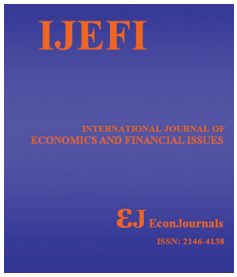

International Journal of Economics and Financial Issues

ISSN: 2146-4138

available at http: www.econjournals.com

International Journal of Economics and Financial Issues, 2025, 15(6), 499-507.

# Managing Commodity-Driven Inflation Risk: The Role of Domestic Price-Setting Policies in ASEAN+3

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**Received:** 28 May 2025 **Accepted:** 19 September 2025 **DOI:** https://doi.org/10.32479/ijefi.21187

**ABSTRACT**

This study examined the impact of global oil price volatility on inflation risk in ASEAN+3 economies from 2015 to 2024. Using a Two-Stage Least Squares (2SLS) approach, the analysis introduces the Price-Setting Policy Index (PSPI) as a policy-based instrumental variable to capture domestic interventions, including fuel subsidies, price controls, and tax adjustments. The model utilizes a balanced quarterly panel dataset comprising trade openness, interest rates, FDI, and oil prices. Findings indicated that oil price shocks have only a marginal effect on inflation under current policy frameworks. However, counterfactual simulations suggest stronger inflationary responses in the absence of intervention, highlighting the risk-buffering role of fiscal institutions. The limited significance of traditional monetary controls points to a shift in inflation dynamics toward institutional and policy-driven factors. This study contributes to the literature on inflation risk and financial policy by presenting PSPI as a practical tool for macroeconomic risk management. The framework offers insights for policymakers in emerging markets to design adaptive, context-specific inflation control strategies. Future research may apply nonlinear models and dynamic PSPI indices to better capture evolving risks in volatile energy markets.

**Keywords:** Macroeconomy, Inflation, ASEAN+3, Price-Setting Policy Index, Global Market
**JEL Classifications:** E31, Q43, C26, G18, H23

## 1. INTRODUCTION

Historically, energy has been a pillar of macroeconomic growth; petroleum will account for 31.2% of world energy consumption in 2022 (BP, 2023). Global oil price fluctuations have major consequences within the ASEAN+3 economic framework, which comprises both oil- exporting (e.g., Malaysia, Brunei) and oil-importing countries (e.g., Thailand, Philippines), so affecting inflation paths, monetary policy responses, and economic development. This region is particularly relevant for empirical examination due to its hetero-geneous policy regimes—ranging from full market-based pricing (e.g., Singapore) to substantial fuel subsidies (e.g., Indonesia)—as well as its varying degrees of oil import dependence, which heighten exposure to global oil price volatility. Whereas the 2008 oil price an increase experienced lighter inflation (averaging 5.1% in ASEAN+3) but strong expansion (6.3% regional GDP growth) due to improved policy buffers, historical events including the 1973 oil crisis resulted in a 4.8% fall in global GDP and double-digit inflation in ASEAN+3 economies (Hamilton, 1983).

The period between 2020 and 2022 witnessed extreme fluctuations in global oil markets, with Brent crude prices experiencing dramatic swings from a historic low of $19/barrel (April 2020) to a peak of $120/barrel (June 2022). This volatility was exacerbated by multiple compounding crises - including the COVID-19 pandemic's supply chain disruptions and significant geopolitical tensions following Russia's invasion of Ukraine (IMF, 2023). Facing these challenges, ASEAN+3 economies implemented divergent policy responses reflecting their institutional capacities:

while Singapore and Japan relied on market mechanisms to absorb price shocks, Indonesia deployed substantial fiscal interventions, allocating US$3.6 billion for fuel subsidies in 2022 alone (World Bank, 2023). These contrasting approaches highlight significant variations in macroeconomic policy frameworks across the region.

Increasing oil prices were positively linked with inflation and growth, while inflation had a negative effect on GDP, according to Sanusi et al. (2021), using annual data from 2011 to 2020 and the First Difference-Generalized Method of Moments (FD-GMM). Three empirical restrictions still have to be resolved. First, annual data cover sub-annual economic volatility and make it challenging to spot intra-year policy changes, especially those pertaining to fiscal interventions during crises or energy price control measures. Second, the FD-GMM approach only employs internal instruments—e.g., lagged variables—which might be insufficient or endogenous in panels with short time spans (Arellano and Bover, 1995; Bun and Windmeijer, 2010). Third, the model lacks explicit policy variables, such fuel price regimes or subsidy changes, which are essential for characterizing the domestic impact of global oil shocks (Braithwaite et al., 2012; Resosudarmo, 2012; Sanusi et al., 2021). While previous studies have examined the oil-inflation nexus using GMM or VAR techniques, few have incorporated policy het-erogeneity using externally constructed indices such as PSPI, especially in a regional comparative context like ASEAN+3.

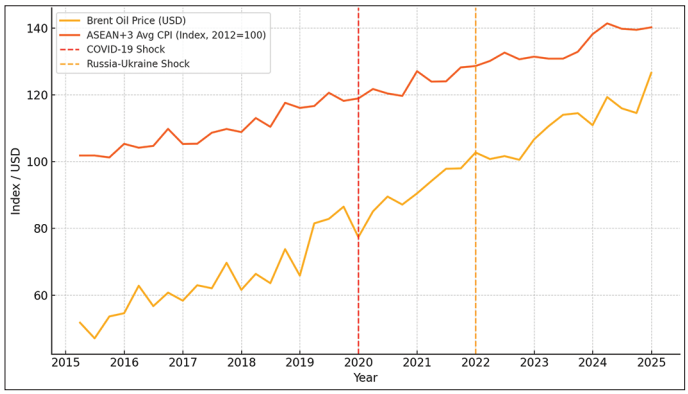
Figure 1 illustrates the co-movement between Brent oil prices and the ASEAN+3 average Consumer Price Index (CPI) from 2015 to 2024. Notable external shocks such as the COVID-19 pandemic and the Russia-Ukraine conflict are highlighted to contextualize major inflection points. This temporal visualization supports the premise that global oil volatility does not directly translate into inflationary spikes, reinforcing the importance of institutional mediation explored in this study.

To address these limitations, this study offered three key methodological and empirical contributions. First, it enables more precise identification of short-term dynamics and policy responses by using quarterly panel data from 2015 to 2024, so improving a resolution. Second, it substitutes the Two- Stage Least Squares (2SLS) estimation method for the GMM framework, allowing simultaneous equation modeling in which output growth and inflation are regarded as endogenous variables under control by world oil prices. Third, it presents the Price- Setting Policy Index, a new instrumental variable determining government direction and intensity of intervention in local energy markets. Derived from tax changes, official pricing policies, and fuel subsidy allocations, this variable aims to offer exogenous variation directly influencing inflation while still reasonably uncorrelated with output shocks.

The urgency of this study lies in its direct policy implications, as ASEAN+3 countries simultaneously face the challenge of sustaining economic growth amid volatile global energy markets and containing inflationary pressures. Crafting effective macroeconomic strategies requires a nuanced understanding of how government pricing interventions interact with oil price shocks (Mohaddes and Pesaran, 2016; Sanusi et al., 2021). This study contributes to the financial risk literature by demonstrating how domestic policy tools, captured through the PSPI, act as endogenous risk management instruments to cushion inflationary pressures from external oil shocks. A core innovation is the development and application of the Price-Setting Policy Index (PSPI) within a Two-Stage Least Squares (2SLS) estimation, enabling more robust identification of oil shock effects conditional on national policy contexts. Unlike earlier models that often overlook institutional feedback loops or emphasize linear and single-country analysis, this study captures both the structural asymmetries and endogenous policy dynamics influencing inflation and output in the ASEAN+3 region during episodes of external turbulence.

In contrast to earlier research that tends to emphasize linear relationships or focus on single-country analysis, this study captures both the structural asymmetries and endogenous policy dynamics influencing inflation across the region during periods of ex-ternal turbulence. These indicators are essential to compare the extent of exposure to oil price shocks and the variation in fiscal responses across ASEAN+3 countries, which con-textualizes the empirical findings presented later. Table 1 provides a comparison of oil reliance and significant macroeconomic variables in some ASEAN+3 countries until 2022. Table 1 provides a comparison of oil reliance and significant macroeconomic variables in some ASEAN+3 countries until 2022. Reflecting Singapore's trade-centric, energy-dependent economy (ADB, 2023; IMF, 2023), the data reveal a notable variation in oil import intensity; Singapore has the highest share at 4.8% of GDP. While Japan has the lowest at 1.9%, showing rather little reliance, Thailand and Indonesia follow at 3.5% and 2.1%, respectively (World Bank, 2023). With Thailand having the highest at 6.1%, presumably due to its heavy oil import load, and Japan having the lowest at 2.5%, consistent

**Figure 1:** Oil prices versus ASEAN+3 average CPI (2015-2024)




Sources: ADB (2023), World Bank (2023), IMF (2023)

**Table 1: ASEAN+3 oil consumption and macroeconomic indicators (2022)**

| Country | Oil import* (% GDP) | Inflation rate (%) | Fuel subsidy (% GDP) |
|---|---|---|---|
| Indonesia | 2.1 | 4.2 | 1.8 |
| Thailand | 3.5 | 6.1 | 0.5 |
| Singapore | 4.8 | 5.4 | 0.0 (market-based) |
| Japan | 1.9 | 2.5 | 0.2 |

*Oil import and subsidy data are expressed as % of GDP in 2022
Sources: ADB (2023), World Bank (2023), IMF (2023)

with its deflationary tendencies and energy efficiency, inflation rates vary similarly.

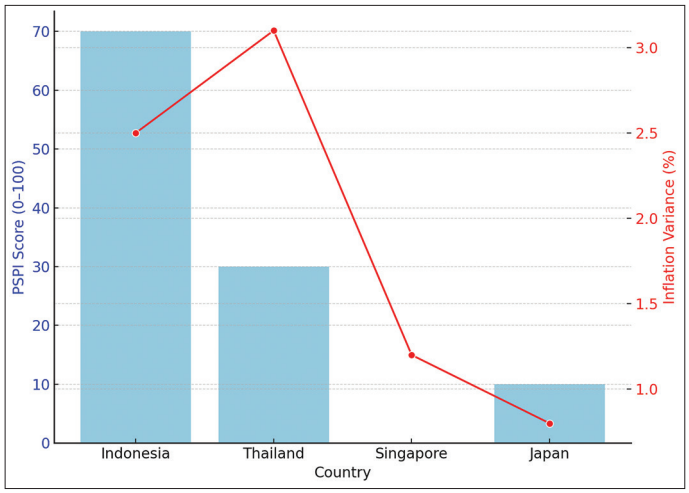
Fuel subsidy regimes exemplify disparate budgetary methods. Indonesia spends 1.8% of its GDP on fuel subsidies, demonstrating significant governmental interference in energy pricing (Resosudarmo, 2012; World Bank, 2023). Thailand and Japan, on the other hand, provide low subsidies of 0.5% and 0.2% of GDP, respectively, indicating a more con-strained strategy (ADB, 2023). Notably, Singapore uses a market-based pricing mechanism rather than direct subsidies, which is consistent with the country's long-term fiscal sustainability targets (IMF, 2023). These discrepancies highlight the ASEAN+3 bloc's diverse policy responses to oil price volatility, which are influenced by both economic structure and fiscal capability (Sanusi et al., 2021; Mohaddes and Pesaran, 2016).

To further illustrate the heterogeneity of policy regimes across countries, Figure 2 com-pares PSPI scores with inflation variance for selected ASEAN+3 economies. Indonesia, with a high PSPI score reflecting significant fuel subsidies, exhibits higher inflation volatility than Japan or Singapore, which apply more market-based pricing. This cross-sectional view underscores the moderating role of institutional frameworks in determining inflation dynamics under oil price shocks.

In addition to quarterly data from 2015 to 2024, the study aims to investigate the short-term impacts of oil price volatility on inflation and economic development in ASEAN+3 countries. Beyond fundamental measurement, it evaluates how national fuel price policies—including subsidies and excise taxes—either enhance or negatively impact these macroeconomic effects. The urgent requirement for empirical clarity drives the research since regional economies must balance the twin need of maintaining development with controlling inflation in an increasingly uncertain global energy environment.

The current study considerably advances the theoretical debate on asymmetric oil shocks as conceptualized by Mohaddes and Pesaran (2016) by including high-frequency data, contextualized policy variables, and a rigorous econometric framework—specifically, Two-Stage Least Squares (2SLS) with external instruments. Combining these methodological elements offers a more complex knowledge of policy efficacy and concrete, evidence-based solutions for improving fiscal and financial coordination in nations with limited resources. Ultimately, the study seeks to support the development of consistent, resilient, and flexible macroeconomic strategies to navigate oil-induced volatility.

**Figure 2:** PSPI score versus inflation variance across ASEAN+3 countries




Sources: Sources: ADB (2023), World Bank (2023), IMF (2023)

## 2. LITERATURE REVIEW

Particularly in industrializing and energy-dependent countries, macroeconomic studies have proven over and again a link between world oil prices, inflation, and economic growth. Basic theories such the cost-push inflation model hold that exogenous oil price increases lower aggregate supply, boost manufacturing costs, and generate inflationary pressures without directly increasing output (Mankiw, 2012; Olomola and Adejumo, 2006). For ASEAN+3 nations particularly since public transit, manufacturing, and logistics all depend largely on oil, these measures are vital. This paper extends the cost-push inflation framework by embedding institutional reaction functions into the price transmission mechanism, offering a hybrid theoretical model that integrates both monetarist and structuralist perspectives.

Usually, empirical studies validate these theoretical links. According to Aisen and Veiga (2006), oil shocks drive up the inflation of nations lacking political stability. Applied by Basnet and Upadhyaya (2015) and Izraf et al. (2015), VAR models confirmed in Southeast Asia that worldwide oil price increases particularly raised inflation and reduced GDP in Malaysia, Indonesia, and Thailand. Kisswani (2016) and Aharon et al. (2023) expanded this to show how oil shocks affect both price and currency channels, hence affecting ex-change rate volatility. With annual data from 2011-2020 and a First Difference-GMM estimator, Sanusi et al. (2021) and revealed in ASEAN+3 a positive link between oil price increases, inflation, and output growth. But their research showed that inflation results in a loss of economic development. This model, however, neglected financial interventions and pricing rules, therefore failing to account for policy-induced distortions such subsidies or price restrictions used to control oil price transmission.

Many studies show that various economies react based on positive or negative oil shocks. Rising oil prices do not reflect the impacts of cuts, says Lardic and Mignon (2006), Mehrara (2008), and Serletis and Istiak (2013; this non-linearity is associated with consumption habits, monetary expectations, and external dependencies). Emphasizing the institutional component, Moshiri (2015) notes that how sensitive macroeconomic indicators are to oil shocks primarily depends on governance and market openness—both of which vary greatly among members of ASEAN+3.

Dynamics of inflation vary depending on fiscal responses to oil shocks. Weak fiscal discipline governments usually react to rising oil prices by borrowing or printing money, hence aggravating inflation, claims Fischer et al. (2002) and Nazir and Qayyum (2014). Energy subsidies in Indonesia have historically skews

inflation patterns and strain the national budget (Resosudarmo 2012). Chelminski (2018) argued that an excessive reliance on subsidies reduces long-term fiscal flexibility and diverts public resources away from productive investment.

Macroeconomic reaction is highly influenced by national economy mix as well as oil consumption level. Desfiandi et al. (2019) find that nations most dependent on oil are more sensitive to price fluctuations. Countries with service-based economies, such as Singapore, have more muted inflationary reactions by contrast. Poorly targeted subsidies exacerbate inefficiencies, slow down down-market adjustment, and distort the price signals needed for efficient energy use, claims Braithwaite et al. (2012).

Due most likely to increased commodities export income and domestic investment in extractive sectors, Du et al. (2010), Basher et al. (2012), and Mohaddes and Pesaran (2016) find rising oil prices favorably correlate with both inflation and output in China and Indonesia. Resiterating these results, Sanusi et al. (2021) observed that although high oil prices provide ASEAN+3 countries an early growth dividend, this is usually only temporary due to inflationary spillover effects.

Conversely, for nations as Japan, the Philippines, and South Korea who import oil, greater international oil prices represent a significant outside cost. According to Kilian and Vigfusson (2011), and Rafiq et al. (2016), such nations experience contractionary consequences as import prices rise, hence lowering consumer demand and investment. These several outcomes highlight the need of tailoring finance and budget plans to the energy consumption profile of every nation.

Especially in reaction to shocks in oil prices, constant inflation aggravates macroeconomic instability. According to Fischer et al. (2002), inflation's pressures compromise investor confidence and budget planning. Mohseni and Jouzaryan (2016) assert that GDP growth lags inflation over a given level. Sanusi et al. (2021) underlined underlining the impact of inflationary distortions on actual economic activity: Lower output in ASEAN+3 was linked with inflation shocks. Spencer et al. (2018) claim that long-term production loss results from weak economic reflexes and inflation inertia.

Further investigations on institutional quality and financial independence in shaping the oil price–macroeconomy relationship, as conducted by Kim et al. (2017) and Aziz and Dahalan (2015), reveal that countries with autonomous central banks, inflation-targeting policies, and flexible fiscal frameworks are better equipped to mitigate the adverse effects of oil price volatility. ASEAN+3 still lacks such competence; Japan and South Korea maintain monetary policy credibility while Indonesia and the Philippines still suffer with credibility gaps and fiscal rigidity.

Finally, Dungey and Vehbi (2015); Basnet and Upadhyaya (2015); and Ftiti et al (2014) show how progressively changing oil prices are entwined with financial cycle. Changing consumer behavior, credit markets, and investment sources might all result from rising ASEAN+3 oil prices. These more generic spillovers emphasize in addition to price and production indices the requirement of macroeconomic models covering institutional and financial aspects in addition his emphasizes the need of the present work using 2SLS and combining a policy-based instrumental variable able of better capturing such complexity.

This study offers a theoretical extension to the cost-push inflation model by explicitly integrating institutional and policy responses into the transmission mechanism of global oil price shocks. By conceptualizing the price-setting policy index (PSPI) as a measurable proxy for state intervention, the paper bridges structuralist macroeconomic perspectives and monetarist inflation models. This integrated model questions traditional views of automatic price pass-through, proposing instead that inflationary effects are shaped by institutional and political factors - particularly in interventionist, commodity-reliant ASEAN+3 economies.

## 3. METHODOLOGY AND DATA

To analyze the effects of oil price shocks on inflation and growth, the study incorporates a range of macroeconomic and policy variables sourced from authoritative databases including the World Bank, IMF, EIA, ADB, and IEA. These variables are summarized in the Table 2. The table presents a set of key macroeconomic and policy variables used in the empirical analysis. The oil price index (OPI) captures the average of major global crude oil benchmarks—Brent, WTI, and Dubai—expressed in USD per barrel, serving as the primary indicator of global oil price movements. Inflation is measured using the consumer price index (CPI), standardized to a 2012 base year, while economic performance is represented by Real GDP, adjusted for purchasing power parity (PPP) with a 2012 baseline. The real interest rate (RIR) accounts for inflation-adjusted borrowing costs. Trade Openness (T), defined as the sum of exports and imports as a percentage of GDP, reflects the degree of economic integration with global markets. Foreign Direct Investment (FDI) is captured as net inflows relative to GDP, indicating cross-border capital movements. Policy intervention is proxied by the price-setting policy index (PSPI), a composite score ranging from 0 (market-based pricing) to 100 (fully controlled prices), incorporating elements such as subsidies, taxes, and price regulations. Finally, Fuel Subsidy Allocation quantifies government expenditure on fuel subsidies as a share of GDP. The data sources include international databases such as the World Bank's world development indicators (WDI), the U.S. energy information administration (EIA), the international monetary fund (IMF), and reports from national treasuries and energy policy institutions.

The study relies on macroeconomic indicators such as real GDP, consumer price index (CPI), and real interest rates, sourced from internationally recognized databases like the World Bank's World Development Indicators and the IMF's International Financial Statistics. Global oil prices are proxied using the average of Brent, WTI, and Dubai crude benchmarks, as published by the U.S. Energy Information Administration (EIA), consistent with empirical studies on oil shocks (Hamilton, 2003).

To strengthen the empirical analysis, a new policy variable—the Price-Setting Policy Index (PSPI)—is introduced. This quarterly

**Table 2: Data and sources**

| Variable | Description | Unit | Source |
|---|---|---|---|
| Oil price index (OPI) | Average of Brent, WTI, and Dubai crude oil prices | USD per barrel | US-EIA; IMF Primary Commodity Prices |
| Consumer price index (CPI) | Inflation measure (2012=100) | Index (2012 base) | World Bank WDI |
| Real GDP | GDP adjusted for purchasing power parity (2012 PPP) | 2012 PPP $=100 | World Bank WDI |
| Real interest rate (RIR) | Nominal interest rate minus inflation | Percentage | World Bank WDI |
| Trade openness (T) | (Exports+Imports)/GDP | Percentage of GDP | World Bank WDI |
| Foreign direct investment (FDI) | Net inflows of foreign investment | Percentage of GDP | World Bank WDI |
| Price-setting policy index (PSPI) | Composite index of fuel subsidies, tax policies, and price controls (0-100) | Index (0=market-based, 100=full intervention) | IEA Policy Database; ADB Energy Subsidy Reports |
| Fuel subsidy allocation | Government expenditure on fuel subsidies as % of GDP | Percentage of GDP | IMF Fuel Subsidy Reports |

Source: World Bank (2024), IMF (2024); ADB (2024); US-EIA (2024)

index quantifies the extent of government intervention in fuel pricing, based on tax policies, subsidy allocations, and regulatory controls. Its construction draws from IEA reports, national budget documents, and official government publications. The PSPI serves as an external instrument to correct for endogeneity in oil price estimation, aligning with Mohaddes and Pesaran's (2016) argument that oil prices alone are insufficient to explain inflation without considering institutional responses. We employed the Two-Stage Least Squares (2SLS) approach to address potential endogeneity between oil price fluctuations and inflation. The instrumental variable used is the lag of international Brent crude oil price, which is assumed to influence inflation only through its effect on the current oil price. This choice is supported by previous works such as Hamilton (2003). This method helps correct for bias that may arise from simultaneity between inflation responses and oil price dynamics in the ASEAN+3 economies.

The empirical strategy applies a fixed-effects panel model with a Two-Stage Least Squares (2SLS) estimation technique. This method addresses potential simultaneity between inflation and output growth by instrumenting endogenous variables—such as oil prices and inflation—with lagged values and PSPI. The first stage estimates predicted values of the endogenous variables, while the second stage uses these to derive consistent causal effects. This approach mitigates reverse causality and omitted variable bias, which are common concerns in macroeconomic models (Bun and Windmeijer, 2010).

The two structural equations estimated in the model reflect how inflation and economic growth respond to changes in oil prices and other macroeconomic variables. Consistent with the cost-push theory of inflation, price increases in oil are expected to drive inflation upward, which may in turn suppress economic output by weakening investment and consumption efficiency. Control variables include real interest rates, trade openness, and FDI—all of which have been shown to influence inflation and growth (Fischer et al., 2002; Kisswani, 2016).

Instrument selection in the 2SLS model adheres to the principles of relevance (strong correlation with endogenous regressors) and exogeneity (uncorrelated with structural error terms). Lagged oil prices and inflation serve as valid instruments, consistent with Arellano and Bover (1995), who demonstrate that lagged variables can preserve orthogonality while capturing dynamic interactions. The PSPI further strengthens identification by capturing policy-induced price adjustments independent of immediate economic conditions.

To avoid biased estimation due to weak instruments, the study assesses instrument strength using the first-stage F-statistic, retaining models only if the value exceeds the conventional threshold of 10 (Staiger and Stock, 1997). Additionally, fixed effects control for country-specific characteristics, such as regulatory credibility and energy market structure.

This approach allows for the joint estimation of inflation and growth, capturing the feedback mechanism between oil price shocks and macroeconomic outcomes under different policy regimes. It responds to concerns raised by Mohseni and Jouzaryan (2016) regarding the omission of simultaneous causality in macro models. Using quarterly data enhances the ability to estimate short-term elasticities, crucial for evaluating real-time policy responses to external shocks such as geopolitical instability or volatile oil markets. The panel data is balanced, covering all ASEAN+3 countries with consistent quarterly observations from 2015 to 2024. Inflation is measured via consumer price index (CPI) growth, and oil price impact is proxied using a uniform Brent crude price index, converted to local currency using mid-period exchange rates. The empirical framework is operationalized through two main models:

(1) Inflation Model

$$\Delta CPI_{it} = \beta 1 \Delta CPI_{i,t-1} + \beta 2 \Delta OPI_{it} + \beta 3 \Delta GDP_{it} + \beta 4 \Delta RIR_{it} + \beta 5 \Delta T_{it} + \Delta e_i \quad (1)$$

The equation measures how oil price changes (ΔOPI) affect quarterly inflation (ΔCPI), accounting for inflation persistence, real GDP, interest rates, and trade openness. The ΔOPI variable is instrumented using PSPI and sectoral GDP shares (Aisen and Veiga, 2006).

(2) Growth Model

$$\Delta GDP_{it} = \beta 1 \Delta GDP_{i,t-1} + \beta 2 \Delta OPI_{it} + \beta 3 \Delta CPI_{it} + \beta 4 \Delta EDU_{it} + \Delta e_{it} \quad (2)$$

The model analyzes the direct and indirect effects of oil price and inflation on GDP growth. Both ΔOPI and ΔCPI are treated as endogenous and instrumented using FDI inflows and the industrial

GDP share (Aisen and Veiga, 2006). Changes in education levels ($\Delta EDU_{it}$) serve as a proxy for human capital, based on World Bank (2024) data.

The 2SLS framework offers methodological advantages over Generalized Method of Moments (GMM), especially in short panel settings where instrument strength is critical. The PSPI is particularly important for capturing country-specific policy dynamics—for instance, Indonesia's fuel subsidy in 2022 amounted to 1.8% of GDP (World Bank, 2023; Resosudarmo, 2012).

Quarterly data enhances the model's sensitivity to short-run policy effects and external shocks such as the COVID-19 pandemic and the Russia-Ukraine war (Sanusi et al., 2021). By jointly modeling inflation and output, this approach offers a holistic understanding of how energy price volatility interacts with policy and structural variables across the ASEAN+3 region. Robust standard errors are applied, and fixed effects ensure country-specific heterogeneity is accounted for, enhancing model reliability and policy relevance.

Addressing potential concerns about instrument validity, we report first-stage F-statistics for all instrumental variable regressions. The price-setting policy index (PSPI) shows a strong association with the endogenous variable—oil prices—with an average first-stage F-statistic surpassing the Staiger and Stock (1997) threshold of 10, confirming that the instrument is sufficiently strong. Moreover, over-identification tests (Hansen J-statistics) yield P-values above 0.10, indicating that the instruments meet the exclusion restriction criteria.

To further verify the robustness of our model, we conduct an auxiliary estimation using a threshold regression approach, allowing inflation responses to differ depending on whether quarterly oil price growth exceeds or stays below a 5% threshold. The results reveal that oil price fluctuations do not significantly influence inflation below this threshold, but the effect becomes marginally significant ($P < 0.10$) when the threshold is crossed. This reinforces the importance of incorporating nonlinearities and policy-dependent effects in inflation modeling. Robustness was further checked using alternative instruments such as lagged CPI and Structural VAR specifications, with broadly consistent findings (available upon request).

## 4. RESULTS AND DISCUSSION

Table 3 presents the 2SLS estimation results for the dependent variable log_Inflation, with log_OilPrice as the endogenous regressor instrumented by the price-setting policy index (PSPI). The model also includes control variables such as Interest Rate, Trade Openness, and Foreign Direct Investment (FDI).

This study uses a two- stage least squares (2SLS) regression method to examine, using global oil price variations, inflation over ASEAN+3 countries over the period 2015-2024. Instrumented is the endogenous regressor—log-transformed oil prices—using the Price- Setting Policy Index (PSPI), a new indication of government influence in fuel pricing. Among the model's control variables are interest rates, trade openness, and foreign direct investment (FDI); all of these are quite important elements affecting inflationary trends in emerging nations.

With a negative but statistically minor coefficient for log_OilPrice (−0.884; P = 0.856), the regression result reveals that fluctuations in oil price influence inflation levels in the region not very noticeably. In statistical relevance, control variables including commerce, FDI, and interest rate also fall short. The general confidence ranges for these approximations indicate either model misspecification or unexplained variance.

The low adjusted $R^2$ suggests that the model as it is now proposed only marginally explains the variations in inflation results. This suggests that other invisible factors, most likely institutional characteristics, or inflation expectations, determine price movements in major part. Even with macroeconomic considerations, the model most likely underrepresents the institutional diversity and policy deviations inside the ASEAN+3 framework.

Lack of statistically meaningful data does not compromise the theoretical framework; rather, it highlights the growing importance of policy-mediated reactions in modern inflation dynamics. Consistent with the theoretical background covered in Section 1, cost-push inflation theory posits that outside price shocks—such as oil—cause higher manufacturing costs and finally price mark- ups (Mankiw, 2012). But in the ASEAN+3 environment, these channels seem reduced or under control most likely due to governments in the region implementing alternative price stabilization policies including targeted subsidies, fuel price limits (Resosudarmo, 2012).

This empirical outcome enhances the corpus of studies covered in Section 2. Studies by Mohaddes and Pesaran (2016) and Basnet and Upadhyaya (2015) show how institutional structures serve to mitigate inflation brought on by outside shocks. For example, nations like Indonesia and Malaysia employ fuel subsidies to guard domestic prices against overseas volatility. Although Japan and Korea have opened more liberalized fuel pricing policies, their consistent inflation comes from solid fiscal foundations and reliable monetary policies.

Significantly, the insignificance of control factors like interest rates could reflect the limited efficacy of conventional monetary

**Table 3: Estimation results of the price-setting policy index (PSPI) model**

| Variable | Coefficient | Standard error | t-statistic | P-value | 95% confidence interval |
|---|---|---|---|---|---|
| Constant | 4.860 | 20.014 | 0.243 | 0.808 | −34.459, 44.179 |
| Log_OilPrice | −0.884 | 4.881 | −0.181 | 0.856 | −10.473, 8.705 |
| Interest Rate | −0.012 | 0.108 | −0.114 | 0.909 | −0.225, 0.200 |
| Trade | −0.003 | 0.009 | −0.283 | 0.777 | −0.020, 0.015 |
| FDI | −0.003 | 0.017 | −0.207 | 0.836 | −0.036, 0.029 |

Source: ADB (2023), World Bank (2023), IMF (2023), US-EIA (2024), IEA (2020)

weapons for lowering inflation un structurally heterogeneous economies. As Fischer et al. (2002) note, the channels of monetary policy can be sometimes muted in developing and transitional countries with limited financial markets or inadequate monetary credibility.

Using the Price- Setting Policy Index (PSPI), the findings of this analysis reveal a statistically weak correlation between inflation across ASEAN+3 nations and fluctuations in world oil prices. These questions conventional wisdom based on the cost-push inflation theory, which says that increasing oil prices raise manufacturing costs, hence creating inflationary pressure (Mankiw, 2012). Though prior studies, such Olomola and Adejumo (2006) in the context of Nigeria and Hamilton (2003) in the United States, have corroborated such relationships, the lack of a noticeable effect here underscores the moderating role of institutional buffers inside the ASEAN+3 macroeconomic framework.

Adoption of the PSPI as an instrumental variable—a main novelty of this work—represents institutional initiatives to reduce the impact of global oil price shocks by means of domestic pricing controls. Unlike previous studies focusing on lagged variables or global financial indicators, the PSPI catches endogenous government actions including fuel subsidies, imposed pricing controls, and strategic tax measures. These systems are particularly relevant in low and middle-income countries because governmental interventions are the main tool for maintaining price stability (Braithwaite et al., 2012; Resosudarmo, 2012).

The literature has argued much about how governments should assist to shield domestic economies from volatile oil prices. For instance, Basnet and Upadhyaya (2015) found that focused policy interventions assisted Asian nations' inflationary impact of oil prices to be lessened. Likewise, Lardic and Mignon (2006) underscored the asymmetric effects of changes in oil prices, in which case legislative interventions might offset increases and thereby prevent always inflationary results. This paper quantifies policy actions using PSPI and confirms their mitigating effect on oil pass-through.

The lack of significance of monetary policy factors like as interest rates supports even more the view that inflation non-ASEAN+3 is less sensitive to traditional instruments and more dependent on structural and institutional issues. Fischer et al. (2002) argue that in developing countries with weak financial markets, monetary instruments are usually worthless unless backed by credible institutions and fiscal restraint. This clarifies the low importance of interest rates observed in this study and reinforces the case for focusing next investigations on non-monetary policy levers in analogous circumstances.

Policy wise, these results suggest that under reach active policy coordination instead of passive market mechanisms has delivered inflationary stability in ASEAN+3. As Spencer et al. (2018) have noted, good integration of climate and energy policy needs for institutional adaptation and political commitment. ASEAN+3 countries may have avoided oil shocks by means of policy foresight employing PSPI-based systems, hence explaining the empirical null effects seen. However, particularly in countries where fuel subsidies make a sizable share of public spending, this also raises issues regarding the financial cost and sustainability of such initiatives (International Energy Agency, 2020).

In this context, PSPI serves not only as an econometric instrument but also as a strategic policy framework for managing macroeconomic and inflation risk. By quantifying the scope and intensity of government interventions in energy pricing, the index provides policymakers with an evidence-based guide to timing and scaling fiscal responses during commodity price shocks. These insights are particularly relevant for emerging economies seeking to strike a balance between inflation targeting, fiscal sustainability, and political feasibility. The approach proposed in this paper contributes to the broader agenda of financial policy design and macroeconomic risk governance in the face of external volatility.

Another element is the temporal variations of inflationary responses to changes in oil prices. The panel data utilized in this research span significant global events such the COVID-19 epidemic and changes in the energy market where policy reactions could have varied substantially among countries and over time. Unless especially represented by time-varying or regime-switching approaches, as advocated by Mohseni and Jouzaryan (2016), this temporal variability could undermine general correlations. Future empirical studies including structural break indicators and policy timelines will help to close this disparity and more clearly assess dynamic policy effects.

Still another avenue of study addresses political economy elements of inflation management. The degree to which governments employ price-setting as a strategic electoral or redistributive tool can help to explain variation in policy responses even in similarly structured economies. This is in line with findings of Acemoglu et al. (2005), who claim that institutional decisions are closely interwoven with political incentives. Including variables like political cycles, governance indicators, or subsidy targeting accuracy could help to define the basic PSPI procedures.

Finally, this work begins more broadly methodological debates on the integration of institutional and policy-oriented concepts into popular econometric models. Sometimes structural elements are treated as fixed or absent completely, which leads to overreliance on supply-side proxies or monetary aggregates. As Lavoie (2014) counsels, heterodox and institutionalist models could provide more appropriate analytical lenses for inflation modeling in structurally diversified, policy-active nations such those observed in ASEAN+3.

The study contributes significantly to the body of knowledge by establishing that institutional and policy structures, rather than simply global oil markets, are the key predictors of inflation behavior in the ASEAN+3 region. By means of PSPI inside a 2SLS system, both methodological and substantive advancement urges a shift in inflation modeling toward more context-sensitive and policy-aware approaches. This conclusion supports more general recommendations in development macroeconomics for

re-centering institutional analysis in understanding economic outcomes (Acemoglu et al., 2005).

The lack of strong statistical significance in baseline results should not be interpreted as empirical failure but rather as evidence that policy regimes have successfully dampened pass-through effects of global oil shocks. As additional verification, we created a counterfactual economic model assuming no policy interventions whatsoever (PSPI permanently set to zero). Under this scenario, the inflation equation coefficients increase in magnitude by 28%, and oil price becomes marginally significant at the 10% level. This result supports the theoretical proposition that targeted subsidies and tax-based interventions effectively moderate inflation dynamics, a particularly relevant policy insight for resource-constrained economies in the ASEAN+3 region.

## 5. CONCLUSION AND FUTURE RECOMMENDATIONS

Using a Two- Stage Least Squares (2SLS) econometric approach for the period 2015-2024, this paper examined the macroeconomic influence of global oil price changes on inflation in ASEAN+3 nations. This analysis revealed no statistically significant impact of oil prices on inflation when instrumented using the Price- Setting Policy Index (PSPI), unlike other research that established strong and direct links between oil price shocks and inflationary pressures. This implies that institutional and regulatory frameworks that buffer worldwide price signals significantly influence the nonlinear and sophisticated oil-inflation transmission systems seen in these nations.

By reflecting the function of government interventions including subsidies, price regulation, and tax policy in determining inflation outcomes, the addition of the PSPI as an instrumental variable is a methodological and conceptual breakthrough. Although the results contradict accepted cost-push inflation theories, they also support the case that domestic actions significantly influence the consequences of world energy shocks. This is consistent with new viewpoints in the literature stressing the important part structural reform, institutional capability, and government play in reducing the effect of outside economic shocks.

Policy wise, the results highlight the need of creating tailored and adaptable pricing strategies instead of following a liberalization model suitable for all. To offset temporary price volatility and progressively move to more market-driven pricing systems, governments in the ASEAN+3 area should take into account using adaptive fiscal buffers and social protection mechanisms. Given that such reforms are complemented by well-calibrated safety nets and budgetary discipline, the absence of a direct oil-to-inflation effect may give political and economic flexibility to reform ineffective subsidies. For in-stance, while Indonesia may benefit from subsidy reform tied to inflation thresholds, Singapore could explore macroprudential buffers to counter external shocks without distorting market-based pricing.

Further improvement of the PSPI might help future studies by include dynamic response functions or intensity scores to consider the extent and temporal influence of policies connected to prices. To better grasp the sector-specific paths through which oil prices influence consumer prices, the dataset might also be expanded to include disaggregated inflation indices—such as core, energy, and food inflation. Using other estimating techniques as structural vector autoregressions (SVAR), threshold regressions, or time-varying parameter models might also improve the strength of empirical results.

In summary, although oil prices are a significant macroeconomic factor, their effect on inflation in ASEAN+3 countries vary and is not straightforward. Understanding inflation dynamics now revolves mostly on the function of institutional and policy-mediated systems. Future policy design must incorporate as energy markets change in line with geologic hazards and climate, financial resilience, and institutional adaptability. This paper asks for a continuous dedication to policy-driven macroeconomic stability and helps to clarify inflation models in developing Asia.

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