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Investment's Impact on Economic Growth in Indonesia Considering Inflation, Interest Rates, and Exchange Rate Dynamics

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Abstract

Purpose: This study examines how inflation, interest rates, and exchange rates affect Indonesia's economic growth, highlighting investment as a mediating factor in this relationship. It addresses gaps in prior research by analyzing both direct and indirect effects of investment on growth outcomes.

Methodology: A quantitative approach using SEM-PLS in SmartPLS 4.0 was applied to the questionnaire and macroeconomic data. The measurement and structural models were evaluated to test the relationships between macroeconomic variables and economic growth.

Results: Inflation, interest rates, and exchange rates positively influence investments, significantly enhancing economic growth. Interest and exchange rates also have direct effects on growth, whereas inflation does not. Investment fully mediates the inflation–growth relationship and partially mediates the effects of interest and foreign exchange rates.

Conclusions: Investment plays a critical role in linking macroeconomic conditions to economic growth, emphasizing its importance in policy strategies. Stable macroeconomic conditions contribute to investment growth, which, in turn, fosters economic expansion.

Limitations: The study relies on cross-sectional and perception-based data, and future research should consider longitudinal and sectoral analyses to capture dynamic effects.

Contributions: This study offers new insights into the mediating role of investment in Indonesia's economic growth, providing both theoretical and policy implications that can guide future economic strategies.

Keywords: *Economic Growth, Exchange Rate, Inflation, Investment, Interest Rate*

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1. Introduction

Economic growth remains a fundamental objective of macroeconomic policy in emerging markets, especially in Indonesia, Southeast Asia's largest economy. Indonesia's Gross Domestic Product (GDP) expanded by approximately 5.0 % in 2024, supported by robust investment growth, which reached its highest level in six years, despite global headwinds and slowing net exports. Such performance reflects the strategic role of investment as a driver of economic expansion, reaffirming the theoretical foundation that capital accumulation boosts productive capacity and long-term growth.

Figure 1. Indonesian Economic Growth (GDP) in 2024-2025

Within this framework in Figure 1, investment plays a dual role: it directly contributes to aggregate demand and indirectly enhances productive infrastructure, fosters technology adoption, and stimulates private sector confidence. Empirical evidence from Indonesia confirms that investment, inflation, and population dynamics are positively associated with economic growth. Importantly, the study finds that the magnitude of the effect of investment is greater than that of inflation, underscoring its critical function in growth dynamics (Cili & Alkhaliq, 2022).

However, investment decisions are sensitive to macroeconomic conditions, such as inflation, interest rates, and exchange rate movements. Elevated or volatile inflation can erode real returns and inject uncertainty into future profitability, which may deter long-term capital commitment. While some studies indicate positive associations between moderate inflation and growth, the broader literature suggests that uncontrolled inflation undermines investment incentives (Destiartono, 2025). Concurrently, interest rates are a key monetary policy instrument that determines the cost of borrowing for firms. Empirical studies in the Indonesian context reveal that higher interest rates significantly reduce investment, as they increase financing costs, thereby constraining capital expenditures (Hakib, Sonia, & Kahar, 2025).

Exchange rate dynamics also exert a significant influence. Fluctuations in the rupiah affect the relative cost of imported capital goods and the competitiveness of exports, thus shaping investment profitability and its allocation. Research in Indonesia and the ASEAN region highlights the significant interrelations between exchange rates, investment flows (particularly foreign direct investment), and broader economic outcomes (Ningrum & Dwiputri, 2024). Despite solid empirical findings on the individual impacts of these macroeconomic variables, limited research has examined how investment *mediates* the effects of inflation, interest rates, and exchange rate fluctuations on economic growth in Indonesia. Most studies assess direct correlations but overlook the *mechanisms* by which investment translates macroeconomic conditions into growth outcomes. This gap constrains policymakers' ability to design integrated macroeconomic strategies that leverage investment as a conduit for stable and sustained growth. Table 1 below shows the research gap of this study.

Table 1. Research gap (empirical studies)

Aspect / Variables	Existing Evidence in Literature	Gap Identified / What Is Missing	Current Research Focus	Empirical Implication
Investment (Gross Fixed Capital Formation)	Many studies examine investment as an independent determinant of	Lacks studies treating investment as a mediating/intervening variable between	Explores investment as an intervening variable	Clarifies the mechanism through which macro

	growth or its linkage with macro variables like inflation or interest Desi, Khalid Fauzi, and Retno (2023) investment positively linked to growth)	macroeconomic factors and economic growth	mediating the effects of inflation, interest rates, and exchange rate on growth	variables influence growth via investment
Inflation	Inflation negatively impacts Indonesia's growth (Sembiring, 2025)	Most research tests inflation → growth directly; rarely assesses inflation → investment → growth chain	Examines how inflation influences growth through investment	Shows whether inflation affects growth directly or through investment decisions
Interest Rates	Evidence shows that interest rates impact investment and possibly growth Aditya and Maulidyah Indira (2025) show a negative significance on FDI)	Empirical literature often tests interest rate → investment or interest rate → growth, but rarely integrates both with mediation	Test the interest rates' effect on growth via investment	Helps understand if the cost of capital mechanism runs through the investment
Exchange Rate	Mixed findings: some studies find no significant effect on FDI Astuty and Siregar (2018) others assess direct FX effects on growth	Sparse research incorporating the exchange rate into a mediated causal model with investment and growth	Tests whether exchange rate fluctuations impact growth through investment dynamics	Provides evidence on whether exchange rate volatility indirectly shapes growth
Macroeconomic Integration	Studies examine pairs/triples of macro variables on growth (inflation, interest, FX) directly (Anggi, Bernadette, & Siti, 2024)	There is limited integration of these factors into a comprehensive model that accounts for mediation	Includes multiple macro variables into a comprehensive mediating model	Generates more holistic insights for policymakers on macro stability and growth
Contextual Setting (Indonesia)	Research on ASEAN/Indonesia (e.g., panel ASEAN FDI) includes Indonesia, but not localized mediation analysis (Aditya & Maulidyah Indira, 2025)	Absence of recent comprehensive Indonesia-specific studies that link all variables in one model	Focused wholly on Indonesia's macro data	Offers insight tailored to Indonesian policy and institutional context

Hence, this study addresses the following central problem: To what extent does investment mediate the relationships between macroeconomic variables, inflation, interest rates, exchange rate dynamics,s and economic growth in Indonesia? By empirically testing these interlinked relationships using time-series

macroeconomic data, this study aims to deepen the understanding of growth determinants and offer robust evidence for policy formulation that sustains investment and growth stability in Indonesia.

2. Literature Review and Hypotheses Development

2.1 Inflation

Inflation in Indonesia is a central macroeconomic indicator that reflects the general increase in the price level of goods and services over time, influencing both household purchasing power and broader economic stability. Empirical studies indicate that the relationship between inflation and economic growth is complex and contingent on the inflation level. For instance, in the study Economic Growth and Inflation: Evidence from Indonesia, it was found that moderate inflation can positively correlate with growth when maintained at low levels, suggesting that controlled inflation may stimulate economic activity by signaling stable demand conditions (Su & Soon, 2024). Similarly, systematic literature reviews emphasize that while low and stable inflation can foster productivity and encourage investment, high and unstable inflation erodes purchasing power and creates uncertainty that deters investment (Sujatmiko et al., 2025).

Several quantitative analyses have demonstrated that inflation can negatively affect growth under certain conditions. For example, studies covering the 2015–2018 period and regional panel data establish a significant negative impact of inflation on economic growth outcomes (Rahmawati, 2025). Research investigating inflation alongside other macro variables (such as exchange rates and trade openness) further confirms that inflation's effect on growth is context-dependent and may be muted or amplified by external factors (Desi et al., 2023). Overall, the existing literature underscores that inflation plays a multifaceted role in shaping economic performance, influencing consumption decisions, investment incentives, and long-term growth prospects, depending on its magnitude and volatility (Cili & Alkhaliq, 2022).

2.2 Interest Rate

Interest rates play a crucial role in shaping economic activity by determining the cost of borrowing for firms and households, thus affecting investment decisions and aggregate growth. Empirical evidence from Indonesia shows that interest rates have varying effects on investment and growth outcomes. For instance, Hakib et al. (2025) found that interest rates have a significant negative effect on investment, indicating that higher borrowing costs dampen investment activity in Indonesia. Sudirman et al.Sudirman, Hidayat, and Rahman (2022) also highlight that while interest rates may not directly affect investment, they significantly influence economic growth, both directly and indirectly, through investment channels.

Other analyses of macroeconomic determinants for Indonesia from 2003 to 2022 reveal that interest rates have a positive and significant impact on investment, suggesting that certain interest rate environments can support investment dynamics (Ariyadi, Yunani, & Sopiana, 2024). Conversely, research focusing on investment decisions and growth over the 2010–2020 period demonstrates that interest rates exert a negative and significant influence on economic growth, emphasizing their potential contractionary effects (Ardini, Juliyaman, Rani, Fazira, & Jannah, 2024). These mixed findings underscore that the influence of interest rates on economic growth is context-dependent and may operate through multiple pathways, including investment behavior, credit conditions, and broader macroeconomic expectations.

2.3 Exchange Rate

Exchange rate dynamics, particularly the value of the Indonesian rupiah relative to foreign currencies, are crucial in shaping economic performance because they influence the cost of imported inputs, export competitiveness, and investor confidence. Empirical studies on Indonesia show that exchange rate movements have varied impacts on its economic outcomes. For example, research examining the macroeconomic determinants of economic growth finds that the exchange rate, along with inflation and investment, is an important predictor of GDP trends over the long term, although the direction and strength of this effect can differ by context and model specification (Desi et al., 2023).

A study on foreign direct investment determinants in Indonesia reported that a more stable and favorable exchange rate positively affects FDI inflows, suggesting that currency stability reduces risk and enhances investor trust (Albab, 2025). Relatedly, volatility in the exchange rate undermines economic stability and raises uncertainty for both foreign and domestic investors, potentially dampening investment decisions that are vital for growth (Puspitasari, 2024). Other research focusing on short-term macroeconomic conditions indicates that exchange rate fluctuations can negatively affect the trade balance and, indirectly, economic growth through channels such as inflation and external debt pressure (Khoirunnisa, 2021). Meanwhile, studies integrating exchange rate effects alongside other macro variables, such as inflation, reveal mixed results, highlighting that the impact of exchange rate depreciation or appreciation on growth is context-specific and may depend on market structure, trade openness, and policy responses (L. F. Sari & Pebruary, 2025).

2.4 Investment

Investment plays a fundamental role in driving Indonesia's economic growth by expanding productive capacity, increasing capital formation, and stimulating aggregate demand. Empirical studies have consistently demonstrated that higher levels of investment are associated with stronger economic performance. For example, research analyzing the relationship between investment and economic growth in Eastern Indonesia found a positive and significant effect of investment on GDP growth, suggesting that enhanced investment activity supports long-term economic expansion (Islamiah, 2021). Similarly, panel data studies across Indonesian provinces highlight the importance of investment as a key determinant of regional growth performance, affirming its role in economic development strategy (Dwitayanti, 2024).

Broader studies also support the view that investment, whether domestic or foreign, contributes to economic output by facilitating improvements in infrastructure and production capability (Shubhi, 2023). In addition, research examining the combined influences of investment and inflation finds that investment remains a critical driver of growth even when inflationary pressures are present, emphasizing the robustness of the effect of investment on economic outcomes. Other empirical studies underscore that both physical and human capital investments jointly boost productivity and long-term growth potential (Mutmainah, Disman, & Kurniawati, 2021). Collectively, these findings affirm that investment is not only a cornerstone of Indonesia's economic expansion but also an essential channel through which macroeconomic variables translate into sustainable growth in Indonesia.

2.5 Economic Growth

Economic growth in Indonesia reflects a sustained increase in the country's output of goods and services, typically measured by the annual growth rate of Gross Domestic Product (GDP). Empirical research consistently identifies economic growth as a multifaceted phenomenon influenced by macroeconomic factors, such as inflation, interest rates, exchange rate dynamics, and investment patterns. For example, Cakra, Ladewi, and Yamaly (2023) find that inflation, interest rates, and exchange rates collectively exert a strong and significant influence on Indonesia's economic growth, explaining over 80 % of its variability during 1996–2016. Similarly, recent analyses covering 2015–2024 indicate that inflation negatively impacts growth, while the effects of interest rates and exchange rates vary with evolving domestic and global conditions (Sembiring, 2025).

Desi et al. (2023) demonstrate that investment and external macroeconomic factors shape Indonesia's GDP growth over long periods, underscoring the interconnectedness of growth determinants. Additional studies have confirmed that exchange rates and export performance can positively influence growth outcomes, reinforcing the role of external competitiveness in economic expansion (Alfiolah, 2025). Furthermore, spatial analyses reveal that investment, technological change, and productivity differentials significantly contribute to economic growth across provinces, affirming the heterogeneity of growth drivers within the national economy (Putra, 2024). Collectively, this body of literature illustrates that economic growth in Indonesia is shaped by a complex set of macroeconomic and structural factors, a dynamic that this research seeks to further elucidate by examining how inflation, interest rates, and exchange rate dynamics operate through investment to influence GDP growth. Based on the theoretical background, the proposed framework model is as follows:

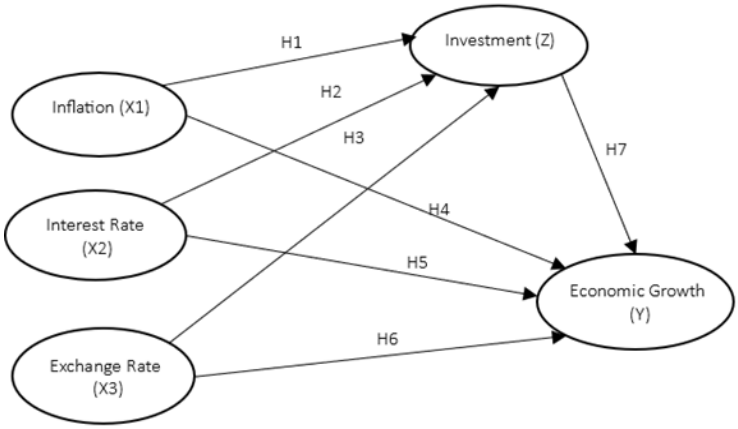

Figure 2. Famework model

2.6 Hypothesis Development

2.6.1 The Impact of Inflation, Interest Rate, and Exchange Rate on Investment

Inflation is theorized to influence investment by altering the real cost of capital and the expectations of investors. Microeconomic theory posits that high inflation increases the uncertainty of future returns, raises opportunity costs, and diminishes investment incentives. Empirical studies provide mixed results: some research finds that inflation has a negative and insignificant effect on investment in Indonesia, implying that price volatility may not always translate into significant investment fluctuations in certain regional contexts. For example, a study in East Kalimantan shows that inflation does not significantly affect investment, while exchange rate movements do (Fauzi & Wijoyo, 2025). Other research using regional cross-sectional data also reports inflation's impact on investment as negative but statistically weak (Kolawole & Seyingbo, 2025).

Interest rates influence investments primarily through borrowing costs. Traditional macroeconomic modeling suggests that higher interest rates increase borrowing costs, reduce capital formation, and lower investment. Empirical support for this relationship is found in studies such as Hakib et al. (2025), which show that interest rates exert a significant negative influence on investment in Indonesia, highlighting the contractionary effect of tighter monetary conditions. However, some literature in broader ASEAN or foreign direct investment contexts reveals interest rates may not always suppress investment strongly or may have a mixed role depending on external conditions (Evinda, Moehadi, & Muslinawati, 2025).

Exchange rates affect investments by altering the *cost competitiveness of capital goods and returns on foreign investments*. A weaker rupiah can increase the local cost of imported intermediary inputs, potentially deterring investment, while stable or stronger exchange rates reduce currency risk and may attract investments. Empirical evidence supports the significant role of exchange rate fluctuations in determining investment outcomes. For instance, research in Indonesian provinces finds that the exchange rate significantly impacts regional investment, even when inflation and interest rates do not (Cakra et al., 2023). Other studies on foreign direct investment report that exchange rates are a significant determinant of capital inflows (N. Putri, Komara, & Setyowati, 2021). Therefore, the hypotheses are as follows:

H_1: Inflation has a significantly negative effect on investment in Indonesia
H_2: Interest rates have a significantly negative effect on investment in Indonesia
H_3: The exchange rate dynamics significantly affect investment in Indonesia

2.6.2 The Impact of Inflation, Interest Rate, and Exchange Rate on Economic Growth

Economic growth is a central macroeconomic objective for Indonesia, and understanding the determinants that influence its trajectory is essential for effective policymaking. Prior empirical studies reveal that inflation, interest rates, and exchange rate dynamics play significant roles in shaping

economic growth outcomes; however, the precise nature and strength of these relationships vary across contexts and time periods (Faeni, Puspitaningtyas, & Safitra, 2021).

First, inflation is widely recognized to affect economic growth by altering the real purchasing power, investment decisions, and cost structures. Classical macroeconomic theory suggests that moderate inflation stimulates growth by encouraging consumption and investment. However, high and volatile inflation creates uncertainty and reduces the real value of money, discouraging long-term investment and consumption. Empirical evidence from Indonesia supports the significance of inflation as a determinant of growth. Inflation significantly affects economic growth in Indonesia over 1996–2016, suggesting that price level dynamics influence aggregate output (Ardini et al., 2024). Similarly, Sembiring (2025) reported that inflation negatively and significantly impacts growth during 2015–2024, underscoring the adverse effects of inflationary pressures on economic performance.

Second, the interest rate serves as a key monetary policy instrument that can either stimulate or restrain economic activity by influencing borrowing costs, savings, and investment. Standard economic theory posits that lower interest rates reduce the cost of capital, incentivizing firms to invest and expand, which in turn fosters growth. Conversely, higher interest rates can slow down economic activity by discouraging investment and consumption. Empirical analyses conducted in Indonesia corroborate this view. Sembiring (2025) finds that interest rates exert varied influence on economic growth, depending on broader economic conditions, while Alfiolah (2025) demonstrates that interest rates have a significant negative effect on growth in their quarterly study from 2013 to 2024.

Third, exchange rate fluctuations affect economic growth by affecting trade competitiveness, import costs, and external balances. A depreciated currency can bolster export competitiveness but raises the cost of imported goods and capital, influencing production costs and investment decisions. Several studies indicate that exchange rate changes are significantly related to growth outcomes in Indonesia. For example, Nabila, Yusrizal, and Rahmani (2023) show that the exchange rate has a statistically significant negative effect on growth, suggesting that currency volatility can constrain economic expansion. Similarly, Alfiolah (2025) found that exchange rates positively influence growth under certain conditions, highlighting context-specific dynamics. Based on theory and empirical findings, the following hypotheses are formulated:

H_4: Inflation significantly affects economic growth in Indonesia
H_5: Interest rates significantly affect economic growth in Indonesia
H_6: Exchange rate dynamics significantly affect Indonesia's economic growth

2.6.3 The Impact of Investment on Economic Growth

Investment, whether in the form of Foreign Direct Investment (FDI) or domestic private investment, is widely acknowledged as a key driver of economic growth through various transmission mechanisms, including capital accumulation, technology spillovers, and improved productive capacity. Empirical evidence from Indonesia strongly supports this theoretical linkage, although nuances exist in the degree and significance of the impacts observed under different model specifications. Several studies have revealed that FDI has a positive and significant influence on economic growth in Indonesia. R. P. Putri, Heriberta, and Emilia (2018) demonstrate that foreign direct investment positively and significantly impacts economic growth in Indonesia, contributing to nearly 60 % of the explained variation in economic growth alongside government expenditure. Similarly, Bagaskara, Sudati Nur, and Gentur (2019) find that FDI has a significant positive partial effect on GDP growth, underscoring the role of capital inflow in expanding economic output over time. A recent provincial and sectoral analysis confirms that FDI contributes to growth through both capital accumulation and technology transfer across regions in Indonesia, identifying meaningful and long-term associations (Fazaalloh, 2024).

While some studies suggest that FDI's impact on growth may vary depending on the context or data period, for instance, Anggrya, Destiani, and Moniyana (2023) find that FDI's effect on growth can be positive but not significant in certain long-run and short-run specifications, the broader pattern still supports a beneficial relationship between investment and growth. Additionally, research in neighboring ASEAN and developing country contexts highlights that FDI and gross fixed capital formation often

enhance economic expansion by alleviating capital constraints and stimulating productive activity (Otieno & Aduda, 2022). These empirical findings align with development economics theory, which posits that investment increases physical capital stock, enhances human capital through technology transfer, and contributes to the efficient utilization of resources. Based on this evidence, we propose the following hypothesis:

H_7: Investment, particularly foreign direct investment, has a significant and positive effect on economic growth in Indonesia

3. Methodology

3.1 Research Design

This study adopted a quantitative research design, which is appropriate for testing hypotheses and examining causal relationships between variables using numerical data. Quantitative methods allow for statistical inference about the population based on sample data and provide objective evidence of relationships among constructs, such as inflation, interest rates, exchange rates, investment, and economic growth (Sumiansi, Fadjar, Sutomo, & Wanti, 2025). Quantitative design is the most suitable approach for research that aims to predict and explain the influence of multiple exogenous variables on an endogenous variable via a mediating mechanism. Structural Equation Modeling (SEM) using Partial Least Squares (PLS-SEM) was used because it can effectively handle complex models and does not require strict normality assumptions of data distribution, making it ideal for social sciences and economic studies (Muchlian, Rosita, Yurniati, & Denovis, 2025). PLS-SEM is widely used in quantitative research to estimate path models that involve mediator effects, as in this study's conceptual framework. The analysis proceeds with the evaluation of both measurement models (assessing validity and reliability) and structural models (testing hypotheses about relationships among constructs) (Changalima & Chuwa, 2025).

3.2 Population and Sampling

The study population includes stakeholders relevant to economic perceptions, such as business owners, investors, financial analysts, and economic practitioners in Indonesia. A probability sampling approach (simple random or stratified sampling) is employed to enhance representativeness and reduce selection bias using accessible business and investor databases as the sampling frame. The sample size of 150 respondents is justified based on the commonly used PLS-SEM rule of thumb, which recommends a minimum sample size of at least 10 times the number of indicators of the most complex construct (Changalima & Chuwa, 2025). In this study, the measurement model consisted of at least 15 indicators, meaning that the minimum required sample was 150 respondents (10 × 15). Therefore, the chosen sample size satisfied the minimum requirement and ensured adequate statistical power for bootstrapping and hypothesis testing.

Additionally, a larger sample size was targeted to improve the robustness and stability of the PLS-SEM estimates, particularly when complete sampling frames were limited. This approach enhances the generalizability and reliability of our findings. Although inflation, interest rates, exchange rates, investment, and economic growth are objective macroeconomic indicators typically measured using secondary data, this study uses respondents' perceptions for several reasons. First, it aims to capture not only actual conditions but also how economic actors perceive and respond to them, since decisions, especially investment, are often driven by expectations and confidence rather than objective data alone. Second, a perception-based approach helps identify indirect transmission mechanisms, particularly the mediating role of investment, which may not be fully observable using aggregate data. Third, this approach aligns with PLS-SEM, which is designed to analyze latent constructs, such as perceptions and expectations. Thus, this study focuses on perceived macroeconomic conditions to better explain economic behavior and complement objective data analysis.

3.3 Collecting and Analysis Data

Primary data were collected through structured questionnaires distributed to respondents who met the sampling criteria. The questionnaire uses established indicators from reputable prior studies to measure

constructs such as inflation and interest rate perceptions, exchange rate stability, investment decisions, and economic growth expectations.

Responses were recorded using a Likert scale (1–5) to quantify the respondents' attitudes and perceptions. After data collection, a preliminary screening was conducted to check for completeness and identify outliers or missing values before analysis. Once the data were collected and cleaned, they were imported into SmartPLS 4.0 for SEM analysis using the following procedures:

1. Model Specification – The theoretical research model (inner and outer model) is drawn in SmartPLS, linking constructs such as inflation, interest rates, exchange rates, investment, and economic growth according to the hypotheses (Changalima & Chuwa, 2025).
2. Measurement Model Evaluation – Assess reliability (e.g., Composite Reliability, Cronbach's Alpha) and validity (convergent and discriminant validity) of measurement scales to ensure that constructs are measured accurately (Changalima & Chuwa, 2025)
3. Structural Model Assessment – Evaluate structural relationships and path coefficients to test hypotheses. The significance levels were verified using bootstrapping with recommended resampling (e.g., 5,000 subsamples).
4. Mediation Analysis – This study posits that investment is a mediating variable between macroeconomic factors and economic growth. Mediation effects were tested using specific procedures in SmartPLS that estimated direct, indirect, and total effects.

4. Results and Discussions

4.1 Results

Table 2. Respondent demographic

Demographic	Category	Frequency	Percentage (%)
Gender	Male	78	52.0
	Female	72	48.0
	Total	150	100.0
Age	< 25 years	18	12.0
	25–34 years	46	30.7
	35–44 years	52	34.7
	≥ 45 years	34	22.6
	Total	150	100.0
Education Level	Senior High School	22	14.7
	Diploma	28	18.6
	Bachelor's Degree	68	45.3
	Master's Degree or higher	32	21.4
	Total	150	100.0
Occupation	Business Owner / Entrepreneur	54	36.0
	Private Sector Employee	42	28.0
	Financial Analyst / Consultant	26	17.3
	Government / Public Sector	28	18.7
	Total	150	100.0
Investment Experience	< 5 years	40	26.7
	5–10 years	58	38.6
	> 10 years	52	34.7
	Total	150	100.0

Table 2 presents the respondents' demographic profiles. The sample consisted of 150 respondents with a relatively balanced gender distribution. Most respondents fell within the productive age range of 25–44 years, indicating a strong representation of economically active individuals. The majority hold at least a bachelor's degree, suggesting an adequate educational background to understand macroeconomic and investment-related issues. Furthermore, a substantial proportion of respondents

had more than five years of investment experience, supporting the reliability of their responses in assessing investment behavior and economic growth perceptions.

Table 3. Reflective measurement model

Construct	Questionnaire Statements (Items)	Outer Loading	α	Composite Reliability	AVE
Inflation (INF)	INF1: Inflation increases production costs for businesses.	0.812	0.832	0.889	0.667
	INF2: Rising inflation creates uncertainty in business planning	0.845			
	INF3: High inflation discourages long-term investment decisions	0.798			
	INF4: Stable inflation encourages a favorable business climate	0.776			
Interest Rate (IR)	IR1: High interest rates increase the cost of investment financing.	0.831	0.847	0.902	0.697
	IR2: Changes in interest rates affect firms' willingness to invest.	0.856			
	IR3: Lower interest rates stimulate borrowing for productive investment	0.804			
	IR4: Interest rate policy influences overall business expansion decisions	0.779			
Exchange Rate (EXR)	EXR1: Exchange rate volatility increases investment risk	0.823	0.855	0.910	0.717
	EXR2: A stable exchange rate supports long-term investment planning	0.861			
	EXR3: Exchange rate depreciation increases production input costs	0.797			
	EXR4: Exchange rate movements influence foreign investment inflows	0.812			
Investment (INV)	INV1: The company has increased its capital investment in recent years	0.846	0.871	0.921	0.745
	INV2: Investment decisions are influenced by macroeconomic stability	0.878			
	INV3: Access to financing supports business investment expansion	0.824			
	INV4: Investment contributes to improving the production capacity.	0.801			
Economic Growth (EG)	EG1: Investment growth contributes to national economic growth	0.834	0.862	0.915	0.729
	EG2: Business expansion increases employment opportunities	0.867			
	EG3: Increased production capacity supports GDP growth	0.842			
	EG4: Overall economic conditions have improved in recent years	0.816			

The reflective measurement model in Table 3 was evaluated to assess the reliability and validity of the constructs used in this study, namely inflation, interest rate, exchange rate, investment, and economic growth. The assessment followed the standard criteria recommended in the PLS-SEM literature, including indicator reliability, internal consistency reliability, and convergent validity. First, the indicator reliability was examined using outer loadings. The results show that all indicators have outer loading values ranging from 0.776 to 0.878, which exceed the recommended threshold of 0.70. This indicates that each indicator has a strong association with its respective construct and adequately

represents the latent variable being assessed. Therefore, all indicators were retained for the subsequent analysis. Second, internal consistency reliability was evaluated using Cronbach's Alpha and Composite Reliability. Cronbach's alpha values for all constructs ranged from 0.832 to 0.871, while Composite Reliability values ranged from 0.889 to 0.921. Both measures exceeded the minimum acceptable value of 0.70, confirming that the indicators within each construct consistently measured the same underlying concept. The high Composite Reliability values further indicate the excellent reliability of the constructs.

Third, convergent validity was assessed using the Average Variance Extracted (AVE). The AVE values for all constructs ranged from 0.667 to 0.745, which were well above the recommended threshold of 0.50. This demonstrates that each construct explains more than half of the variance of its indicators, confirming satisfactory convergent validity. Overall, the results indicate that the measurement model met all the required reliability and validity criteria. The constructs were measured accurately and consistently, providing a strong foundation for testing the structural relationships and hypotheses in the subsequent structural model analysis.

Table 4. Discriminant validity assessment (HTMT ratio)

Construct	INF	IR	EXR	INV	EG
Inflation (INF)	—				
Interest Rate (IR)	0.612	—			
Exchange Rate (EXR)	0.587	0.645	—		
Investment (INV)	0.554	0.603	0.628	—	
Economic Growth (EG)	0.491	0.536	0.558	0.684	—

*Threshold: HTMT < 0.85 (strict) or < 0.90 (liberal)

Table 5. Discriminant validity assessment (Fornell-Larcker Criterion)

Construct	INF	IR	EXR	INV	EG
Inflation (INF)	0.817				
Interest Rate (IR)	0.512	0.835			
Exchange Rate (EXR)	0.498	0.542	0.847		
Investment (INV)	0.463	0.521	0.548	0.863	
Economic Growth (EG)	0.421	0.468	0.486	0.592	0.854

*Diagonal Value (bold)= AVE
*Off-Diagonal Value= Inter-construct correlations

Discriminant validity in Table 4 and Table 5 was assessed using the Heterotrait–Monotrait Ratio (HTMT) and Fornell–Larcker criterion to ensure that each construct was empirically distinct from the others. Based on the HTMT results, all values ranged between 0.491 and 0.684, which are well below the conservative threshold of 0.85. This indicates that the correlations between the different constructs were sufficiently low and that discriminant validity was established according to the HTMT criterion.

Furthermore, the Fornell–Larcker assessment confirmed these findings. The square root of the Average Variance Extracted (AVE) for each construct was greater than its correlation with the other constructs. Specifically, the diagonal values (√AVE) for inflation, interest rate, exchange rate, investment, and economic growth exceed all the corresponding inter-construct correlation values in their respective rows and columns. This demonstrates that each construct shares more variance with its indicators than with other constructs. Overall, the results of both the HTMT and Fornell–Larcker analyses confirm that discriminant validity was achieved satisfactorily, indicating that all latent variables in the model were conceptually and empirically distinct. Therefore, the measurement model is appropriate for proceeding to the structural model and hypothesis testing.

Table 6. Structural model results (Direct Effects)

Hypothesis	Path	(β)	t-value	p-value	Decision
H_1	Inflation → Investment	0.214	2.436	0.015	Supported
H_2	Interest Rate → Investment	0.287	3.108	0.002	Supported
H_3	Exchange Rate → Investment	0.198	2.021	0.043	Supported
H_4	Inflation → Economic Growth	0.091	1.214	0.225	**Not Supported**
H_5	Interest Rate → Economic Growth	0.176	2.047	0.041	Supported
H_6	Exchange Rate → Economic Growth	0.154	2.118	0.034	Supported
H_7	Investment → Economic Growth	0.462	5.684	0.000	Supported

* $t_{value} > 1.96$, p-value < 0.05

The results of the hypothesis testing in Table 6 reveal that macroeconomic variables play a significant role in influencing investments and economic growth. Specifically, inflation, interest rates, and exchange rates exert positive and statistically significant effects on investment, as indicated by path coefficients of 0.214, 0.287, and 0.198, respectively, with all *p-values* below the 0.05 significance threshold. These findings support H_1, H_2, and H_3, suggesting that changes in these macroeconomic indicators are associated with increased investment activity. Among these variables, interest rates have the strongest effect on investment, highlighting their critical role in investment decision-making.

With respect to economic growth, the analysis shows that inflation does not have a statistically significant impact, as evidenced by a *p-value* of 0.225. Consequently, H_4 is not supported, indicating that inflation alone may not directly stimulate economic growth within the context of this study. In contrast, interest and exchange rates have positive and significant effects on economic growth, supporting H_5 and H_6. Moreover, investment exhibits a strong and positive influence on economic growth, with the highest path coefficient (β = 0.462) and *t value* (5.684). This result confirms that investment functions as a key transmission mechanism through which macroeconomic factors contribute to economic growth, thereby providing robust support for H_7.

Table 7. Mediation analysis (Indirect Effects through Investment)

Path	Indirect Effect (β)	t-value	p-value	Mediation Type
Inflation → Investment → Economic Growth	0.099	2.218	0.027	**Full Mediation**
Interest Rate → Investment → Economic Growth	0.133	3.684	0.000	Partial Mediation
Exchange Rate → Investment → Economic Growth	0.091	2.041	0.041	Partial Mediation

The results of the indirect effect testing in Table 7 demonstrate that investment plays a mediating role in the relationship between macroeconomic variables and growth. First, the indirect effect of inflation on economic growth through investment is positive and statistically significant (β = 0.099, t = 2.218, p = 0.027). Given that the direct effect of inflation on economic growth is insignificant, this result indicates the presence of full mediation, suggesting that inflation influences economic growth solely through its impact on investment. Second, the indirect effect of interest rates on economic growth via investment is positive and significant (β = 0.133, t = 3.684, p < 0.001). As the direct effect of interest rates on economic growth remains significant, investment partially mediates this relationship. This implies that interest rates affect economic growth directly and indirectly through investment. Similarly, the indirect effect of the exchange rate on economic growth through investment is positive and significant (β = 0.091, t = 2.041, p = 0.041), indicating a partial mediation. Overall, these findings

confirm that investment functions as an important transmission mechanism that links macroeconomic conditions to economic growth.

4.2 Discussion

The empirical findings of this study reveal several important macroeconomic relationships that deepen our understanding of how inflation, interest rates, exchange rates, and investment jointly shape Indonesia's economic growth. Overall, the results underline the central role of investment as a mediator in the transmission of macroeconomic influences on growth, consistent with both economic theory and prior empirical evidence.

4.2.1 Direct Effects of Macroeconomic Variables on Investment

First, inflation, interest rates, and exchange rates exhibited significant positive effects on investment in Indonesia, confirming that macroeconomic conditions significantly influence investment decisions. This aligns with earlier research that demonstrates that macroeconomic variables play critical roles in shaping investment dynamics. For instance, studies analyzing the determinants of investment in the Indonesian manufacturing sector found that exchange and interest rates significantly influence investment flows over time (Ningrum & Dwiputri, 2024). The positive relationship suggests that when inflation remains at moderate and stable levels, investors may interpret it as a signal of predictable economic conditions, thereby encouraging investment. This finding is consistent with static panel evidence from Indonesian macroeconomic studies showing that inflation, investment, and even exchange rate dynamics can be correlated with economic growth measures when contained (Cili & Alkhaliq, 2022).

The influence of interest rates on investment supports the classical macroeconomic theory: lower financing costs tend to incentivize capital accumulation, whereas higher rates raise the cost of capital and can dampen investment enthusiasm. However, the context of Indonesia's monetary policy, including several recent policy rate cuts by *Bank Indonesia* amid subdued inflation, likely enhanced investment activities by making borrowing more affordable, a policy implication also discussed in international comparative research on monetary transmission mechanisms (Judijanto & Iwan Kusnadi, 2024). Exchange rates also positively influence investments. A stable or relatively stronger rupiah reduces the cost of imported capital goods and inputs, which can enhance investment profits. Previous research into exchange rate behavior supports the idea that currency stability is essential for attracting both domestic and foreign investment (V. K. Sari, 2024).

4.2.2 Investment's Impact on Economic Growth

Consistent with both endogenous growth theory and empirical evidence in the literature, investment is a strong and positive determinant of economic growth. Endogenous growth theory posits that investment, particularly in physical capital, human capital, and technology, fundamentally drives long-run economic expansion because it fosters productivity improvements and capital accumulation. Empirically, multiple studies have supported this link. For example, research analyzing long-run patterns in Indonesia finds that higher investment levels, including Foreign Direct Investment (FDI) and domestic investment, correlate with stronger GDP growth (Wahyuliana, Ruslan, Suhartini, & Ansar, 2025). Additional studies on Indonesia confirm that increases in investment are associated with higher growth rates. Some analyses show that investment realization significantly impacts GDP, highlighting its role in elevating economic performance (Asrian & Saharuddin, 2024). However, not all studies find this influence uniformly positive; for instance, when macro conditions are unstable or supportive institutions are weak, the growth-enhancing effects of investment can be muted (Mustofa & Faizin, 2025). Despite these nuances, the overall body of evidence, including the findings of this study, indicates that investment is a key driver of growth in Indonesia.

4.2.3 Direct Effects of Macroeconomic Variables on Economic Growth

Beyond its effect on investment, certain macroeconomic variables also exhibit direct relationships with economic growth. The interest and exchange rates maintained positive direct effects on GDP growth. This suggests that, aside from investment channels, these variables influence growth by shaping consumption, trade competitiveness, and financial conditions. Empirical studies have corroborated that

interest rates can positively affect growth by stimulating credit availability and consumer spending when set appropriately (Mustofa & Faizin, 2025). The positive direct effect of the exchange rate is consistent with research showing that currency stability improves export competitiveness and economic stability, which, in turn, supports growth. Although some studies find exchange rate volatility to have negative effects, variations in methodology, time periods, and external shocks (e.g., global trade tensions or commodity price swings) can result in context-specific outcomes (Yusuf, 2023). In contrast, inflation did not have a significant direct effect on economic growth in this study. This supports a strand of literature that suggests that inflation impacts growth more indirectly and nonlinearly; for example, moderate inflation may not hinder growth directly but can erode real income and investment returns when excessive or volatile. Prior panel analyses and time-series studies echo this complexity, showing that inflation's influence on growth becomes negative only when it exceeds certain thresholds or when macro policy frameworks are unstable (Mustofa & Faizin, 2025).

4.2.4 Mediation Effects of Investment

Perhaps the most compelling contribution of this research is the demonstration that investment serves as a mediating channel through which macroeconomic variables influence economic growth, particularly inflation. Although inflation's direct effect on growth was not statistically significant, its indirect influence via investment was both positive and significant, indicating full mediation. This means that inflation's impact on economic growth primarily operates by shaping investment decisions, a mechanism supported by prior economic research that emphasizes the transmission of macroeconomic conditions through private sector investment behavior (Cili & Alkhaliq, 2022). The findings also reveal partial mediation of interest and exchange rates. Economic theory suggests that interest rates influence growth through both investment and broader financial conditions, including consumption and credit market dynamics, a pattern observable in empirical studies on monetary policy transmission (Mustofa & Faizin, 2025). Similarly, exchange rate fluctuations affect growth directly by altering export and import prices and indirectly by affecting investment decisions and expectations of future profitability. Evidence from Indonesian macroeconomic linkages supports these multifaceted channels (Yusuf, 2023).

4.2.5 Policy Implications and International Evidence

The overall findings have important implications for policymakers. First, maintaining macroeconomic stability (stable inflation and exchange rates) and a prudent interest rate policy is crucial for fostering an investment-friendly environment. Investment flows, particularly when consistent and robust, have the potential to amplify growth significantly, a claim supported by research showing the strong positive influence of investment on GDP in Indonesia and other developing economies (Wahyuliana et al., 2025). Second, the results reinforce the value of policies aimed at expanding productive investment (both domestic and foreign). Indonesia's recent economic growth performance, achieving the fastest expansion in three years due to strong investment support, illustrates how investment can propel growth even amid external pressures. Ensuring regulatory certainty, improving institutional quality, and enhancing infrastructure can further maximize the growth effects of investment, consistent with global evidence that supportive policy environments strengthen the contribution of investment to economic performance.

5. Conclusions

5.1 Conclusion

This study investigates the roles of inflation, interest rates, and exchange rates on investment and economic growth in Indonesia, highlighting the mediating effect of investment. The findings show that macroeconomic variables significantly influence investment, which in turn drives economic growth. Inflation impacts growth indirectly through investment, while interest rates and exchange rates affect growth both directly and through investment channels. The study underscores the crucial role of investment as a mediator and provides important insights for monetary and fiscal policy to foster long-term economic expansion.

5.2 Research Limitations

The study has several limitations. It relies on cross-sectional survey data, limiting causal inference. Perception-based measurements for macroeconomic variables may introduce biases, and the model omits other important factors such as fiscal policy and institutional quality. The generalizability of the results is constrained by the specific population studied, and the findings may not apply across all sectors or to other countries. Additionally, the cross-sectional mediation analysis cannot confirm the temporal ordering of the relationships.

5.3 Suggestions and Directions for Future Research

Future research should incorporate additional macroeconomic variables, such as fiscal policy and trade openness, to create a more comprehensive model. Longitudinal or panel data methods should be employed to capture dynamic relationships over time, providing stronger evidence of causal pathways. Comparative studies across ASEAN or emerging economies could offer insights into regional patterns. Furthermore, sectoral studies should explore how different industries respond to macroeconomic variables, and research into institutional and governance factors could enrich the understanding of economic growth determinants in Indonesia.

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Author Contributions

ST conceptualized the study, developed the research methodology, and was responsible for data collection and analysis. ST also drafted the manuscript and contributed to the interpretation of the results. Both authors reviewed and revised the manuscript critically for important intellectual content. ST gave final approval for the manuscript to be published.

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