

The Impact of Loose Monetary Policy on Attracting Foreign Direct Investment (FDI) in Emerging Economies: Moderating Role of Inflation



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ABSTRACT: This study examines the impact of loose monetary policy, including money supply and interest rates, significantly influences Foreign Direct Investment (FDI). Moreover, it investigates the moderating effect of inflation on the interaction between monetary policy and FDI absorption. This study applied quantitative research methods and designed a 5-point Likert scale survey. Then, the study conducted descriptive analysis, Cronbach's Alpha test, EFA and moderator variable analysis. The results proved the money supply (0.82), interest rate (-0.65) influence FDI absorption in emerging economies and moderating unstandardised coefficient (0.723) of inflation. This research provides a novel exploration of how loose monetary policy impacts FDI adoption in emerging economies, emphasising the moderating role of inflation. Also, it offers actionable insights for policymakers to enhance FDI absorption while addressing the challenges posed by inflation dynamics.

KEYWORDS: FDI, Money supply, Interest rate, Moderating role of inflation, emerging economies.

1. INTRODUCTION

In the 4.0 industry, emerging economies are vital in global growth (Wu and Pan, 2021). Yet, their ability to attract foreign direct investment (FDI) often depends on macroeconomic factors such as monetary policy and inflation. Loose monetary policies, involving lower interest rates and increased money supply, are frequently used to stimulate investment (Odumisor, 2019). However, the interplay between these policies and inflation presents a complex challenge, potentially influencing FDI decisions. This study will explore how inflation moderates the impact of loose monetary policies on FDI inflows, providing valuable insights for policymakers. Moreover, this topic is particularly significant for understanding how emerging economies can balance growth and stability while attracting global investment. There are a number of studies that highlight the role of monetary policies in influencing investment flows. Most focus on developed countries; however, they overlook the unique challenges faced by emerging markets. These economies are often confronted with higher inflation volatility, structural weaknesses, and unpredictable policy environments (Ha and Ohnsorge, 2019), which directly affect FDI absorption. Furthermore, some studies rarely examine the moderating role of inflation in this relationship, leaving a challenging gap in understanding how inflation pressures interact with loose monetary policy decisions to shape FDI inflows in emerging countries (Frankel, 2010). In short, there is a need for a deeper and broader understanding of how loose monetary policy attracts FDI in emerging economies while also providing a new perspective on how inflation is moderated in these markets to balance growth and sustain it. This article aims to address existing research gaps by investigating two primary research questions. The first main question is: "Is Foreign Direct Investment in emerging economies affected by loose monetary policy?". To further explore this, the authors also propose two sub-research questions: "How negatively does the interest rate impact FDI absorption in emerging economies, and how positively does monetary supply impact FDI absorption in emerging economies?". Then, the second main research question that needs to be addressed is: "How positively does inflation moderate the relationship between monetary policy and FDI absorption in emerging economies?". Accordingly, this study has three objectives. First, it aims to examine whether loose monetary policy has a significant impact on FDI in emerging countries. This paper seeks to clarify the conceptual framework of two key macroeconomic mechanisms: inflation and interest rate, and analyse how these mechanisms affect loose monetary policy in emerging countries.

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Moving on to the second objective, the authors identify the moderating role of interest rates in affecting the relationship between monetary policy and FDI absorption in emerging economies. Finally, this paper aims to contribute practical insights to enhance FDI absorption in emerging markets by proposing actionable strategies. Methodologically, the study conducted descriptive analysis, Cronbach's Alpha test, EFA, and moderator variable analysis. The results proved the money supply (0.82) and interest rate (-0.65) influence FDI absorption in emerging economies, and the moderating unstandardised coefficient (0.723) of inflation. The remainder of the paper is organised into five sections: Section 2 introduces the conceptual framework, outlining the factors that impact FDI absorption in emerging economies. Sections 3 and 4 delve into the research methodology and present the research findings. Section 5 provides critical analysis and discussion. Finally, the conclusion provides practical recommendations, highlights future research directions, and summarises the main findings.

2. LITERATURE REVIEW

2.1. Foreign Direct Investment in emerging economies

Foreign Direct Investment (FDI) is vital in the economic development of emerging markets, which are characterised by rapid growth, economic liberalisation, and increasing integration into global markets. Moosa (2002) described FDI as the process in which residents or entities of one country, known as the source country, gain ownership of assets in another country (the host country) to control activities such as production, distribution, and others of a firm. Similarly, The United Nations' World Investment Report (1999) defined FDI as a long-term investment, reflecting a sustained interest and control by a resident of an entity in one economy (foreign investor or parent enterprise) in an enterprise located in a different economy other than that of the foreign direct investor (FDI enterprise, affiliate enterprise or foreign affiliate). With emerging economies, according to Hoskisson et al. (2000), they classified these economies as low-income, fast-growing nations driven by economic liberalisation, primarily situated in Asia, Latin America, Africa, and the Middle East, and transition economies such as China and the former Soviet Union. Throughout some academic literature in international business and finance, Barbopoulos et al. (2014) highlighted that there are associated costs and benefits for multinational firms undertaking FDI in emerging markets. These can include strategic, behavioural, and macroeconomic benefits, lower costs, new and rich sources of inputs/resources, and fast-growing markets which provide various and enormous market opportunities (Berry, 2006). FDI is an important factor for economic growth, especially in emerging and developing economies (Dinh et al., 2019; Opeyemi, 2020). It is also crucial for emerging economies as it avails resources necessary to optimise the level of economic development (Ismaila and Imoughele, 2015). For example, Mukhtarov et al. (2020) also argued that money supply has a significant impact on FDI inflows in Africa, but the impact of the interest rate is statistically insignificant. In ASEAN, Hoang and Bui (2015) also argued that interest rate has a significant impact on FDI inflows, and Mugableh (2015) argued that money supply impacts significantly on FDI inflows.

2.2. Anchoring theoretical framework

2.2.1. Transaction Cost Economics (TCE)

According to Transaction Cost Economics (TCE), it provides a useful lens for understanding how economic exchanges are shaped by institutional and policy environments (Dixit, 1998). This framework emphasises minimising transaction costs, which include the costs of searching for information, negotiating and enforcing contracts for goods and services, and managing risks in the sphere of markets or exchange (Everaert et al., 2010). In the context of FDI absorption, loose monetary policy in emerging economies significantly influences these costs by creating a more favourable investment climate. Moreover, TCE also highlights how investors evaluate the institutional and policy frameworks of target countries (Bellavitis et al., 2017). In emerging economies with loose monetary policies, foreign investors assess whether the financial environments lower transaction costs, support efficient contract enforcement, and offer a stable policy outlook (Claessens and Yurtoglu, 2013). If these conditions are met, investors are more likely to perceive the market as cost-effective and attractive. It is important to consider the impacts of loose monetary policy, which attracts foreign investors and increases FDI absorption in emerging economies, as it responds to TCE. Due to its focus on cost reduction, TCE plays a vital role in explaining how monetary easing lowers borrowing costs and currency risks, making local investments more financially attractive for foreign investors (Swianiewicz, 2004). Additionally, TCE emphasises the role of institutional environments, showing how monetary policy can enhance liquidity and reduce uncertainty (Fujiwara et al., 2005), fostering investors' confidence to invest in emerging economies (Barger and Kuczynski, 1996). However, TCE's limitations must also be considered. It overemphasises transaction costs, potentially neglecting strategic factors like market size or competitive positioning, which often drive long-term FDI decisions. Therefore, while TCE has limitations, it can be complemented with other theories or frameworks (Zhao et al., 2004). On the contrary, it also effectively highlights cost-related benefits such as mitigating transaction costs, enhancing liquidity, and fostering institutional confidence (Khan et al., 2024). Several additional aspects, such as

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risk and uncertainty management, are demonstrated, for instance, by addressing how monetary policy lowers financial and operational risks and explaining why FDI inflows increase under accommodative monetary conditions. Investors are drawn more to environments where transaction risks are minimised (Frankel, 2010). This ensures a more holistic understanding of the various economic, institutional, and strategic factors influencing FDI absorption in emerging economies.

2.2.2. The Eclectic Paradigm

The Eclectic Paradigm (OLI Framework), developed by John Dunning (1979), explains FDI through three interconnected advantages: Ownership, Location, and Internalisation. Loose monetary policy in emerging economies directly impacts the Location advantage by creating a favourable investment climate through lower capital costs, improved market opportunities, and enhanced macroeconomic stability. Additionally, Ownership and Internalisation advantages provide insights into how multinational corporations respond to these conditions to maximise profitability and control. Ownership advantages arise when firms with unique resources, such as financial strength or proprietary technologies, capitalise on reduced borrowing costs and increased liquidity in emerging markets (Bekaert and Harvey, 2003). Loose monetary policy enables these firms to expand and penetrate new markets more effectively (Mishkin and Savastano, 2007). However, these advantages may be challenged by increased competition, as favourable financial conditions attract numerous global firms, intensifying market rivalry (Stopford et al., 1991). Furthermore, economic policy inconsistencies in some emerging economies may limit the ability of firms to fully leverage their ownership strengths (Chen and Yu, 2012). Moreover, Location advantages are particularly influenced by loose monetary policy. With Location advantages, reduced borrowing costs, currency depreciation, and enhanced infrastructure investments create a cost-effective environment for foreign investors (Merna and Njiru, 2002). Additionally, monetary easing often stimulates infrastructure development and government support, further attracting FDI (Yamin and Sinkovics, 2009). However, prolonged loose monetary policy can result in inflationary pressures, eroding cost benefits over time (White, 2009). Volatility in exchange rates also poses a risk, as firms require stability for sustained returns, which excessive currency fluctuations may undermine (Eichengreen and Hausmann, 1999). Interestingly, Internalisation advantages highlight the strategic benefits of maintaining control over operations rather than outsourcing or licensing (Cantwell and Narula, 2001). Loose monetary policy often leads to regulatory incentives, such as tax breaks and reduced entry barriers, encouraging firms to internalise production or service facilities. While this ensures operational control and cost management, firms may face risks associated with inefficient local labour markets, political instability, or weak contract enforcement (Edwards and Lustig, 2001). Additionally, dependence on a host country's monetary environment poses a challenge; a policy reversal, such as monetary tightening, could increase operational costs and threaten profitability (Akyüz, 2011). Thus, while the OLI framework highlights risks such as policy volatility, inflation, and local market inefficiencies, it underscores the complexities of relying solely on these advantages. On the other hand, it provides a structured analysis of the benefits of loose monetary policy in attracting FDI inflows, highlighting cost-efficiency and market opportunities through Ownership and Location advantages, with Internalisation emphasising the strategic choice of maintaining control.

2.3. The impact of loose monetary policy

2.3.1. Monetary supply

Money supply, or monetary supply, refers to the total stock of monetary assets available within an economy at a specific point in time. It includes all the forms of money used by individuals, businesses, and governments for transactions, saving, and investment (Tobin, 1989). The money supply is a key indicator and is classified into different categories, commonly labelled as M1, M2, and M3, based on the liquidity of the assets included. First of all, M1, the narrowest measure, includes physical currency in circulation (coins and notes) and demand deposits like current accounts that can be used directly for consummating transactions and payments. M2, a broader measure, includes M1 along with savings deposits, small time deposits, and retail money market mutual funds. It measures the total volume of money supply in the economy; thus, liquidity may arise in the economy when the level of broad money within the system exceeds the total output in the economy (Nathan, 2023). Broad money may be measured in different ways depending on the peculiarities of diverse economies as well as their varying levels of financial and economic development (Nathan, 2023). Finally, M3 is the broadest measure of the money supply, less liquid than M2, encompassing M2 along with large time deposits, institutional money market funds, and other larger liquid assets such as savings banks, shares, and bonds. From the philosophical perspective of monetarism put forth by Milton Friedman, the money supply is important in the macroeconomic context for foreign businesses and banks. Ensuring economic stability and preventing inflation depends more on maintaining steady growth in the money supply than on maintaining stable interest rates (Kaldor, 1985).

Moreover, money supply has various macroeconomic impacts when positively affecting FDI absorption through exchange rates and economic growth. First of all, the exchange rate is one of the macroeconomic impacts of monetary supply that easily affects

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FDI inflows. An increased money supply can depreciate the local currency, making domestic assets more affordable and potentially increasing the cost of repatriating profits for foreign investors, thereby boosting FDI inflows (Islahiyah, 2024). Secondly, economic growth is also a significant impact on absorbing FDI inflows. A well-managed increase in money supply can stimulate economic growth by enhancing liquidity and encouraging investment (Bellemare, 2024). Robust economic growth creates a favourable environment for FDI, as investors seek opportunities in expanding markets (Alfaro et al., 2004). Accordingly, Yang and Shafiq (2020) argued that the rate of FDI has a positive relationship with the economic growth of the country, proving that the more money supply in the economic sectors, the more economic growth rises. Conversely, Islahiyah (2024) might contend that money supply also has many limitations when affecting FDI absorption. Exchange rate volatility may deter investors due to increased uncertainty, negatively impacting FDI decisions. Foreign investors are highly sensitive to currency risks, as fluctuations in exchange rates can either enhance or diminish the returns on their investments. According to Islahiyah (2024), if foreign incomes decline and the local currency depreciates, investors may see this as a warning sign of economic instability. This could lead to capital flight, where foreign investors withdraw their investments to avoid potential losses, exacerbating the depreciation of the currency and potentially triggering a financial crisis (Krugman, 2017). Moreover, economic growth disparities between host countries and others can create limitations in absorbing FDI inflows through the money supply.

H1: Monetary supply positively impacts FDI absorption in emerging economies.

2.3.2. Interest rate

Interest rate is the percentage charged on the total amount of money borrowed or earned over a period of time (Pritchard, 2015). It is expressed as an annual percentage of the principal amount and is a good measure of FDI inflows. Interest rates apply to loans, deposits, and other financial products, serving as a fundamental concept in finance and economics, and acting as the cost of borrowing money or the reward for saving it (Singhanian and Gupta, 2011). Interest rates are set by central banks, such as the Federal Reserve in the United States or the European Central Bank, as part of monetary policy (Friedman and Kuttner, 2010). These rates influence broader economic factors, including inflation, economic growth, credit risks, and exchange rates. Moreover, there are several types of interest rates, such as the nominal interest rate—the stated percentage rate without adjustment for inflation (Summers, 1982). The second is the real interest rate—the nominal rate adjusted for the effects of inflation, reflecting the true cost or return (Mishkin, 1981). Fixed interest rates are the third type, remaining constant over the loan or investment period (Ndikumana, 1999). Finally, a floating interest rate is a rate that fluctuates over time based on market conditions or a benchmark rate (Poncet, 2022). Overall, interest rates are crucial for individuals, businesses, and governments, affecting personal loans, mortgages, credit cards, corporate financing, and public debt, and directly and significantly impacting FDI absorption (Kiplagat, 2016; Agyeman et al., 2021). As described by Ahmed and Mayowa (2010), interest rates are a macroeconomic variable that has a positive impact on FDI inflows. According to Gross and Trevino (2008), a relatively high interest rate in a host country positively influences FDI absorption toward the local country. This is because lower rates are the aim for investors, who seek favourable interest rates or higher returns (Habanabakize and Meyer, 2018). Consequently, capital may be attracted from a host country with high rates to a local country with low rates (Siddiqui and Aumeboonsuke, 2014). Favourable interest rates can increase FDI as they enable higher returns on investments, even though risks might be elevated (Singhanian and Gupta, 2011). As a result, investors focus on low-cost funding sources, directing their investments towards countries or regions offering opportunities for higher returns (Habanabakize and Meyer, 2018). Additionally, foreign investors often survey economies with low interest rates, which enable them to obtain higher returns from their investments (Kiplagat, 2016). Several prior studies by Khan and Zahra (2016) and Chakrabarti (2001) have demonstrated the magnetic power of interest rates in attracting FDI into developing economies. For example, Fazira and Cahyadin (2016) argued that interest rates significantly impact FDI inflows in ASEAN-6 countries. Furthermore, Agyeman et al. (2021) also confirmed that interest rates positively affect FDI inflows in selected African economies. Conversely, an inverse correlation suggests that increased interest rates can negatively affect business activities, leading to more expensive credit requirements (Kiplagat, 2016). Higher rates result in increased financing costs for foreign investors seeking to establish or expand operations in a host country (Stulz, 2009), reducing the attractiveness of investing. For instance, loans taken to develop infrastructure or manufacturing facilities become costlier, cutting into potential returns (Brealy et al., 1996). Moreover, foreign investors are less likely to take risks in economies with high or volatile interest rates (Engel, 2016). Elevated rates signal inflationary pressures, making investors cautious about long-term commitments (Ball et al., 1990). Uncertainty surrounding borrowing costs or currency fluctuations can further discourage FDI (Itagaki, 1981). Additionally, high interest rates often cause fluctuations in exchange rates as capital flows in and out of the country (Sader, 2000). This volatility increases the risks associated with FDI (Asamoah et al., 2022), especially for investors concerned about repatriating profits in their home currency (Amirahmadi and Wu,

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1994). Unpredictable exchange rate movements may result in financial losses during currency conversion. For example, Kiplagat (2016) found a negative and insignificant relationship between interest rates and FDI in Africa.

H2: Interest rate is negatively correlated with FDI absorption in emerging economies.

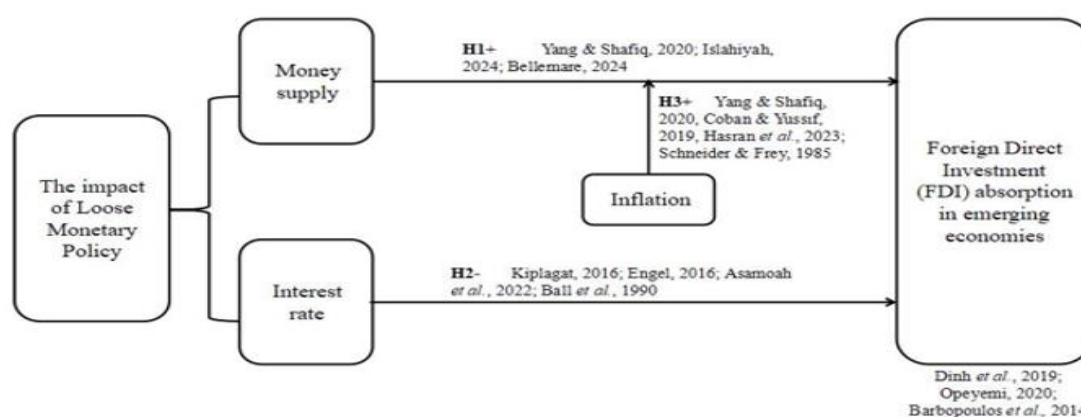
2.3.3. Moderating role of Inflation

From the Monetarism theory developed by Milton Friedman, inflation is described as a phenomenon invariably rooted in monetary factors (Tafti, 2012). Inflation is the rate at which the general level of prices for goods and services in an economy rises over a period, leading to a decrease in the purchasing power of money and posing a serious threat to macroeconomic stability across the world (Salim, 2019). It reflects how much more expensive a set of goods and services has become over a specified period, often measured annually (Alchian and Klein, 1973). Central banks and governments monitor inflation closely because it can significantly affect economic stability (Agénor and da Silva, 2013). Furthermore, inflation is typically measured using price indices, such as the Consumer Price Index (CPI) or the Producer Price Index (PPI). The CPI tracks changes in prices paid by consumers for a basket of goods and services (Armknrecht and Ginsburg, 1992), while the PPI measures changes in prices at the wholesale level (Swick et al., 2006). Moreover, there are three primary types of inflation: demand-pull inflation, cost-push inflation, and built-in inflation (Rajeev, 2023). First of all, demand-pull inflation occurs when the demand for goods and services exceeds their supply (Machlup, 1960). Factors such as increased consumer spending or government expenditure can drive up demand, leading to higher prices (Machlup, 1960). The second type is cost-push inflation, which happens when the production costs of goods and services rise due to increases in wages, raw materials, or energy costs (Batten, 1981). Producers pass these higher costs on to consumers through increased prices (Loy and Weiss, 2019). Finally, built-in inflation, also known as wage-price inflation, is driven by a feedback loop where rising wages lead to increased spending and higher demand, which in turn drives up prices (Stockhammer and Onaran, 2013). As prices rise, workers demand higher wages to maintain their purchasing power (McConnell, 1956). Currently, the moderating role of inflation in the relationship between money supply and FDI remains a subject of debate. Some studies argue that inflation strongly stimulates the money supply, significantly shaping FDI. Yang and Shafiq (2020), for instance, confirmed that inflation spurs the relationship between money supply and FDI inflows in emerging economies, including those in Africa and ASEAN. For example, Schneider and Frey (1985) emphasised that high inflation can negatively affect the money supply, leading to currency depreciation, making FDI decision-makers less inclined to invest in the country. However, Davison (2024)'s study argued that reducing inflation is an effective method for moderating the money supply, which can increase FDI inflows. Similarly, Opeyemi (2020)'s research asserted that inflation should be regulated directly by the money supply to remain low and stable, thereby maximising FDI inflows. Conversely, others believe inflation provides only weak stimulation for the money supply. The resulting limited monetary expansion might not suffice to enhance export competitiveness or economic growth, thus exerting minimal influence on FDI inflows. Empirical studies suggest that while an expansionary money supply can boost industrial growth in the short term, its long-term effects may be negative (Sahoo and Sahu, 2023). The impact on FDI can also vary based on broader economic contexts and political policies (Okonkwo et al., 2015). This ongoing debate underscores the complexity of the relationship between inflation, money supply, and foreign direct investment.

H3: Inflation positively moderates the impact of money supply on FDI absorption in emerging economies.

Figure 1

The Paper Conceptual Framework



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3. METHODOLOGY

3.1. Research approach and strategy

Quantitative and qualitative research methods are widely applied in the social sciences. In this study, a quantitative research approach was chosen. According to Creswell and Creswell (2018), this approach focuses on collecting and analysing numerical data to explore and confirm phenomena. By applying statistical techniques, it allows for the examination of data to draw objective and measurable conclusions (Babbie, 2010). This approach was used to effectively address the research questions and identify relationships between variables. The study followed a deductive methodology, which aligns closely with the quantitative approach, enabling the development of inferences, predictions, and the validation of hypotheses based on statistical evidence.

3.2. Sampling technique and procedure

Accurate reporting of the sampling technique, population, and sample size is essential to ensure data reliability. The two most common sampling methods in scientific research are probability sampling and non-probability sampling (Bryman, 2012). This study opted for a probability sampling approach to enhance the precision of the findings. Consequently, a survey was chosen as the appropriate method for data collection. The survey utilised a 5-point Likert scale to gather numerical responses, with participants rating their agreement from 1 ("strongly disagree") to 5 ("strongly agree") (Brown, 2011).

The authors developed a survey using Google Forms with a 5-point Likert scale. The survey was distributed directly and online to a number of domestic and international universities specialising in Economics and Banking, as well as to both foreign enterprises headquartered in developing countries but operating in Vietnam and domestic enterprises. For the sampling technique, the study employed a stratified sampling method to select 385 responses, comprising the same proportion 50% of international respondents and local ones. Then, the authors employed a simple random sampling method by randomly selecting 192 internationals out of 417 and 193 locals out of 622 collected answers. The study required high precision with the survey question of whether the respondents are local or come from emerging economies or others in the Background Information section of the survey.

3.3. Data analysis description

The survey data was thoroughly analysed using SPSS software to generate descriptive statistics for the relevant variables. Then, Cronbach's Alpha was applied to assess the reliability and internal consistency of the survey items. Following this, Exploratory Factor Analysis (EFA) was conducted to explore the relationships between different sub-variables and group them into fewer components. Pearson correlation analysis was used to determine the strength and direction of linear relationships between the variables. Finally, linear regression analysis was conducted to test the proposed hypotheses and assess the impact of two independent variables, Money Supply and Interest Rate, on the dependent variable, FDI absorption in emerging economies. In addition, the study used the plugin "SPSS Process Macro" to analyse the role of the moderator variable.

4. FINDINGS

4.1. Descriptive analysis

Table 1

Descriptive Statistics of the dependent variable: FDI absorption (FDI)

Statistics		FDI1	FDI2	FDI3	FDI4
N	Valid	385	385	385	385
	Missing	0	0	0	0
Mean		4.78	4.52	4.76	3.98
Mode		5	5	4	4
Std. Deviation		.731	.482	.950	.635

The mean score for FDI1, at 4.78, indicates that respondents, on average, strongly agree that FDI, as a form of long-term cross-border investment, significantly contributes to the economic growth and development of emerging economies. The mode, recorded as 5, reflects that the majority of participants strongly agree with this view of the fact that Foreign Direct Investment plays an important role in promoting economic growth and development in emerging economies. The standard deviation of 0.731 illustrates the variability in respondents' responses, indicating how closely their responses cluster around the mean of 4.78. A similar analysis was conducted for the remaining sub-variables in Table 1. In addition, descriptive statistics were performed for the two independent variables and the moderator variable in the same manner.

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4.2. Cronbach's Alpha

Table 2

Cronbach's Alpha of the dependent variable (FDI)

Reliability Statistics		Item-Total Statistics			
Cronbach's Alpha	N of Items	Scale Mean if Item Deleted	Scale Variance if Item Deleted	Corrected Item-Total Correlation	Cronbach's Alpha if Item Deleted
.788	4	SED1 9.64	12.666	.715	.755
		SED2 8.25	10.796	.650	.766
		SED3 8.72	11.454	.622	.662
		SED4 9.18	12.337	.719	.763

All sub-variables in the dependent variable (FDI) exhibited adjusted item-total correlation coefficients of 0.3 or higher. The calculated Cronbach's Alpha coefficient was 0.788, which significantly exceeded the recommended threshold of 0.6 and exceeded the Cronbach's Alpha value obtained if any particular item was deleted. Furthermore, the Cronbach's Alpha value with item deletion was higher than the adjusted item-total correlations across all sub-variables. Similar results were observed in the Cronbach's Alpha analyses for the other variables. Therefore, the statistical table below summarises the final test results for each group of variables, where MS, IR, and INF represent "Money Supply," "Interest rate," and "Inflation," respectively.

Table 3

The results of the final test of each group of variables

	Variable	Number of sub-variables before test	Number of sub-variables after test	Cronbach's Alpha	Name of eliminated sub-variables
1	FDI	4	4	0.788	None
2	MS	4	4	0.759	None
3	IR	4	4	0.849	None
4	INF	4	4	0.805	None

4.3. Exploratory Factor Analysis (EFA)

The rotated component matrix grouped the 12 sub-variables into four separate factors, with no sub-variables being eliminated in the process. Each sub-variable had a factor loading greater than 0.5

Table 4

Rotated Component matrix

Component with loading factors							
1		2		3		4	
FDI1	.776	MS1	.705	IR1	.687	INF1	.651
FDI2	.678	MS2	.652	IR2	.655	INF2	.696
FDI3	.835	MS3	.831	IR3	.702	INF3	.588
FDI4	.789	MS4	.812	IR4	.718	INF4	.748
Extraction Method: Principal Component Analysis.							
Rotation Method: Varimax with Kaiser Normalization.							
a. Rotation converged in 7 iterations.							

4.4. Multiple Linear Regression Model

FDI: Mean of FDI1, FDI2, FDI3, FDI4

MS: Mean of MS1, MS2, MS3, MS4

IR: Mean of IR1, IR2, IR3, IR4

INF: Mean of INF1, INF2, INF3, INF4

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Table 5
Coefficients

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	4.553	.523		3.566	.015
1 MS	.748	.155	.820	3.142	.003
IR	-.532	.176	-.650	-4.085	.024

a. Dependent Variable: FDI

Table 5 shows that the significance levels (Sig.) are 0.003 and 0.024, obtained from the t-test for two variables, which are lower than the threshold $\alpha = 0.05$. This result indicates that the two independent variables, Money Supply (MS) and Interest rate (IR), have a significant influence on the dependent variable, FDI absorption in emerging economies. As a result, both hypotheses are accepted.

4.5. Moderator Analysis

Table 6

Moderator results of FDI variable

Model : 1

Y : FDI

X : MS

W : IFN

Sample

Size: 385

OUTCOME VARIABLE:

FDI

Model Summary

R	R-sq	MSE	F	d11	d12	p
.556	.456	.211	7.621	3.000	381.000	.000

Model

	coeff	se	t	p	LLCI	ULCI
constant	3.375	.032	82.744	.000	4.991	4.757
MS	.362	.076	1.018	.000	.137	.264
INF	.551	.085	5.474	.000	.295	.559
Int_1	.723	.072	5.007	.000	.382	.558

The results showed that Money Supply (MS) significantly affects FDI absorption in emerging economies (FDI), as indicated by a p-value of 0.000, which was less than 0.05. Similarly, Inflation (INF) also significantly affected FDI, with a p-value of $0.000 < 0.05$. According to the theoretical framework, the interaction between MS and INF had a significant impact on FDI, indicating that INF acted as a moderator in the relationship between MS and FDI. Furthermore, the p-value for the interaction term (Int_1) was $0.000 < 0.05$, confirming that the interaction between MS and INF affected FDI. This finding supports the conclusion that INF moderates the relationship between MS and FDI. The unstandardised coefficient for Int_1 is 0.723, which is greater than 0, indicating that a higher level of INF will enhance the impact of MS on FDI. Therefore, hypothesis H3 is accepted, affirming that Inflation has a positive impact on the impact of Money Supply on FDI absorption in emerging economies.

5. DISCUSSION

5.1. Summary Results

Linear regression analysis showed that money supply (MS) had the most significant influence on FDI absorption in emerging economies (FDI), with a coefficient of 0.82. In addition, interest rate (IR) showed a significant impact, with a coefficient of -0.65.

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Furthermore, inflation acted as a moderator, enhancing the influence of money supply on FDI absorption in emerging economies, with a moderator coefficient of 0.723.

5.2. Theoretical implication

The first hypothesis underscores that monetary supply constitutes a critical determinant in shaping Foreign Direct Investment (FDI) absorption in emerging Asian economies, particularly within the transformative context of industry 4.0. The standardised coefficient of money supply is 0.82, indicating a strong effect. This result emphasises that an expanded monetary supply creates conducive macroeconomic conditions for FDI inflows, aligning with the Transaction Cost Economics (TCE) framework and the Eclectic Paradigm (OLI Framework), as highlighted by Everaert et al. (2010), Fujiwara et al. (2005), Yamin and Sinkovics (2009). Moreover, the authors agree with the view of Islahiyah (2024), who posits that an expanding monetary supply offers distinct advantages to foreign investors, notably by increasing the relative cost of repatriating profits, thereby enhancing FDI inflows. In other words, increasing monetary expansion impacts economic growth, creating a favourable environment for FDI absorption. Additionally, this research aligns with the viewpoint of Yang and Shafiq (2020), who argued that FDI has a positive relationship with the economic growth of the country and also confirmed that more money supply in economic sectors leads to increased economic growth. Thus, it can be concluded that the money supply is a crucial element in attracting FDI inflows in emerging economies.

The finding of the second hypothesis reveals significant theoretical and empirical conflicts in the relationship between interest rate and FDI absorption in emerging Asian economies, particularly within the context of industry 4.0. The standardised coefficient of interest rate is -0.65, indicating a fair effect. This result highlights that the low interest-rate environment is frequently regarded as a driving force for FDI inflows, as it reduces borrowing costs, enhances investor confidence, promotes cost-effective investment opportunities, and ensures macroeconomic stability, aligning with the TCE framework and OLI framework, as highlighted by Everaert et al. (2010), Fujiwara et al. (2005), Yamin and Sinkovics (2009). Moreover, the authors reaffirm this with empirical evidence, which further illustrates that competitive interest rates draw capital from high-rate economies to areas with lower rates (Habanabakize and Meyer, 2018; Fazira and Cahyadin, 2016). However, prolonged periods of low interest rates may distort market dynamics, potentially leading to financial instability and inflationary pressures (Stulz, 2009; Ball et al., 1990). Conversely, high interest rates, although discouraging for some investors, can signal robust financial systems, attracting risk-tolerant investors seeking higher returns (Singhania and Gupta, 2011). In summary, while low interest rates have numerous positive impacts on attracting FDI, high interest rates can result in negative or negligible effects on FDI inflows, contributing to economic instability.

The result of hypothesis three illuminates inflation's role in moderating the relationship between money supply and FDI absorption in emerging Asian economies, generating significant theoretical debate. The unstandardised coefficient for Int_1 of money supply is 0.723, indicating a strong moderating effect. This finding emphasises that moderate inflation, driven by controlled monetary expansion, can stimulate FDI inflows by depreciating the local currency and improving export competitiveness, particularly aligning with the TCE framework. Moreover, the authors further emphasise that inflation can undermine FDI absorption by eroding purchasing power and increasing uncertainty, destabilising the investment climate, and reiterating the view of Schneider and Frey (1985), who argued that high inflation can deter investors due to its association with currency depreciation and economic instability. In addition, this paper reaffirms the view of Sahoo and Sahu (2023) and Okonkwo et al. (2015), who noted that although inflation may temporarily boost industrial growth through monetary expansion, its long-term effects on FDI can be negative, particularly if inflation leads to policy inconsistencies or political instability.

5.3. Practical implications

In general, money supply is an important factor that attracts FDI in emerging economies (H1). The research result also supports this opinion with a standardised coefficient of 0.82. Money supply always brings positive effects in attracting FDI inflows in both the short and long run in emerging economies (Dinh et al., 2019). Therefore, Dinh et al. (2019) argued that governments should be looking at the money supply because the formulation and flexible use of monetary policies to support growth should be prioritised, leading to the absorption of maximum FDI benefits. Moreover, Alfaro et al. (2004) also argued that countries with a better financial system can exploit FDI more efficiently. In addition, it also makes domestic assets and markets more attractive to foreign investors, particularly in capital-intensive industries like infrastructure, technology, and manufacturing (Liu et al., 2014). For policymakers, they should strategically expand the money supply to enhance liquidity within the economy, reduce borrowing costs, and support economic growth. These measures make domestic assets and markets more attractive to foreign investors, particularly in capital-intensive industries like infrastructure, technology, and manufacturing.

Following this, the interest rate has been proven by results with a standardised coefficient of -0.65, which is a fair coefficient variable (H2). Policymakers should aim to maintain interest rates at levels that balance affordability for investors with economic

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stability. Low interest rates reduce the cost of borrowing for foreign investors, making it more appealing to finance large-scale projects such as infrastructure, manufacturing, and technology-driven ventures (Kiplagat, 2016). This affordability enables foreign firms to expand their operations, contributing to job creation and economic growth. However, governments and central banks must exercise caution to avoid prolonged periods of excessively low interest rates, which may lead to market distortions, speculative investment bubbles, or financial instability. Policymakers should instead focus on dynamic interest rate strategies, adjusting rates based on macroeconomic conditions to ensure sustained investor confidence. Clear communication of monetary policy decisions and transparent interest rate benchmarks can enhance predictability, further reassuring foreign investors about the stability of the financial environment (Moschella and Pinto, 2019).

According to the research results, the standardised coefficient of inflation (0.723), which is a moderating variable with money supply to attract FDI absorption in emerging Asian economies, shows a statistically significant impact (H3). Policymakers in emerging economies should adopt strategies to ensure that inflation remains moderate and stable, as excessive inflation can erode purchasing power, destabilise financial systems, and deter foreign investors. At the same time, a controlled level of inflation can enhance the positive effects of monetary expansion by depreciating local currencies, improving export competitiveness, and fostering industrial growth (Agénor and da Silva, 2013). Moreover, governments should integrate inflation management with broader economic policies, such as fiscal discipline and structural reforms, to enhance the effectiveness of monetary supply in attracting FDI. Strengthening institutional frameworks, improving transparency, and ensuring consistent policy implementation can further mitigate the risks associated with inflation volatility (Wahyudin, 2024). By maintaining inflation within an optimal range, emerging economies can maximise the benefits of monetary supply policies, creating an attractive and secure environment for long-term FDI inflows.

5.4. Limitation

The research paper provides critical insights into how loose monetary policy influences FDI absorption in emerging economies, yet it has notable limitations. One major limitation is its reliance on survey data collected from a specific group of employees and managers in local and Asian SME enterprises, which might not fully represent broader economic dynamics in all emerging markets. Additionally, the study does not sufficiently address potential endogeneity issues, such as reverse causality between FDI and monetary policy. Moreover, the research could benefit from a comparative cross-country analysis to account for structural and institutional differences across various emerging economies, enhancing its generalisability.

5.5. Direction for future research

Future research could focus on exploring the impact of financial development levels on the effectiveness of loose monetary policies in attracting FDI in emerging economies. Specifically, examining how variations in financial market maturity, infrastructure, and institutional quality influence the interplay between monetary supply, interest rates, and inflation on FDI absorption. Additionally, comparative analyses across regions with varying technological gaps could provide insights into the transferability of monetary policy benefits. Such research would deepen the understanding of context-specific strategies to optimise FDI inflows while balancing growth and financial stability in diverse emerging market conditions.

5.6. Conclusion

The study concludes that loose monetary policy significantly influences FDI absorption in emerging economies, with money supply having the strongest impact and interest rates playing a moderate role. Inflation acts as a critical moderator, enhancing FDI inflows under controlled levels but posing risks when excessive. The research highlights that increasing monetary supply fosters liquidity and economic growth, creating favourable conditions for FDI. However, prolonged low-interest rates or unstable inflation can undermine these benefits. Policymakers should ensure balanced monetary strategies, integrating inflation management to maximise FDI absorption and support sustainable economic development in emerging markets.

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