

Stock Market Interest Rate Fluctuation and Its Influencing Factors

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Abstract: The stock market is an indispensable part of the financial market, and the fluctuation of interest rate in the stock market is also a common and important phenomenon in the financial market, which is unpredictable, complex and elusive. This paper examines the impact of interest rate fluctuations on the stock market and its influencing factors. The research results are as follows: The impact of such interest rate fluctuations on the stock market can be reflected in indirect influencing factors such as corporate financing costs and investors' investment preferences. Changes in intermediate factors caused by interest rate fluctuations largely determine the rise and fall of stock prices, thus forming a closed loop and once again having the same or different impacts on stock market investors and all walks of life. As an important factor in the financial market, the change of interest rate is also affected by various indicators, such as interest rate policy and inflation.

Keywords: Stock market interest rate fluctuation, Enterprise financing costs, Investor investment choice, Interest rate policy, Inflation

1. Introduction

In today's economic market, the stock market fluctuates seriously, and the direction of change is difficult to fathom. Interest rate is the main influencing factor of stock market changes, the two complement each other and affect each other. Interest rates represent the time value of money, or simply the cost, and the fluctuation of interest rates has a huge impact on the stock market, mainly reflected in the stock price and other aspects. On the contrary, various factors in the stock market will also affect the change range of interest rate[1]. This paper aims to study the story of interest rate fluctuation and its influencing factors. The research direction focuses on the stock market interest rate as the research center and discusses the impact of interest rate fluctuation on other factors and the reasons for its impact. The significance of this research lies in its potential to help investors and financial institutions identify potential risks and implement appropriate hedging strategies to mitigate investment uncertainties.

The government and regulators can formulate more effective monetary policy and financial supervision measures based on the research results, promoting economic stability and sustainable development. Additionally, analyzing these relationships enables more accurate economic trend predictions and provides a strong foundation for advancing the theoretical framework of financial economics.

2. Interest Rate

2.1. Definition of Interest Rate

The book *Finance* written by Friedman et al., effects that interest rate is usually defined as the rate of return on investment, which indicates the use value of funds in a certain period of time. The book also mentions the nominal interest rate and the real interest rate, which are divided according to whether inflation.

In this paper, the primary focus is on the real interest rate[2]. Interest rates affect economic activity, including spending, investment, and savings decisions, and are usually influenced by central bank policies, market supply and demand, and inflation expectations. The stock market interest rate studied in this paper usually refers to the rate of return related to the stock market, especially the rate of return on stock investment. In corporate finance by Ross, Westfield et al., it is stated that the rate of return of stock investment can include, dividend yield, which refers to the ratio of dividends paid each year to the stock's market price, reflecting the returns that investors receive through dividends[3]. Although investors will consider the impact of short-term market fluctuations when evaluating dividend yield, it focuses on reflecting the company's long-term profitability and evaluating long-term investment return in general, which is a long-term income indicator. Capital gains rate is the rate of return brought about by the rise in stock prices, that is, the ratio of the difference between the selling price and the buying price of the stock, the capital gains rate can be divided into short-term capital gains rate and long-term capital gains rate according to the holding period of investors. In summary, the stock market interest rate is an important indicator to evaluate the return and risk of stock investment.

2.2. The Impact of Interest Rates on Economic Activities

The impact of interest rates on economic activities is multifaceted. For individuals such as households and enterprises, lower interest rates will reduce borrowing costs, and more individuals will choose to invest through borrowing. On the contrary, an increase in interest rates will lead to an increase in borrowing costs, restraining people's consumption and investment to a certain extent. The analysis of borrowing cost focuses more on the aspect of "expenditure". If analyzing from the perspective of "income" of savings, the continuous increase of interest rate will promote the return on savings to the same trend, which will prompt people to choose to reduce consumption and save more funds, and vice versa. Expanding the analysis to national currencies, changes in interest rates significantly affect capital flows and currency valuation. Higher interest rates lead to currency appreciation and improve the country's export competitiveness, attracting more foreign investors.

Regarding interest rate volatility, this paper highlights the negative correlation between interest rate fluctuations and stock market returns. Chen 's research demonstrates that the VAR regression equation has passed the significance test, confirming that the interest rate has a significant impact on the stock market volatility[4].

2.3. 2023-2024 Macro Financial Market Interest Rate Fluctuations and Stock Market Interest Rate Fluctuations

Following the serious impact of the epidemic in the previous four years, China and the global economy is gradually recovering. However, nations are now grappling with significant challenges such as inflation and the pursuit of rapid economic growth. In the report *China's Economic Situation Analysis and Forecast in 2023* , it is highlighted that China will strengthen monetary policy response by lowering interest rates and prevent external economic and financial risks from spilling over to China.[5] On the other hand, FOMC Meeting Statement indicated that the U.S. Federal Reserve has raised interest rates, prompting other economies to follow suit to remain competitive.[6] Similarly,

some emerging countries are facing the risk of capital outflows and rising interest rates as investors seek greater profits.

3. The Impact of Interest Rate Fluctuations on the Stock Market

Interest rate, a crucial variable in the financial market, has a profound and complex impact on the stock market. The fluctuation of interest rate indirectly affects the change of stock price by affecting the financing cost of enterprises and the investment choice of investors, thus affecting the overall performance of the stock market.

3.1. Enterprise Financing Costs

As an important indirect factor of the impact of interest rate fluctuation on the stock market, corporate financing cost is mainly affected by the level of interest rate. When the interest rate rises, the borrowing cost increases, and vice versa. Zhou's research shows that, on the one hand, the increase of interest rate can relatively reduce the expected cash flow of enterprises, because after the rise in interest rate, the financing cost of enterprises will be relatively increased, resulting in the decrease of profits of enterprises, and the stock price will also fall[1]. On the contrary, when the interest rate is lowered, the financial expenses payable by the enterprise will also be relatively reduced, and the profit will also increase, resulting in rising stock price. Similarly, through long-term observation of the relationship between interest rate changes and enterprises, it can manifest that when the interest rate rises, the borrowing interest of enterprises will increase significantly, which makes the capital cost of enterprises in the construction of new projects continue to increase. However, for startups that rely on external financing, such as manufacturing and real estate companies, high interest rates may not only lead to a decline in profits and even affect cash flow but also increase their financing costs, resulting in financing difficulties and affecting their subsequent development, both of which will cause their stock prices to fall. In an environment of high interest rates and higher debt financing costs, some companies will choose to issue more equity to obtain capital, however, this may dilute the shares of existing shareholders, which will have a huge impact on the price growth.

3.2. Investor Investment Choice

The investment choice of investors is analyzed from the perspective of resource allocation, and as mentioned above, the impact of interest rate on economic activities, when the interest rate is lowered, most consumers believe that the fixed income assets of banks cannot achieve a higher rate of return, so they will transfer their funds to the stock financial market, which leads to the rise in stock prices. And changes in interest rates will directly affect investors' risk appetite. In the environment of high interest rates, investors tend to be conservative and tend to choose low, low and medium risk investment tools, such as bonds or money market funds, and are willing to choose different investment tools to meet their risk preference. This conservative attitude will lead to the outflow of stock market funds[7]. Causing the stock price to drop. In contrast, in a low interest rate environment, investors may be more willing to take risks and choose more medium - and high-risk investment instruments, which will drive stock prices higher. The investment choice of the investor will focus on the prevailing market sentiment and investment strategy. Interest rate fluctuations are often accompanied by changes in market sentiment. When market interest rates rise, investors may adopt a more cautious strategy, choose to withdraw more investment products, or even carry out stop loss operations to avoid large losses. And if the market will achieve interest rate cuts for a period of time, investors may actively enter the market, extend the investment period, and increase the amount of investment to increase the purchase.

3.3. Industry Impact

The stock market is a major financing channel for all walks of life, and the relationship between the two is complex and interdependent. Both of them are closely related to the changes in interest rates. Most industries, as intermediate factors, are affected by the changes in interest rates, causing some of their factors to rise, and thus affecting the changes in their stock prices. First, the financial sector, closely linked to the stock market, is an important sector that typically benefits from rising interest rates. Among them, banks and some financial institutions can increase the loan interest rate, thereby increasing the spread income. As a result, financial stocks tend to outperform during rate hike cycles. Moreover, the real estate industry is very sensitive to interest rates. Higher interest rates can dampen consumer demand for home purchases, putting pressure on property developers and construction companies. In the context of rising interest rates, this will lead to a decline in the share prices of listed companies related to real estate. In addition, compared with other industries, the technology industry has a certain resilience, because its growth potential is large, and it can withstand the impact of rising interest rates to a certain extent.

4. Influencing Factors of Interest Rate Fluctuations

As the price of funds, interest rate can affect its fluctuation of many factors within a complex action process and the level of interest rate is ultimately determined by the comprehensive impact of various factors.

4.1. Interest Rate Policy

Interest rate fluctuations are influenced by a combination of factors, with the Chinese central bank's interest rate policy and its response to current economic conditions being the key factors. Zeng's report indicates that as an important part of monetary policy, China's interest rate policy is mainly a policy model that continuously adjusts the level and structure of interest rate to achieve the supply and demand of social funds and achieve the objectives specified in monetary policy[8]. In the context of a market economy, the change of interest rate directly or indirectly affects the allocation of market resources, social and economic production and economic operation at the national level. From the perspective of the interest rate policy, the interest rate policy often relies on various economic indicators, such as GDP growth rate and unemployment rate. Depending on the market background, if GDP growth slows or unemployment rises, the central bank may stimulate economic activity through cutting interest rates. Therefore, interest rate policy will guide the main direction of interest rate change.

4.2. Inflation

Inflation is an economic phenomenon in which the general price level continues to rise and the purchasing power of money declines. According to Fisher's equation, the nominal interest rate can be expressed as the sum of expected inflation and real interest rate[9], a relationship also identified by Lv. When a country's economy suffers from serious inflation, the interest income generated by borrowing is far from making up for the loss of currency depreciation caused by inflation. As a result, individuals and businesses become reluctant to borrow money[10]. This reluctance leads to an increase in the demand for money in the market, while the supply of money remains insufficient, ultimately causing interest rates to rise. This analysis shows that inflation can affect the level of interest rate by influencing the national interest rate policy, regulating the financing cost of enterprises and other forms. Therefore, the impact of inflation is not only reflected in the regulation of the macro-operation of the national economic market, but also affects the better decisions made by individual

investors or enterprise investors. It is evident that changes in the level of market interest rates are largely subject to whether there is serious inflation in the country. In the complex and changeable dynamic economic environment, nations can better manage economic opportunities and risks by enhancing the monitoring of these crucial factors.

4.3. Investor Sentiment

Investor sentiment Investors and interest rate fluctuations are mutually reinforcing and mutually influencing complex relationships. Fluctuations in interest rate affect investors' investment preferences, which are reflected in their risk appetite, investment period, capital investment amount, etc., and investors' impact on interest rate fluctuation can also be reflected in many aspects. First, investors' confidence and market expectations can significantly influence their investment decisions. When the market economy is performing well and the relevant background shows a consistent corporate profit growth, investors' confidence tends to rise, fostering optimistic about the projects they invest in, which increases their demand for credit, and this demand increases the level of market interest rates. On the other hand, during periods of economic downturn, pessimism about the economic outlook may lead investors to scale back their investments, reducing credit demand and driving interest rates downward.

Secondly, insights from behavioral finance reveal how emotions and psychological biases influence investment decisions. There are many psychological biases in the investment process, and some investors may make irrational decisions due to overconfidence or confirmation bias, resulting in increased market volatility. For example, investors tend to ignore risks in a bull market and overtrade, resulting in large flows of money into risky debt, which raises interest rates. In a bear market, investors may withdraw most of their money because of extreme risk aversion, causing interest rates to fall sharply.

4.4. Global Economic Model

The change of interest rates is a common phenomenon in all countries in the world, yet the dynamics between interest rates in different countries vary based on unique economic contexts and interdependencies. The most fundamental influencing factor is the interest rate policy and monetary policy of each country, which are determined by economic conditions. These policies guide changes in interest rates domestically, and also influence interest rates in other countries. For example, when interest rates in the United States decrease, investors in that country may choose to transfer funds to countries with higher returns in order to ensure their own interests, and as participants in other countries' economic markets, affect the interest rates of other countries. The second aspect is that there is a certain degree of linkage in the global financial market. The circulation and dissemination of funds are like forming a closed loop, and the inflow of funds from one place will be accompanied by the outflow of funds from another place. Therefore, when a country has a financial crisis, investors will re-evaluate the bond market. They will choose to withdraw most of the money or other selfish choices, which will cause the yield of the country and the related country's Treasury bonds to fall. Similar to the circulation of the financial market, the international complex trade relations, the emergence of trade is always accompanied by economic exchanges, trade frictions, tariff policies and trade regulations formulated by various countries will affect the flow of national capital. Global trade relations further complicate the interplay of interest rates. For example, a trade conflict between the two countries would inhibit investment and consumption in each other's economies, thereby affecting the rise in interest rates in both markets.

5. Conclusion

This paper has explored the impact of interest rate fluctuations and the influencing factors of interest rate fluctuations, which can realize mutual influence and mutual restriction in some environments. On the one hand, this paper studies corporate financing costs, investors' senior investment preferences and various industries as indirect influencing factors before interest rate fluctuations and stock markets. On the other hand, it also introduces the impact of interest rate policies, inflation and global economic models on interest rate fluctuations. The findings suggest individual investors or large-scale investors such as enterprises should rationally analyze the economic environment, their own investment needs and various influencing factors, and by analyzing the relationship between them, they can continuously reduce their own investment risks to a certain extent, and make a more reasonable investment choice. In the economic market, stock market interest rate fluctuations is complex and multidimensional, with various impacts and influencing factors.. Future research should aim to uncover deeper insights into these dynamics, contributing to a more comprehensive understanding of their implications in the economic market.

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