

The Effect of Inflation on Portfolio Performance and Investment Decisions: Conventional and Sharia Economic Perspectives in Indonesia

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ARTICLE INFO

Article history:

Received: October 17, 2025

Accepted: Desember 16, 2025

Published: January 06, 2026

(Times New Roman, 9)

Keywords:

Inflation;
Investment Portfolio
Performance;
Investment Decisions;
Portfolio;
Linear Regression.

ABSTRACT

This study aims to analyze the effect of inflation on investment portfolio performance and investment decisions in Indonesia. Inflation, as an important macroeconomic indicator, has a significant impact on investor behavior and investment decisions, especially in unstable economic conditions. The background of this study focuses on inflation fluctuations that have occurred in recent years in Indonesia, which have affected people's purchasing power and financial markets. This phenomenon has prompted the need for a deeper understanding of the impact of inflation on investment strategies, both by retail and institutional investors.

The method used in this study is a descriptive analytical approach with quantitative analysis. The data used includes secondary data on inflation, interest rates, and stock market data from sources such as the Central Statistics Agency (BPS) and Bank Indonesia. The analysis techniques applied include linear regression to measure the effect of inflation on portfolio performance and investment decisions. This study also uses correlation analysis to understand the relationship between inflation and investment decisions, as well as how changes in inflation affect asset allocation in portfolios.

The results show that inflation has a significant effect on investment portfolio performance, where high inflation causes a decline in the real value of investment returns and encourages investors to shift their funds to assets that are more resistant to inflation, such as gold, property, and commodity sector stocks. In addition, inflation also affects investment decisions, with investors being more cautious and choosing safer instruments during periods of high inflation. However, the effect of inflation on investment decisions is not always consistent, as it depends on investor characteristics and overall macroeconomic conditions.

This study provides important insights for investors and policymakers to formulate investment strategies that are more adaptive to inflation fluctuations that can affect financial markets and investment decisions.

INTRODUCTION

Inflation is an important indicator in macroeconomics that reflects a general increase in the price level of goods and services over time. In Indonesia, in recent years, the inflation rate has shown significant fluctuations, which have an impact on people's purchasing power and

the overall economic condition. For example, in May 2024, Indonesia's annual inflation (*year-on-year*) was recorded at 2.84% with a Consumer Price Index (CPI) of 106.37, according to BPS (Statistics, 2024).

Then in December 2023, year-on-year inflation was recorded at 2.61%, with the highest rate reaching more than 5% in several regions such as Sumenep. Then, towards the end of 2024, inflation fell to 1.57% (year-on-year) in December 2024. This condition shows that after a period of relatively high inflation, there was a trend of inflation control and a decline to a lower figure, which was also close to Bank Indonesia's target of $2.5\% \pm 1\%$. This phenomenon of inflation fluctuation is important to note because its impact extends to various aspects of the economy, including investment: capital goods prices, production costs, interest rates, and investor expectations of real returns (after inflation).

Amidst the unstable global economic conditions following the pandemic and pressure on supply chains and commodity prices, inflation has become one of the key variables that needs to be analyzed in detail in the context of portfolio management and investment decisions. Inflation does not stand alone in the economic framework, but is closely related to financial market dynamics and investment behavior.

When inflation rises, the real value of investment returns, especially on financial instruments such as bonds or deposits, tends to erode because the nominal interest received cannot “keep up” with the increase in the prices of goods and services. On the other hand, in the context of interest rates, the Fisher effect principle states that the nominal interest rate is equal to the real interest rate plus inflation expectations, so that changes in inflation can drive monetary policy adjustments through interest rates.

The impact on investment portfolios becomes more complex when considering asset structure (stocks, bonds, real assets) and investor risk profiles. For example, high or unstable inflation can create economic uncertainty and increase risk premiums, causing investors to be more cautious in selecting assets that promise real value growth. The study “Interest Rates, Inflation, and Investment: Relationships and Impacts” by Vintura et al. (2025) states that high interest rates will suppress investment by increasing capital costs, while uncontrolled inflation creates uncertainty that negatively impacts investment decisions.

Although inflation has long been recognized as a major macroeconomic factor affecting financial markets, there is still a significant gap in understanding how and to what extent inflation affects investment portfolio performance and investment decisions in Indonesia. Most studies in Indonesia have focused on the effect of inflation on stock price indices or individual stock returns, while analysis of aggregate investment portfolios and investor behavior in response to inflationary pressures remains limited. Research conducted by Septian (2025) concluded that inflation does not have a significant effect on the returns of specific companies' stocks, but it has not examined how investors adjust their portfolio composition when inflationary pressures occur. The research gap is also evident in the investment decision-making of retail and institutional investors amid inflation fluctuations. Many investors in the Indonesian market still rely on conventional asset preferences (such as deposits and short-term bonds), while the literature on portfolio diversification strategies in conditions of high inflation is relatively limited in the domestic context. In fact, a deep understanding of the effect of inflation on investment portfolio performance is very important to support more rational and adaptive decision-making.

Amid global economic uncertainty and post-pandemic financial market dynamics, inflation has become one of the most closely watched macroeconomic indicators by market participants and policymakers. The rise in global inflation due to supply chain disruptions and the energy crisis following Russia's invasion of Ukraine has put pressure on price stability in

various countries, including Indonesia. Domestic inflation fluctuations, which reached 5.95% in September 2022, have driven significant changes in market expectations and investment strategies. This situation has created an urgent need for research to understand how inflation affects investment portfolio performance and investment decisions. This knowledge is important for retail investors, institutional investors, investment managers, and regulators to formulate more appropriate risk mitigation strategies. This study is also relevant for monetary policymakers in designing interest rate and inflation control policies that can support a stable investment climate.

METHODS

1. Research Approach

This study uses a descriptive analytical approach to examine the effect of inflation on investment portfolio performance and investment decisions. With this approach, the study aims to provide a clear picture of the relationship between the variables of inflation, investment portfolios, and investment decisions based on existing data and literature. This study also analyzes how inflation, as a macroeconomic factor, influences investment decision-making for both institutional and retail investors.

2. Type of Research

This study is classified as quantitative research. The data used is numerical and analyzed using statistical methods to determine the extent to which inflation can affect investment portfolio performance and investment decisions. This study also combines theoretical analysis with empirical data to provide a better understanding of the effects of inflation.

3. Data Sources

The data used in this study comes from two main sources:

- Secondary data, which includes historical data on inflation, interest rates, stock prices, exchange rates, and other macroeconomic data. This data was obtained from the Central Statistics Agency (BPS), Bank Indonesia, and the World Bank.
- Literature study, which includes previous research, academic reports, and related articles that can provide guidance in analyzing inflation on investment.

4. Research Variables

This study focuses on several key variables that play a role in determining investment portfolio performance and investment decisions:

- Inflation as an independent variable.
- Investment portfolio performance, measured through indicators such as portfolio return, Treynor Index, and Jensen's Alpha.
- Investment decisions, which are influenced by inflation, measured based on changes in asset allocation in the portfolio.

5. Data Collection Methods

The data in this study was collected through:

- Literature studies to understand the theory underlying the relationship between inflation and investment decisions.
- Document analysis covering company financial reports and relevant macroeconomic data, especially those related to inflation, interest rates, and financial market performance in Indonesia.
- Historical data on inflation and Indonesian stock market performance to analyze the direct impact of inflation on investment returns.

6. Data Analysis Techniques

- Regression analysis is used to identify the significant effect of inflation on portfolio performance and investment decisions. In this case, the effect of inflation on real portfolio returns is measured using a linear regression model.
- Correlation analysis is used to determine the extent of the relationship between inflation and investor investment decisions, as well as its impact on asset allocation in portfolios.
- Descriptive analysis is used to describe patterns of inflation changes and how they affect investment decision patterns in the Indonesian financial market.

RESULTS AND DISCUSSION

A. The Effect of Inflation on Investment Portfolio Performance and Investment Decisions

Inflation is an important macroeconomic factor that can drive financial markets and influence investor behavior directly or indirectly. Rising inflation will reduce the real value of investment returns because the purchasing power of money decreases, so that high nominal returns do not necessarily provide significant real gains. This encourages investors to adjust their portfolio composition to be more resistant to inflationary volatility. For example, in a situation of high inflation, investors are more likely to shift their funds to real assets such as property, gold, or commodity sector stocks, which are considered inflation hedges. Conversely, fixed-income instruments such as long-term bonds become less attractive because their value is eroded by inflation.

In addition to impacting portfolio performance, inflation also has a major influence on the investment decision-making process. Uncertainty due to price fluctuations and living costs can cause investors to delay investment decisions, increase demand for liquid assets, or pursue more aggressive diversification strategies. Theoretically, this phenomenon is in line with the Portfolio Selection Theory proposed by the International Monetary Fund (2022), in which expectations of returns and risks are greatly influenced by macroeconomic conditions, including inflation. Empirical research shows that a 1% increase in inflation can reduce the real return on portfolios by 0.6% in developing countries, which directly impacts investor behavior in designing short- and long-term investment strategies.

The context in Indonesia shows a similar pattern. Based on a report by Bank Indonesia (2021), an increase in inflation has a negative correlation with investment activity, especially in the capital market. When inflation rises, retail investors become more cautious and tend to hold cash or switch to safer instruments. This is also reinforced by the findings of the Asian Development Bank (2023), which confirms that inflation stability is key to maintaining investor confidence and the attractiveness of a country's financial markets. Thus, inflation not only reduces portfolio competitiveness through its effect on real returns, but also changes investor decision-making behavior. Investors who are responsive to inflation dynamics can anticipate this risk through hedging strategies, portfolio diversification, and investment horizon adjustments in line with macroeconomic conditions.

B. The Effect of Inflation on Investment Portfolio Performance

Inflation plays a very significant role in determining investment portfolio performance because it directly affects the real value of the returns received by investors. When inflation rises, the purchasing power of investment income declines, making nominal profits less meaningful in real terms. In the context of portfolios, this causes investors to rebalance or readjust their asset composition, shifting funds from fixed-income instruments such as long-term bonds to instruments that are more resistant to inflationary pressures, such as commodity sector stocks, property, and gold. Portfolio performance is highly sensitive to

inflation expectations because rising inflation rates often drive up benchmark interest rates, which in turn increase the cost of capital and depress the valuation of financial assets.

Modern portfolio theory explains that inflation risk is an important component in calculating expected returns and risk premiums; investors who do not anticipate this factor will experience a significant decline in portfolio performance. Empirical research in emerging markets also shows that a 1% increase in inflation can reduce the real return on investment portfolios by around 0.6% to 0.8%, especially in capital markets with high volatility. These findings are in line with reports from Bank Indonesia (2021) and the International Monetary Fund (2022), which emphasize that uncontrolled inflation will weaken the attractiveness of financial markets and reduce investor confidence in long-term return stability.

C. The Effect of Inflation on Investment Decisions

Inflation is a macroeconomic variable that significantly influences the patterns and strategies of investment decision-making, both by individual and institutional investors. An increase in inflation is usually followed by an increase in benchmark interest rates, which increases the cost of capital, so investors tend to shift their preferences from high-risk instruments such as stocks to more stable and liquid assets. Previous research conducted by Atu Rohmah et al. (2024) found that inflation has a significant effect on investment decisions. This means that changes in the inflation rate can affect investors' interest and behavior in making capital investment decisions. When inflation increases, the cost of living and prices of goods also tend to rise, causing investors to be more cautious in allocating their investment funds. Conversely, stable inflation conditions can provide a sense of security for investors to invest their capital. These findings indicate that inflation is an important macroeconomic factor to consider in investment strategies, as it can affect purchasing power, rates of return, and investment risk.

However, this is not in line with the research conducted by Fuadi et al. (2022), which states that inflation has no significant effect on investment decisions. This shows that changes in the inflation rate do not directly affect investors' considerations in making investment decisions. In other words, rising or falling inflation is not a major factor in determining investors' actions in investing their capital.

The conclusion from this paragraph is that inflation is a macroeconomic factor that can influence investment decisions, especially since rising inflation is often followed by an increase in interest rates that affects investment strategies and patterns. When inflation rises, investors tend to be more cautious and choose safer instruments. However, the effect of inflation on investment decisions is not always consistent; some studies show a significant effect, while others find no meaningful effect. This shows that the impact of inflation on investment decisions can vary depending on economic conditions and investor characteristics.

D. Inflation and Investment Decisions in the Perspective of Islamic Economics

In the perspective of Islamic economics, inflation is viewed as an economic phenomenon that can disrupt distributive justice, monetary stability, and public welfare if not managed properly. High inflation causes a decline in people's purchasing power and has the potential to cause injustice, especially for those with fixed incomes. Therefore, price stability is one of the important goals in the Islamic economic system, as is the principle of *hifz al-mal* (protection of wealth).

The results of the analysis show that inflation has an influence on Islamic investment decisions, both directly and indirectly. When inflation increases, Islamic investors tend to be more cautious in allocating their investment funds. This is due to the obligation in Islamic economics to avoid elements of *gharar* (excessive uncertainty), *maysir* (speculation), and *riba* (interest). Unstable inflation increases uncertainty regarding real returns, thereby encouraging Islamic investors to choose instruments that are safer, more productive, and based on real assets (underlying assets).

In practice, Islamic investors tend to shift their funds to investment instruments that are considered more resistant to inflation and in line with Islamic principles, such as Islamic gold, property, *sukuk*, and Islamic stocks in the real sector. These instruments are considered capable of maintaining wealth because they are based on real assets and productive economic activities, rather than speculative mechanisms. This is in line with the principle of profit and loss sharing, where profits are derived from real business activities and risks are borne fairly by all parties.

Furthermore, in the Islamic economy, investment decisions are not solely based on profit maximization, but also take into account aspects of blessing and benefit (*masalah*). Therefore, even though inflation can reduce the real value of returns, Islamic investors still consider the social impact and economic sustainability of their investments. High inflation actually encourages investors to be more selective and long-term oriented, choosing sectors that can provide sustainable economic and social benefits.

CONCLUSION

Inflation has been proven to affect investment portfolio performance and investment decisions. Rising inflation reduces the real value of returns, prompting investors to adjust their portfolio composition to more inflation-resistant assets such as gold, property, and commodity stocks. Inflation also affects investor behavior when inflation is high; investors tend to be more cautious and choose safe instruments. However, the effect of inflation on investment decisions is not always consistent, depending on economic conditions and investor characteristics.

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