 2020). When domestic savings prove insufficient, developing countries require capital for infrastructure, production, business expansion, and growth, making foreign investment inflows a leading alternative financing source urgent (Kellard et al., 2022). The entry of foreign investors enables host nations to join global supply networks, widening access to international markets and improving prospects for domestically produced goods and services (Adriradwa et al., 2025). FDI inflows additionally depend on macroeconomic conditions and institutional quality, whose combined effects ultimately shape how attractive a host country appears to overseas investors.

The determinants of FDI inflows into countries are extremely diverse indeed. Institutional Theory advanced by (North, 1990) argues that nations with supportive business environments are typically more successful at attracting international investment inflows, consistently. High institutional quality can cut transaction costs for firms and foreign investors, thereby easing access to domestic markets and enabling profit (Suddaby, 2013). Rugman (Rugman, 1980) stresses that political stability and strong regulatory quality are essential for a supportive investment climate, because they offer investors credible security and legal certainty when allocating capital safely across opportunities. From a macroeconomic standpoint, nations with controlled inflation, competitive interest rates, and steady exchange rates are more attractive to foreign investors seeking predictability and lower risk.

Most ASEAN members are categorized as developing economies, among them Indonesia, Malaysia, Thailand, the Philippines, Vietnam, Laos, Cambodia, and Myanmar, which still confront numerous challenges in economic development, poverty reduction, and upgrading infrastructure and human capital capacities through sustained policy implementation. By contrast, Brunei Darussalam and Singapore have attained developed status, marked by high per capita incomes, stable governance, and substantial progress across technology, financial services, and public delivery systems and outcomes. Implementing the ASEAN Free Trade Area has significantly accelerated regional economic growth and generated substantial impacts overall. Economic integration through removing tariff and non tariff barriers among members now enables more efficient flows of goods, services, and capital across borders within the region. These conditions strengthen regional competitiveness and also further nurture a more open and competitive climate for business. Consequently, global investors increasingly view ASEAN as a strategic and highly promising investment region for opportunities. A supportive business climate with the vast market potential of its developing economies positions the region among leading destinations for foreign direct investment, as highlighted by (Vidinopoulos et al., 2020).

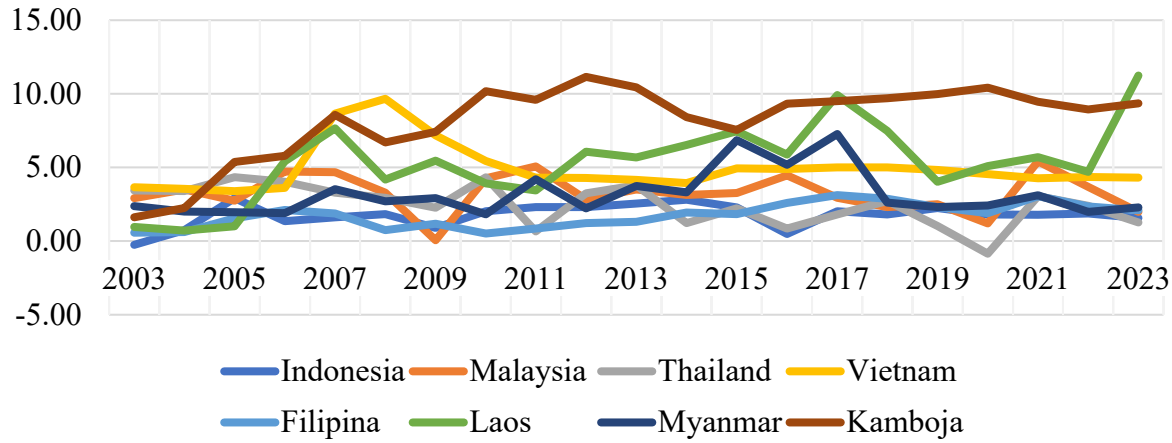

Figure 1. Trends in FDI Inflows (% of GDP) in Developing ASEAN Countries, 2003–2023
Source: (World Bank, 2025) *(processed data)*

From the preceding chart, FDI inflows measured as a share of GDP in developing ASEAN economies have varied repeatedly across the years spanning 2003 through 2023. The COVID-19 pandemic caused volatility in foreign portfolio movements, which also influenced FDI inflows, most notably during 2020 (Subagyo & Restikasari, 2025). Lockdown policies and limits on economic activity disrupted global operations, impairing production chains and distribution, and ultimately diminishing the appeal of foreign investment, thereby depressing FDI inflows for many countries (Widianatasari & Purwanti, 2021). During the study horizon, Cambodia posted the highest FDI at 8.18 percent, followed by Laos at 5.36 and Vietnam at 4.95 percent. Cambodia's elevated FDI inflows are linked to its 1994 Investment Law, which created an open, liberal regime for foreign capital, backed by pro investor policies and a strong legal system (Bickel & Breuer, 2009). The statute streamlined licensing arrangements and eased approval procedures for foreign direct investment (Paramita, 2021). Laos placed second because of pro investor government rules, especially after the 2016 revision to the Law on Investment Promotion. Foreign investors may invest in all sectors and can obtain full ownership in certain industries under prevailing rules (Open Development Mekong, 2024). Vietnam ranked third and is also the fastest-growing economy in the ASEAN region. Despite challenges in political stability, high levels of corruption, and human rights concerns (DW, 2024), Vietnam continues to attract significant FDI inflows due to its competitive corporate tax rates and investment incentives for manufacturers, which enhance competitiveness and appeal to foreign investors (Vietnam Briefing, 2024). Myanmar, on the other hand, recorded relatively low and declining FDI inflows since 2021, mainly due to political instability and regulatory uncertainty. The 2021 military coup created greater uncertainty for foreign investors, while restrictions on specific sectors further constrained the country's potential to attract FDI (Synergy Policies, 2021). Thailand and Malaysia showed moderate levels of FDI inflows, averaging between 2.45% and 3.26%. This suggests that although these countries remain major investment destinations, they face various challenges in sustaining FDI inflows. Indonesia, with an average of 1.76%, and the Philippines, with 1.74%, recorded the lowest FDI inflows in the region, although these figures have remained relatively stable over time. Constraining factors include investment inefficiencies, restrictions in the service trade sector, and regulatory and bureaucratic barriers (S. D. A. Simanjuntak, 2025). Overall, FDI inflows among developing ASEAN economies show

volatile patterns over time and are shaped by multiple determinants. These variations are tightly associated with movements in macroeconomic indicators and institutional strength, including interest rates, exchange rates, inflation, political stability, and the quality of regulation (Ainafa'id & Utomo, 2024).

Interest rates denote the price borrowers must pay to access funds for a defined period, expressed as a percentage of the principal amount borrowed (Huda et al., 2019). Interest rates constitute a principal macroeconomic driver materially influencing FDI inflows across economies. Within ASEAN, interest rates typically fluctuate in line with shifts in global and domestic economic conditions over time. Monetary policy on interest rates enacted by central banks throughout ASEAN can shape FDI inflows through multiple transmission channels. For foreign direct investment decisions, FDI inflows are driven more strongly by real interest rates than by nominal interest rates in practice. This arises because real interest rates capture the true investment return after adjusting for the effects of inflation pressures. Under Fisher's Theory 1930, the real interest rate is derived by deducting inflation from the nominal interest rate for a period. Even if nominal interest rates appear elevated, when inflation is likewise high, the real rate can become low or even negative for many potential investors. Such circumstances diminish FDI's appeal, since investors generally favor countries with higher real interest rates that signal superior post inflation investment returns on a sustained. Research by (Hussain et al., 2023) investigating links between interest rates and FDI concluded that interest rates exert a positive influence on FDI inflows across contexts. The evidence indicates that rising interest rates tend to draw greater FDI inflows, because higher rates create stronger incentives for investors by raising expected returns on investment in receiving economies overall.

Exchange rate refers to the value of a currency compared to foreign currencies (Abimanyu, 2004). Appreciation of local currency against the USD can attract FDI by increasing the value of assets and profits upon conversion, enhancing repatriated earnings for multinational corporations (MNCs) and encouraging inflows (Merian & Aimon, 2024). Conversely, depreciation increases perceived risks, discouraging investment. This finding aligns with (Hussain et al., 2023), who argued that favorable exchange rates stimulate FDI. Most ASEAN countries maintain a currency regime pegged to the US dollar. Rapid economic growth in the region has driven demand for external financing, and under conditions of exchange rate stability and relatively high interest rates, foreign capital inflows have risen.

Inflation refers to the sustained increase in the prices of goods and services over a specified period (Sukirno, 2013). Extremely high levels of inflation can lead to economic instability, while achieving zero percent (0%) inflation is virtually impossible. Therefore, government policies on inflation aim to control or reduce excessively high inflation rates and ensure that inflation remains at a stable level (Syarifudin & Mundiroh, 2020). In the context of FDI, cost-push inflation reduces the competitiveness of domestic production and increases uncertainty in operational costs, thereby diminishing the interest of foreign investors. Conversely, moderate demand-pull inflation can stimulate robust economic growth, sending a positive signal to foreign investors and encouraging FDI inflows (Bramtteo et al., 2025). A study by (Fahmi & Septiani, 2023) on the relationship between inflation and FDI inflows suggests that uncontrolled inflation hurts FDI inflows, as it

erodes the real value of investments. Thus, maintaining inflation stability becomes a crucial factor in sustaining the attractiveness of FDI.

Political stability refers to a government's ability to maintain continuity of governance amidst political tensions or turmoil (Kurul & Yalta, 2017). It reflects a country's capacity to manage potential political disruptions, which in turn may affect its overall economic stability (Sottilotta, 2012). Countries with strong political stability tend to be more attractive to investors, whereas political unrest undermines investor confidence and discourages FDI inflows (Elleuch et al., 2015). Although ASEAN has considerable potential to maintain political and economic stability within the Asia-Pacific region, the organization continues to face several geopolitical challenges that limit its effectiveness. The principle of non-interference, the slow consensus-based decision-making process, and persistent economic disparities among member states are significant obstacles that constrain ASEAN's ability to respond to changes and crises in political stability (Putri et al., 2025). Consequently, the fluctuating pattern of FDI inflows in ASEAN reflects investors' sensitivity to political risks in individual member countries. The presence of political risk compels investors to carefully evaluate investment decisions, as the uncertainty generated by political instability may affect both operations and profitability (D. Simanjuntak, 2018). This finding is consistent with the results of (Rastiati & Khoirudin, 2025), who conclude that political stability has a significant impact on FDI inflows. In other words, the more politically stable a country is, the greater its potential to attract foreign investment.

Regulatory quality refers to a government's ability to formulate and implement regulations and policies that foster the development of various sectors. Clear regulations and streamlined bureaucratic processes can enhance investment inflows into a country, ultimately serving as an essential driver of national development (Widianatasari & Purwanti, 2021). Key factors of concern for investors regarding regulatory quality include legal certainty, policy continuity, and the risk of sudden policy changes that may create uncertainty in the investment environment (Elleuch et al., 2015). According to (Nugraha, 2024), countries with strong and well-structured institutions generally implement regulations that are consistent, transparent, and reliable, thereby providing investors with a sense of security and certainty. Within the ASEAN region, disparities in regulatory quality among member states constitute one of the main determinants of foreign direct investment (FDI) attraction. Countries with stronger regulatory quality tend to be more successful in drawing FDI, consistent with the findings of (Mirkovikj et al., 2024). Moreover, regulatory quality can act as a factor that either strengthens or weakens the relationship between macroeconomic conditions and political stability in influencing FDI inflows. Therefore, improving regulatory quality becomes a crucial step for enhancing a country's ability to attract FDI.

Foreign direct investment FDI in developing nations is considered a multifaceted phenomenon shaped by many determinants tied to competition dynamics in investors' home economies and host economies as described by (Merian & Aimon, 2024). Much of prior literature has examined the immediate impacts of macroeconomic conditions and political stability on inflows of FDI, while omitting regulatory quality as a moderating factor that could magnify or dampen the strength of those relationships. This omission creates a literature gap needing attention, since regulatory quality can moderate effects of macroeconomic and political determinants on FDI and thus significantly alter investment outcomes across countries. Moreover, earlier work often used

relatively short study windows, which constrained understanding of long run FDI behavior significantly. In contrast, the present analysis covers a longer horizon from 2003 to 2023 to deliver a fuller view of how these drivers influence FDI. Still, several earlier investigations have reported inconsistent or contradictory findings too. Such variability may arise from differences in study windows, analytical methods, or unique national contexts under review, thereby underscoring another significant gap within the literature. Accordingly, this research seeks to close those gaps by assessing how macroeconomic conditions and political stability influence FDI across an extended time frame, while explicitly incorporating regulatory quality as a moderating mechanism, an element that prior studies have rarely centered in their empirical designs.

Based on the aforementioned background, the researcher intends to conduct a study entitled *"Foreign Direct Investment in ASEAN: Moderating Role of Regulatory Quality on Macroeconomic Factors and Political Stability."* This research focuses on eight developing countries in the ASEAN region, as classified by the World Bank, namely Indonesia, Malaysia, Thailand, Vietnam, the Philippines, Cambodia, Laos, and Myanmar. The study is expected to provide insights into how macroeconomic factors and political stability influence FDI inflows, with regulatory quality serving as a moderating variable in the context of developing ASEAN countries.

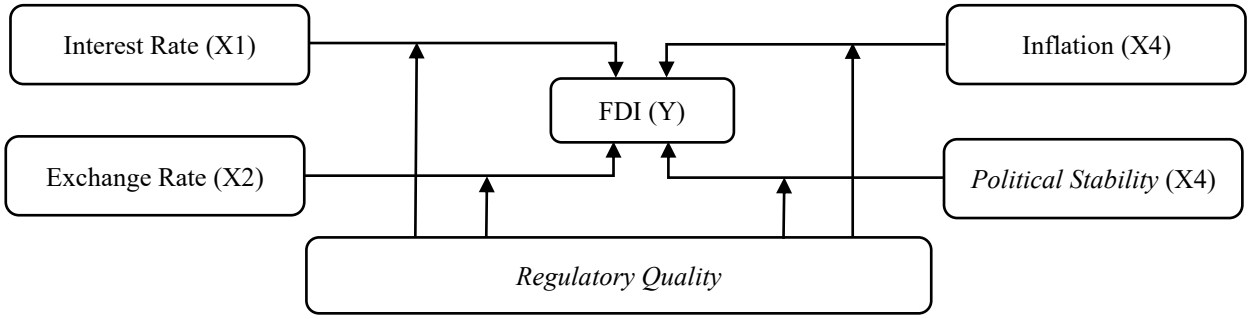

Figure 2. Conceptual Framework

Hypotheses:

- H1: Interest rates have a significant adverse effect on FDI inflows in developing ASEAN countries.
- H2: Exchange rates have a significant positive effect on FDI inflows in developing ASEAN countries.
- H3: Inflation has a significant adverse effect on FDI inflows in developing ASEAN countries.
- H4: Political stability has a significant positive effect on FDI in developing ASEAN countries.
- H5: Regulatory quality moderates the effect of interest rates on FDI inflows in developing ASEAN countries.
- H6: Regulatory quality moderates the effect of exchange rates on FDI inflows in developing ASEAN countries.
- H7: Regulatory quality moderates the effect of inflation on FDI inflows in developing ASEAN countries.
- H8: Regulatory quality moderates the effect of political stability on FDI inflows in developing ASEAN countries.

METHOD

The research approach employed in this study is quantitative. According to (Siyoto & Sodik, 2015), quantitative research involves the use of numerical data, beginning with data collection, followed by interpretation, and ultimately presented in the form of tables, graphs, figures, or other visualizations to conclude the research findings. This approach aims to analyze correlations or differences between the variables under investigation through objective measurement (Sugiyono, 2015). This study employs a quantitative approach to examine the influence of macroeconomic factors and political stability on FDI inflows in developing ASEAN countries. It also tests whether regulatory quality serves as a moderating variable that affects the strength of the relationships among these variables.

The population in this study comprises all ASEAN member countries. The sample was selected using purposive sampling, namely the selection of samples based on specific criteria relevant to the research objectives (Sugiyono, 2015). The criteria applied are as follows:

1. The country is an ASEAN member state classified as a developing country according to the World Bank's income classification.
2. The country has complete and consistent data for all research variables during the period 2003–2023.
3. Based on these criteria, eight countries were selected as the sample: Malaysia, Thailand, Vietnam, Myanmar, Indonesia, Laos, the Philippines, and Cambodia. Two other ASEAN member states, namely Singapore and Brunei Darussalam, were excluded from the sample because they are classified as high-income countries, and thus do not represent the characteristics of developing countries.

This study is cross-country in nature and therefore is not conducted in a specific physical location. The research relies on secondary data obtained from reputable international institutions, including:

1. The World Bank – World Development Indicators (WDI) for data on FDI, real interest rates, exchange rates, and inflation.
2. The Worldwide Governance Indicators (WGI) provide data on the political stability index and the regulatory quality index.

All data employed are annual, covering the period from 2003 to 2023.

The research instrument consists of a panel data table containing the annual values of each variable for the eight sample countries over the 21-year observation period (2003–2023). The operational definitions of the research variables are presented in the following table:

Table 1. Operational Definition of Variables

Variable	Conceptual Definition	Indicator & Unit	Data Source
FDI (Y)	Investment undertaken by multinational private enterprises from one country into	Net FDI inflows (% of GDP)	World Bank (WDI)

Variable	Conceptual Definition	Indicator & Unit	Data Source
	another with the purpose of establishing capital abroad. (Todaro & Smith, 2012)		
Interest Rate (X1)	The cost that must be paid by the borrower for the use of a certain amount of funds over a specific period, often expressed as a percentage (Huda et al., 2019); (Mishkin, 2008)	Real interest rate (%)	World Bank (WDI)
Exchange Rate (X2)	The price of a domestic currency relative to a foreign currency. (Abimanyu, 2004b)	Official exchange rate (per USD)	World Bank (WDI)
Inflation (X3)	A sustained increase in the general price level of goods and services. (Sukirno, 2013)	Annual CPI change (%)	World Bank (WDI)
Political Stability (X4)	A country's ability to maintain governmental continuity amid political turbulence or tensions. (Kaufmann et al., 2011)	Political Stability Index (scale -2.5 to +2.5)	WGI
Regulatory Quality (Z)	The government's ability to formulate and implement sound regulations that promote private sector development. (Kaufmann et al., 2011)	Regulatory Quality Index (scale -2.5 to +2.5)	WGI

This research employs panel data regression, also called pooled data regression, and utilizes the EViews 13 software for analysis. Under this approach, three specifications can be estimated, namely the Common Effect Model CEM, the Fixed Effect Model FEM, and Random Effect Model REM. Choosing the most suitable specification is decided through a sequence of diagnostic tests, specifically the Chow Test, the Hausman Test, and the Lagrange Multiplier Test procedures. Hypothesis testing in this research covers the coefficient of determination R^2, partial significance t test, and simultaneous significance F test to assess how strongly independent variables influence outcomes for the dependent variable within model context. In addition, a moderation assessment is performed to examine whether a moderator variable Z alters the linkage between independent variable X and the dependent variable Y. This moderation evaluation proceeds by constructing an interaction term combining the independent variable and the moderator, and its statistical importance is subsequently examined inside the estimated regression specification for inference.

The general specification of the panel data regression equation utilized in this research is presented below:

$$FDIit=\beta0+\beta1X1it+\beta2X2it+\beta3X3it+\beta4X4it+\beta5Zit+\beta6(X1it\times Zit)+\beta7(X2it\times Zit)+\beta8(X3it\times Zit)+\beta9(X4it\times Zit)+\epsilon it$$

Description :

- FDI*it* : FDI inflows in country *i* at period *t*
- X1*it* : Real interest rate in country *i* at period *t*
- X2*it* : Exchange rate of country *i*'s currency against USD at period *t*
- *X3it* : Inflation rate in country *i* at period *t*

- *X4it* : Political Stability Index of country *i* at period *t*
- *Zit* : Regulatory Quality Index of country *i* at period *t*
- ε*it* : Error term (measurement error or other influencing factors not included in the model)
- β0 : Constant (intercept) in the regression model
- β1,β2,β3,…,β9 : Regression coefficients for each variable

RESULT AND DISCUSSION

Data Analysis

Chow Test

The Chow test serves to assess whether a panel regression is better represented by a Fixed Effect Model FEM or by a Common Effect Model CEM. In this procedure, residual errors from a specification with fixed effects FEM are contrasted against those from a specification with common effects CEM. The null hypothesis posits that the parsimonious alternative, namely the CEM, provides the correct specification. When the p value exceeds 0.05 the null cannot be rejected and the CEM is chosen, whereas a p value below 0.05 indicates that the FEM is more suitable.

Table 2. Chow Test Rest

Redundant Fixed Effects Tests — Equation: Untitled — Test cross-section fixed effects			
Effects Test	**Statistic**	**d.f.**	**Prob.**
Cross-section F	7.263.451	-7,123	0.0000
Cross-section Chi-square	47.052.583	7	0.0000

Source: EViews 13 *(Processed Data)*

Referring to Table 2, the results of the Chow Test indicate that the probability value of the Cross-Section F is 0.0000, which is lower than the significance level α (0.05), thereby rejecting H_0. Hence, the Chow Test suggests that the Fixed Effects Model is the appropriate model to use in panel data analysis. However, since H_0 is rejected in the Chow Test, further testing is required; therefore, the analysis proceeds with the Hausman Test.

Hausman Test

The Hausman test is applied to decide whether the Fixed Effects Model FEM or the Random Effects Model REM is the more suitable specification. Coefficient estimates from both models are contrasted in this procedure to identify which set is more efficient and consistent. Under the null hypothesis, REM is assumed to deliver efficiency superior to FEM. When the p value is below 0.05, the null is rejected, implying that FEM should be preferred. When the p value exceeds 0.05, REM is taken to be the more efficient choice.

Tabel 3. Hausman Test Result

Correlated Random Effects – Hausman Test — Equation: Untitled — Test cross-section random effects			
Test Summary	**Chi-Sq. Statistic**	**Chi-Sq. d.f.**	**Prob.**
Cross-section random	30.034.048	5	0.0000

Source: EViews 13 *(Processed Data)*

For cross section random effects, the chi square statistic equals 30.034048, with a p value of 0.0000, falling beneath the significance threshold $\alpha = 0.05$. Consequently, FEM is chosen as the preferred model. Because both the Chow test and the Hausman test point to FEM as the suitable specification, the Lagrange Multiplier procedure is omitted, and FEM is affirmed as the superior model for empirical analysis.

Classical Assumption Test

Once the regression specification has been chosen, classical assumption diagnostics are executed to confirm that the model meets regression requirements, namely no multicollinearity, no heteroskedasticity, and no autocorrelation in the disturbances. These diagnostics aim to ensure estimated coefficients remain valid and can be interpreted accurately by researchers.

Table 4. Prerequisites of Classical Assumption Tests

Assumption Test	Fixed Effect Model & Common Effect Model	Random Effect Model
Normality	No	Yes
Heteroskedasticity	Yes	No
Multikolinearity	Yes, if X > 1	Yes, if X > 1
Autocorrelation	No	No

Source: (Napitupulu et al., 2021)

In FEM and CEM, normality is not a primary prerequisite, although residual tests can be conducted to examine the distribution. In contrast, in REM, normality is required since the random effects are assumed to follow a normal distribution. A heteroskedasticity test is necessary for FEM and CEM but is generally not required in REM. Multicollinearity should be tested for all models that include more than one independent variable. Autocorrelation is generally not a concern unless a time-series component is present.

Table 5. Heteroskedasticity Test

Heteroskedasticity Test: Glejser			
Null hypothesis: Homoskedasticity			
F-statistic	2.055920	Prob. F(5,130)	0.0751
Obs*R-squared	9.965994	Prob. Chi-Square(5)	0.0762
Scaled explained SS	9.199290	Prob. Chi-Square(5)	0.1014

Source: EViews 13 *(Processed Data)*

The heteroskedasticity test was conducted using the Glejser test. The probability value of Obs*R-Square obtained was 0.0762, which is greater than the significance level of 0.05. Therefore, it can be concluded that the data do not exhibit heteroskedasticity, or in other words, pass the heteroskedasticity test. Consequently, the regression model satisfies one of the key classical assumptions necessary to produce valid and efficient estimations (Napitupulu et al., 2021).

Table 6. **Multikolinearity Test**

Variable	Coefficient Variance	Uncentered VIF	Centered VIF
INTEREST_RATE	0.000507	2.050.022	1.316.328
EXCHANGE_RATE	2.58E-10	2.077.779	1.312.437
INFLATION	0.000434	2.816.332	1.670.217
POLITICAL_STABILITY	0.032338	2.235.842	1.392.784
REGULATORY QUALITY	0.039550	2.254.423	1.878.291
C	0.045999	4.076.899	NA

Source: EViews 13 *(Processed Data)*

A multicollinearity check is performed to verify whether correlations exist among independent variables. The method employed for this test is the Variance Inflation Factor VIF. A model will be deemed reliable when no correlation is detected among the independent variables, with the benchmark defined as a VIF value below 10 threshold. If the Centered VIF scores for the independent variables included within the specification fall under 10, one may conclude that the data exhibit no multicollinearity symptoms, implying that the specification successfully passes the multicollinearity diagnostic test criteria.

Coefficient of Determination Test (R^2)

The coefficient of determination R^2 serves to evaluate how far the regression model explains the variation observed in the dependent variable within the sample. A higher R^2 value implies a larger share of variability in Foreign Direct Investment FDI that the model's independent variables are able to explain collectively. This assessment quantifies the proportion of total variation in FDI that the estimated regression model is able to account for statistically. R^2 takes values between 0 and 1, and values nearer to 1 signal a model with stronger explanatory power overall for the relationships.

Table 7. Coefficient of Determination Test (R^2) Result

Root MSE	0.902868	R-squared	0.713043
Mean dependent var	3.048850	Adjusted R-squared	0.674460
S.D. dependent var	1.691681	S.E. of regression	0.965207
Akaike info criterion	2.883520	Sum squared resid	110.8633
Schwarz criterion	3.247602	Log likelihood	-179.0794
Hannan-Quinn criter.	3.031474	F-statistic	18.48100
Durbin-Watson stat	1.993573	Prob(F-statistic)	0.000000

Source: EViews 13 *(Processed Data)*

Drawing on the regression output in Table 7, the R squared equals 0.7130, meaning that 71.30 percent of the variation in the dependent variable, Foreign Direct Investment FDI, is accounted

for by the model's independent variables. In parallel, the Adjusted R squared of 0.6745 indicates that after correcting for the number of predictors and the sample size, about 67.45 percent of FDI variation remains explained by the specification. Hence, the model provides reasonably strong explanatory power for FDI, although roughly 28.70 percent of the variance is attributable to influences outside the model.

Partial Significance Test (t-test)

The t test is applied to evaluate whether each predictor interest rate, exchange rate, inflation, and political stability exerts a statistically significant effect on FDI as the outcome. Each estimated coefficient is subjected to a t test to determine its statistical significance. The null hypothesis states that the coefficient is not different from zero. If the p value is below 0.05, the coefficient is deemed significant.

Table 8. Partial Significance Test (t-test) Result

Variable	Coefficient	Std. Error	t-Statistic	Prob.
Interest Rate	-0.101506	0.030448	-3.333800	0.0011
Exchange_Rate	0.000149	6.14E-05	2.423541	0.0169
Inflation	0.029277	0.042904	0.682384	0.4963
Political_Stability	0.168117	0.352080	0.477498	0.0339
C	2.330712	0.458902	5.078894	0.0000

Source: EViews 13 *(Processed Data)*

Based on the results of the partial significance test, the Interest Rate variable has a *t*-statistic value of -3.3338 with a probability value of 0.0011 (< 0.05), indicating that the Interest Rate has a significant effect on FDI. The Exchange Rate variable has a *t*-statistic value of 2.4235 with a p-value of 0.0169 (< 0.05), suggesting that the Exchange Rate has a significant effect on FDI. Meanwhile, the Inflation variable, with a *t*-statistic value of 0.6823 and a probability value of 0.4963 (> 0.05), is concluded to have no significant effect on FDI. The Political Stability variable has a *t*-statistic value of 0.4774 and a p-value of 0.0339 (< 0.05), indicating that Political Stability has a significant influence on FDI.

Simultaneous Significance Test (F-test)

The F-test is conducted to assess the overall significance of the regression model in explaining the dependent variable, namely Foreign Direct Investment (FDI). This test aims to determine whether all independent variables in the research model simultaneously influence the dependent variable. In other words, the F-test is performed to analyze whether the constructed regression model is statistically significant. The null hypothesis (H_0) in this test states that the independent variables have no significant effect on the dependent variable. If the *p*-value is less than 0.05, H_0 is rejected, and the model is considered significant as a whole.

Table 9. Simultaneous Significance Test (F-test) Result

Root MSE	0.902868	R-squared	0.713043
Mean dependent var	3.048850	Adjusted R-squared	0.674460
S.D. dependent var	1.691681	S.E. of regression	0.965207
Akaike info criterion	2.883520	Sum squared resid	110.8633
Schwarz criterion	3.247602	Log likelihood	-179.0794
Hannan-Quinn criter.	3.031474	F-statistic	18.48100
Durbin-Watson stat	1.993573	Prob(F-statistic)	0.000000

Source: EViews 13 (Processed Data)

Based on the regression results presented in Table 8, the F-statistic value is 18.4810 with a probability (Prob. F-statistic) of 0.000000. This probability value is far below the conventional significance level ($\alpha = 0.05$), indicating that all independent variables in the model simultaneously have a significant effect on the dependent variable. These findings strengthen the overall validity of the regression model and demonstrate that the independent variables, when considered together, are capable of explaining the variation in the dependent variable.

Moderating Test

The moderation test is conducted to examine whether the moderating variable, namely regulatory quality, can influence the relationship between the independent variables (interest rate, exchange rate, inflation, and political stability) and the dependent variable, Foreign Direct Investment (FDI). The purpose of this test is to determine whether regulatory quality strengthens, weakens, or alters the direction of the effect of the independent variables on FDI. The test is performed by incorporating interaction terms into the regression model, which are constructed as the product of each independent variable and the moderating variable. The null hypothesis (H_0) states that the moderating variable has no significant effect on the relationship between the independent and dependent variables. The *t*-test is used to assess the significance of the interaction coefficients. If the *p*-value is less than 0.05, regulatory quality is considered to moderate the relationship. Conversely, if the *p*-value is greater than 0.05, no moderating effect of regulatory quality is present.

Table 10. Moderating Test Result

Variable	Coefficient	Std. Error	t-Statistic	Prob.
SUKU_BUNGA_KUALITAS_REGULASI	0.119363	0.030507	3.912605	0.0002
NILAI_TUKAR_KUALITAS_REGULASI	-0.000130	6.35E-05	-2.055229	0.0420
INFLASI_KUALITAS_REGULASI	-0.020508	0.027194	-0.754132	0.4523
STABILITAS_POLITIK_KUALITAS_REGULASI	-1.363535	0.462105	-2.950705	0.0038
C	2.330712	0.458902	5.078894	0.0000

Source: EViews 13 *(Processed Data)*

Based on the results of the interaction test, the interaction variable between Interest Rate and Regulatory Quality has a t-statistic value of 3.9126 with a probability of 0.0002 (<0.05), indicating

that Regulatory Quality significantly moderates the effect of Interest Rate on FDI. The interaction variable between Exchange Rate and Regulatory Quality shows a t-statistic value of -2.0552 with a probability of 0.0420 (<0.05), suggesting that Regulatory Quality significantly moderates the effect of Exchange Rate on FDI. Meanwhile, the interaction variable between Inflation and Regulatory Quality has a t-statistic value of -0.7541 with a probability of 0.4523 (>0.05), implying that Regulatory Quality does not moderate the effect of Inflation on FDI. The interaction variable between Political Stability and Regulatory Quality has a t-statistic value of -2.9507 with a probability of 0.0038 (<0.05), indicating that Regulatory Quality significantly moderates the effect of Political Stability on FDI.

The Effect of Interest Rates on Foreign Direct Investment

The results show that interest rates have a statistically significant negative impact on Foreign Direct Investment, with an estimated coefficient of −0.1015. This means that, on average, a one unit rise in interest rates lowers FDI inflows by 0.1015. The evidence underscores that elevated borrowing costs remain a notable barrier for overseas investors in ASEAN. Conceptually, this agrees with Keynes's Marginal Efficiency of Investment Theory 1936 ((Keynes, 1936), which holds that firms invest only when the marginal return exceeds the interest rate. Likewise, (Fisher, 1930) argued that higher interest rates curb investment by increasing the cost of capital. Comparable conclusions were reported by (Agustin et al., 2021) and by (Fahmi & Septiani, 2023), who found a significant negative effect of interest rates on FDI inflows. Accordingly, these findings reaffirm the classical position that monetary policy, especially via interest rates, is central to creating a favorable climate for investment.

H1: The results support H1, indicating a significant adverse effect of interest rates on FDI inflows in developing ASEAN countries.

The Effect of Exchange Rates on Foreign Direct Investment

The analysis indicates that exchange rates exert a significant positive influence on FDI, with a regression coefficient equal to 0.0001. In practical terms, a one unit increase in the exchange rate is associated with a 0.0001 rise in FDI inflows. Although the magnitude is small, it remains economically meaningful given the large volume of FDI inflows in ASEAN countries. Even a minor depreciation can translate into substantial investment increases when aggregated across multinational firms and extended time periods. This pattern suggests that foreign investors respond favorably to currency movements by expanding investment. Theoretically, this partially conflicts with the Currency Areas Hypothesis (Aliber, 1970), which contends that exchange rate volatility increases risk and discourages investment. In the ASEAN setting, however, domestic currency depreciation is often viewed by multinationals as a chance to cut production costs and improve export competitiveness. Similar positive relationships have been documented by (Hossain et al., 2024), (Adewale, 2024), (FoEh et al., 2020), (Hussain et al., 2023), and (Shafiq et al., 2021). Thus, while maintaining exchange rate stability is still important, currency depreciation can under certain circumstances operate as an inducement to invest.

H2: The results support H2, showing a significant positive effect of exchange rates on FDI inflows in developing ASEAN countries.

The Effect of Inflation on Foreign Direct Investment

The findings suggest that inflation has no statistically significant effect on FDI, despite a positive coefficient estimated at 0.0292. This indicates that, on average, a one unit increase in inflation is associated with a 0.0292 rise in FDI inflows, yet the relationship lacks statistical significance. Such a result runs counter to Economic Uncertainty (Mundell, 1961) and to Marginal Productivity Theory (Hicks, 1939), which predict that inflation elevates uncertainty, raises costs, and depresses investment. Even so, the outcome is consistent with (Agustin et al., 2021), (Ainafa'id & Utomo, 2024)), and (Davis & Akbar, 2022), who reported no significant effect of inflation on FDI. A plausible explanation is ASEAN's relatively stable macroeconomic setting, with inflation remaining moderate throughout 2003 to 2023. Given this backdrop, foreign investors tend to weigh other fundamentals more heavily than inflation when committing capital.

H3: The results do not support H3, suggesting that inflation does not have a significant adverse effect on FDI inflows in developing ASEAN countries.

The Effect of Political Stability on Foreign Direct Investment

The estimates indicate that political stability has a significant positive effect on FDI, with a regression coefficient of 0.1681. In essence, greater political stability is associated with higher FDI inflows across ASEAN economies. This accords with Internalization Theory (Rugman, 1980), which maintains that stability provides legal certainty, lowers risk, and supports policy continuity, thereby attracting capital from abroad. Supporting evidence appears in (Priyadi et al., 2024) and (Rastiati & Khoirudin, 2025). Overall, ASEAN countries with stable political settings draw more FDI because they are perceived to offer legal protection, investment security, and continuity of rules. By contrast, instability tends to discourage investors and restrain capital entry. Consequently, political stability emerges as a key attribute enhancing ASEAN's appeal to global investors.

H4: The results support H4, indicating a significant positive effect of political stability on FDI inflows in developing ASEAN countries.

The Moderating Role of Regulatory Quality on the Effect of Interest Rates on Foreign Direct Investment

The evidence shows that regulatory quality significantly moderates the link between interest rates and FDI in a positive manner (coefficient = 0.119363; t = 3.9126; p = 0.0002 < 0.05). This finding refines the conventional theoretical expectation that higher interest rates unequivocally discourage FDI by increasing the cost of capital. In classical macroeconomic and international investment theories, interest rates are viewed primarily as a price signal, where higher borrowing costs reduce firms' incentives to invest abroad. However, the significant moderating effect of regulatory quality

indicates that this price-centric view is incomplete. In contexts where regulatory institutions are strong, transparent, and predictable, the institutional environment becomes a dominant factor shaping investor behavior. Robust regulatory systems reduce non-price frictions such as bureaucratic delays, legal uncertainty, and transaction inefficiencies, thereby shifting investors' decision-making calculus away from short-term interest rate fluctuations. Consequently, increases in interest rates do not automatically depress FDI inflows, because institutional certainty compensates for the rise in financing costs. This aligns with North's Institutional Theory 1990, which posits that institutions reduce transaction costs and enhance economic performance by creating stable expectations. The findings extend this framework by demonstrating that institutional quality not only influences investment directly, but also buffers or reshapes the impact of macroeconomic variables such as interest rates. This nuanced interaction highlights that institutions serve as a strategic complement to monetary factors in shaping FDI dynamics, rather than merely a background condition. It is also consistent with (Agustin et al., 2021), who showed that good governance increases investor resilience to monetary fluctuations. Further support is provided by (Mariotti & Marzano, 2019) and (Kottaridi & Thomakos, 2018), who argue that credible regulation mitigates adverse macroeconomic effects on foreign capital.

H5: The results support H5, demonstrating that regulatory quality significantly moderates the relationship between interest rates and FDI inflows.

The Moderating Role of Regulatory Quality on the Effect of Exchange Rates on Foreign Direct Investment

The results indicate that the interaction between exchange rates and regulatory quality significantly reduces FDI coefficient = −0.0001; t = −2.0552; p = 0.0420 < 0.05. This shows that regulatory quality weakens the positive association between exchange rates and FDI. In other words, although currency appreciation is positively correlated with FDI inflows, that effect becomes smaller as regulatory quality improves. From an investor viewpoint, where regulation is weak, exchange rate swings are worrisome because legal uncertainty, high transaction costs, and corruption risks are also present. In such conditions, domestic currency depreciation can entice investment by lowering production expenses. As regulatory quality strengthens and non economic risks recede, exchange rates play a less central role in location choices. Investors instead give precedence to structural features such as macro stability and regulatory certainty. Accordingly, the influence of exchange rates on FDI diminishes in environments with strong institutions. This pattern is consistent with Mariotti and Marzano 2019, who found that institutional quality neutralizes the impact of exchange rate volatility on FDI, and with Kottaridi and Thomakos 2018, who observed that better governance reduces sensitivity to currency movements. Agustin et al 2021 also reported that credible regulation reduces the speculative appeal of depreciation and shifts FDI toward long term fundamentals. Hence, in ASEAN economies with strong regulatory quality, currency movements cease to be the main driver of foreign investment. Therefore, policymakers should pair stable regulation with consistent macroeconomic policies so that FDI is anchored in structural fundamentals rather than short term currency dynamics.

H6: The results support H6, indicating that regulatory quality significantly moderates the relationship between exchange rates and FDI inflows.

The Moderating Role of Regulatory Quality on the Effect of Inflation on Foreign Direct Investment

The analysis finds that the interaction between inflation and regulatory quality has no significant impact on FDI coefficient = −0.0205; t = −0.7541; p = 0.4523 > 0.05. This implies that regulatory quality does not moderate the relationship between inflation and FDI. In other words, regardless of regulatory strength, investors do not systematically treat inflation as a decisive factor in FDI decisions. This can be attributed to the nature of inflation in ASEAN economies. So long as inflation is moderate, foreign investors generally tolerate price variability as part of the usual macroeconomic risk in developing markets. Even with strong regulation, inflation does not automatically undermine attractiveness, because investors focus more on fundamentals such as political stability, market scale, and infrastructure. Only severe inflation or hyperinflation would materially deter FDI, and such episodes are uncommon in ASEAN. Consistent evidence comes from (Agustin et al., 2021), who concluded that inflation is not a key determinant of FDI in developing countries when it remains moderate. (Kottaridi & Thomakos, 2018) likewise argued that strong regulation does not heighten sensitivity to inflation because other fundamentals dominate decision making. Similarly, (Mariotti & Marzano, 2019) noted that governance quality mainly amplifies structural drivers rather than inflation. The policy implication is that ASEAN governments cannot depend solely on inflation control to attract FDI. While price stability matters, foreign investment is shaped more by a mix of macro fundamentals, regulatory quality, and political certainty. Consequently, monetary efforts to keep inflation moderate should be complemented by broader institutional reforms to support sustained FDI growth.

H7: The results do not support H7, implying that regulatory quality does not significantly moderate the relationship between inflation and FDI inflows.

The Moderating Role of Regulatory Quality on the Effect of Political Stability on Foreign Direct Investment

The estimates demonstrate that the interaction between political stability and regulatory quality significantly reduces FDI coefficient = −1.3635; t = −2.9507; p = 0.0038 < 0.05. This implies that regulatory quality attenuates the positive effect of political stability on FDI. In other words, while political stability generally boosts FDI inflows, the strength of that effect declines as regulatory quality becomes higher. A change in investor priorities provides an explanation, since where regulation is weak, political stability is paramount due to fears of conflict, legal ambiguity, or intervention risk. When regulatory quality is high, however, strong institutions supply legal certainty and contract enforcement even if political conditions are less than ideal. Therefore, political stability becomes less dominant because credible rules are sufficient to safeguard business continuity. This conclusion is in line with Kottaridi and Thomakos 2018, who showed that regulatory quality lowers reliance on political factors, and with Mariotti and Marzano 2019, who found that strong governance neutralizes political risk as a primary determinant of FDI. Agustin

et al 2021 similarly observed that robust institutions mitigate the influence of political fluctuations on foreign investment. For ASEAN, the implication is that improving regulatory quality can lessen exposure of FDI to episodes of political instability. However, this also implies that stability alone will not be enough to lure investors if regulatory systems are already credible and effective. Hence, strategies to attract FDI should foreground institutional reform and regulatory quality alongside efforts to preserve political stability.

H8: The results support H8, showing that regulatory quality significantly moderates the relationship between political stability and FDI inflows.

Limitations of the Study

This study has several limitations:

1. The independent variables are limited to interest rates, exchange rates, inflation, and political stability. At the same time, other factors such as trade openness, infrastructure, and labor costs, which may also influence FDI, are not included.
2. The study period (2003–2023) covers phases of the global financial crisis and the COVID-19 pandemic, which may have introduced bias into the estimation results.
3. The measurement of regulatory quality relies on aggregate data from the Worldwide Governance Indicators (WGI), which may not fully capture sectoral variations in regulatory quality across countries.

Recommendations for Future Research

1. Future studies could expand the scope of variables by including structural factors such as trade openness, digital infrastructure, and wage levels to provide a more comprehensive understanding of the relationship.
2. For ASEAN governments, maintaining interest rates at competitive levels is crucial, as FDI sensitivity to interest rates increases under stronger regulatory regimes.
3. For monetary and fiscal authorities, in addition to stabilizing exchange rates, regulatory improvements are necessary to reduce investor reliance on currency fluctuations.
4. For national policymakers, strengthening regulatory quality and ensuring legal certainty for investment should be a priority, particularly in countries with high levels of political instability.
5. For foreign investors, a strong regulatory framework can serve as a crucial indicator for minimizing non-economic risks when investing in ASEAN.

CONCLUSION

This study examines the determinants of Foreign Direct Investment (FDI) inflows in developing ASEAN countries by analyzing macroeconomic factors and political stability, with regulatory quality as a moderating variable. The results indicate that interest rates hurt FDI, while exchange rates have a positive effect. Inflation is not significant, indicating that investors are tolerant of moderate inflation. Political stability has a significant positive impact, underscoring its role in ensuring legal certainty, mitigating risks, and maintaining policy continuity.

Regulatory quality moderates several relationships. It weakens the adverse effect of interest rates and reduces sensitivity to exchange rate fluctuations. It does not influence the impact of inflation, confirming that inflation is not a primary determinant. Regulatory quality also lessens the effect of political stability, suggesting that credible institutions can substitute for political stability in securing investment.

Taken together, these results offer new insights into the interaction between institutional strength and the macroeconomic drivers of FDI. The findings emphasize that regulatory quality can serve as a structural anchor, mitigating the risks associated with monetary volatility and political uncertainty. This underscores the crucial importance of institutional reforms in fostering a more resilient and attractive investment environment in developing ASEAN countries.

From a policy perspective, differentiated strategies tailored to national contexts are essential to maximize the benefits of FDI inflows across ASEAN. Cambodia and Laos, which already benefit from open investment regimes and streamlined approval procedures, should focus on strengthening legal enforcement and ensuring policy continuity to sustain their high FDI levels. Vietnam, as the region's fastest-growing economy, could further enhance transparency and reduce informal transaction costs to complement its competitive tax incentives, helping offset challenges related to corruption and political risk. In Indonesia and the Philippines, where regulatory and bureaucratic barriers remain major constraints, simplifying licensing systems and addressing service sector restrictions should become priorities to boost investor confidence amid changing interest rate environments. Thailand and Malaysia, which maintain moderate FDI inflows, can strengthen the coordination between monetary and regulatory policies to stabilize investment flows and improve resilience against external shocks. Meanwhile, Myanmar, facing persistent political instability, should prioritize restoring legal certainty and rebuilding credible institutions to regain foreign investor trust. Such context-specific recommendations acknowledge the heterogeneity of ASEAN economies and align with the study's empirical evidence on the moderating role of regulatory quality. By tailoring institutional reforms and macroeconomic policies to their respective national conditions, ASEAN countries can create a more stable and attractive investment climate that amplifies the region's strategic position in the global economy.

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