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Stock Performance and Political (In)stability in OIC countries: An Empirical Evidence

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Abstract

Amongst the major concerns of the Organization of Islamic Countries (OIC) is frequent political unrest inherent in the region. Using available data from the World Governance and Development Indicators, between 2006 and 2019, this study analyses the impacts of political instability on stock market performance in eleven OIC countries. In modelling the relationship between these variables, this study employs the Regression with Driscoll-Kraay standard errors, after observing the presence of heteroscedasticity and autocorrelation in the traditional panel techniques. The empirical findings established the existence of a positive nexus between political instability and stock market performance in the examined OIC countries. Furthermore, the control variables of the study (i.e., economic growth and exchange rate) showed evidence of positive relationships with stock market performance.

Keywords: Stock Performance, Political (In)stability, Organization of Islamic Countries (OIC).

1. Introduction

Political stability is a salient factor for economic development. Many economic experts had traced the secret of sustainable economic development to political and economic stability. More importantly, political instability in the OIC countries has been a concern to academic scholars as OIC countries are rated high among other regions in the world due to crisis among member nations and is a deterrent to the economic performance of these countries. Since the war and political crisis affect the productivity of these countries,a fallin stock performance, thereby affecting economic growth more severely because ofthe lack of well-established political and economic institutions.Additionally, diversity in economic structures, political systems, levels of development, and ethnic backgrounds in most of these countries is also a serious bane confronting member countries. This heterogeneity among these countries is the argument used to counter the practicality of the ICM, i.e., the Islamic Common Market, which has accommodated anunrestrictedproduct flow, labor, entrepreneurship, technology, and capitalamong its members, alongside a shared tariff on the third party members (Coman & Gross, 2012).

Nevertheless, heterogeneity, as it is believed, creates crises even thoughdiversity can provethe opposite if carefully and positively used. However, it would have been brilliant if they utilize their advantage against fighting among themselves.The distribution of trade amongOIC members showed that the intra-OIC trade has not been benefited from the globalization of trade, as well as integrating the member states to global markets in a similar proportion. This can be attributed to the production propensity and economic and political stabilityin developed countries as against that of OIC countries. The countries that have a narrow and unstable export base have providedonly slight encouragement forpossible regional partners regarding long-term, economic relationships. Although, in Turkey 2016 atthe 13th summit of OIC, they emphasized the issueof growing political instability within the Islamic world, which has led tointensifying conflicts in the region,particularlythe Middle East region. They also discussedviablesolutions to current crises. The OIC, however, failed tonurture cooperation and unity between the OIC member countries. Recently, the crisis between Qatar and the Gulf countrieswhich seriously affected intra trade between Qatar and Gulf Nations resulting to capital flight to Europe and other continents that can provide an alternative for Qatar, Muslims leading economy in term of per capita income.

Secondly,the absence of culturalcooperation among OIC member countries has accordingly reducedthe understanding level among the Muslim nations. Such an important factor, i.e., the absence of closeness and understanding between the OICmembers have negativelyaffectedeconomic activities betweenOIC countries. It is highly imperative for any economy to ensure economic and political stability to enhance domestic investment and encourage foreign investors thus the country will achieve sustainable economic development. The emergence of the phenomenon of the‘Daesh terrorism’, as well as the‘Takfiri groups’, which excluded other Muslim sects, necessitated a swift action to restore stability and securityin the Middle East region because it represents the center of gravity of the Islamic world more. This study is motivated by the belief thatthe Organization of Islamic Cooperation (OIC)can providepractical solutions to eradicate this phenomenon. If such conflicts persist, this will negatively affect the Islamic countries. Thus, the focus of this study involvesexamining the association between the stock performance and the ongoing political instability in OIC countries.

2. Political Instability and Stock Performance

Over the last years, political instability, abbreviated as (PI), with its effect on the performance of financial marketshas been discussed and debated for its importance. It is saddening that Muslim countries had fought 16 major wars and coups, ethnic insurgency, and revolutions, religious and political crises which put them inthe mess they are experiencing today. As Muslim countries are blessed with large, vast, and untapped natural resources, they are still lacking behind their counterpart in the world as a result of several wars since the end of World War II, alongside higher levels of inflation and unemployment, political instability, inequality, in addition towidespread corruption. In Southeast Asia,several developing countries emerged as developed economies. However, the OIC member countries are still battlinghigh political instability, political and economic repression, as well as chronic levels of unemployment. This has, in turn, triggeredwidespread Arab springs, i.e., many OIC countries have witnessed a number of extensive revolutions.Previous empirical studies confirmed

this[1], particularly after the latest financial crisis, by examining theconnection between stock markets andpolitical instability. According to Lehkonen and Heimonen (2015),the reduced political risk canresult ina higher portfolio, as well as stock returns. On the other hand, Huang et al. (2015) found a positive association between government bond yields and international political risks.Political instabilitycan affect the performance of the stock market through economic growth. Many OICcountries have recentlyexperienced declining levels of growth, which rangedbetween -0.74% in KSA, in 2017, and -1.5%, -4.7% inQatar, as well as Kuwait, correspondingly (World Development Indicators, WDI, 2020). Suchdeclining levels in growth cannot be surprisingbecause several OICmembersfacedan extended period of wars, in addition to terrorism-related problems.

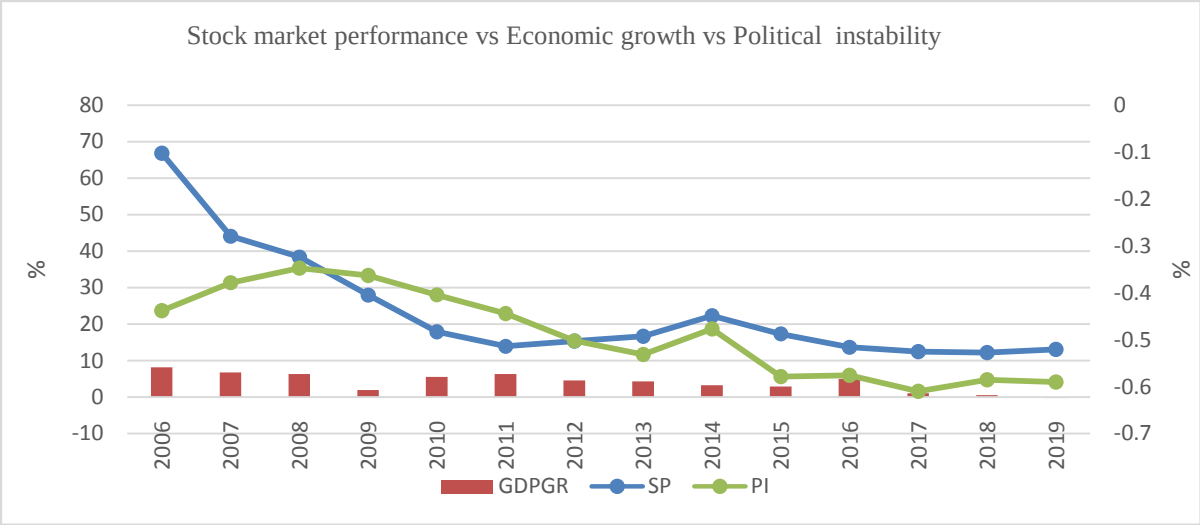

Figure1: The relationship between political instability, economic growth, and stock market performance in OIC countries

Source: Authors' computation from the WDI dataset

In the global economy, development of countries, and their growth, the performance of stock plays a key role. It represents avital component in reducing poverty via increasing employment opportunities and productivity in general. As evident from Figure 1, the political environment witnessed a declining trend for most of the periods. This scarce political stability corresponds to the years of declining growth in the region, hence the steady fall in stock market performance as these political issues persist over time.However, the industry of global Islamic finance has been rapidly growing and recently experiencedan expansionary trajectory.Such a development has not beenuniformedin relation to the OIC members, which affected the industry of Islamic finance. Principally, because the core of Islamic finance involves risk-sharing; the stock market is the first superlative means of risk-sharing (Askari et al., 2011), investigating the key determinants, which contribute to the development of the stock market has becomesignificant research.

[1] The detailed review of literature is included as a section in this study (Section 3)

3. Literature Review

It is generally contended that economic and political stability cause economic growth.Previous studies have establisheda negative connection between economic performance and political instability, whereas others hinted at direct association and no relationship among these variables. Among the studies that support direct linkage is Rafique (2015), whereby he argued that following leaders enforce order and ensures stable law, as well as political stability. It protects countries from outside aggression, safeguardingprosperity, and peace. The consequences of recently erupted Arab uprisings in severalNorth African and Middle Eastern countries were obvious, and post-revolutionary conditions showed that this has resulted in a penetrating political instability situation, which led to slowereconomic growth levels.In the vein, according to Tiniç and Savaser(2020),the international investor has hadthe information advantage over the local investor in the stock market. Based on the available data that covered Turkey from(2007 to 2015), the international investor possessedthe information advantage of 7% of the sample companies. According to the researchers, this has prevailed during political instability because the funding constraints of domestic investors have limited their capacity to impart their data on the stock prices, therebyproviding the international investors a proportional information advantage throughout political turmoil. To test the stock market herding behaviour existence, during Egypt's revolution in 2011, Mertzanis and Allam (2018) utilized the technique of multivariate regression regardingdaily and monthly returns of the EGX30 index. Their empirical findings reveal the existence of adverse herding in extreme market conditions. They suggested that there is a non-linear herding behaviour prior to and in the wake of the revolution throughout the entire period. On the other hand, Aisen and Veiga (2013) acknowledged the total factor productivity to be the chief transmission channel, whereby political instability undesirably affected growth.In Bangladesh from (1984 to 2009), Ahmed and Pulok (2013) found that political stability, in the long run, has negativelyaffected growth, whereas, in the short run, it has exerted a positive effect on growth.

In his study, Kirikkaleli (2020) explored the impact of political risk on financial and economic risks in Venezuela, based on quarterly data spanning 1984Q1 – 2018Q4. Using the wavelet coherence technique, the author found that political risk has strong power for explaining economic risk from 1995 to 2005 in the long run, while between 1984 and 2010, economic risk and political risk are positively correlated at different frequency levels. Nonetheless, changes in political risk significantly result in changes in financial risk in the long run. Moreover, Kobbi and Abdelhedi (2018) investigated the impacts of terrorism and political instability on the financial market in Tunisia. Using the Power ARCH model on data covering 2005 – 2015, the empirical findings support a negative nexus between political instability and terrorism on the financial market. Likewise, Shanaev and Ghimire (2019)examined the presence of political risk premia on 298 listed companies in Russia, between 10/2012 and 09/2017. Relying on the pooled OLS technique, the empirical findings suggest that regional political risk impacts more than international risk;the regional political processes are important for the understanding of the analysis of stock returns with broader markets. Further, Günay (2016) analyzed the impacts of domestic political risk on the Turkish stock market, between 2001 and 2014. The empirical evidence showed a recent increase in the number of breaks, the risk level in recent periods is significantly lower than the early regimes; the risk level trend for all regimes equally shows

a negative slope. Finally, Table 1 providesa summary of several previous studies, which were reviewed in this study.

Table 1: Literature on the relationship between Stock performance, political stability, and economic growth

S/NO	Study	Country/time period	Dependent variable	Model/method	Findings
1	Asteriou and Sarantidis (2016)	18 OECD /1993–2013	stock market returns	Exploratory Factor Analysis	Political Instability is -ve; Bank return (-ive)
2	Yusuf et al. (2020)	West Africa (1996 –2016)	Economic Growth	Dynamic Fixed Effect	Political instability is negative
3	Kirikkaleli (2020)	Taiwan (1997Q1–2015Q2)	Stock market index	ARDL, DOLS, and Markov Switching approaches	Declining economic, political and financial risks are associated with the increasing stock market index
3	Yilmaz & Levent (2015)	emerging Asian countries /2002-2013	GDP	Panel cointegration & causality test	Political Instability -ve Economic freedom (+ive)
4	Hoque et al. (2018)	Bangladesh(1993 – 2016)	Economic growth, FDI, and Stock market development (SMD)	ARDL and Hierarchical regression	Political instability adversely moderates the nexus between economic growth and SMD, FDI, and SMD, as well as economic growth and FDI.
5	Guo et al. (2021)	China and United States (January 1993 – June 2019)	Stock price	Quantile ARDLapproach	The past performance of US stock negatively affects the current stock at medium and high quantiles; the effects of political risk on the Chinese stock market are significant at few quantiles.
6	Aisen and Veiga (2013).	100 developing and developed countries/ 1960–1999	GDP	GMM	Political Instability +ve Economic freedom (+ive) Democracy (+ive)
7	Hoque and	Brazil, India, Indonesia,	Stock market	3-regime	The country-specific

	Zaidi (2020)	South Africa, and Turkey (Jan. 2003 – Dec. 2017)	returns	Markov-switching approach	political unrest adversely influences the stock market performance of four fragile emerging economies throughout the volatility regimes
8	Mohamed Masry (2015)	Egypt (January 2011)	GDP	fixed effects and IV estimates	Political Instability -ve
9	Akther Uddin, Md Hakim Ali, Mansur Masih (2017)	120 developing countries (1996-2014)	GDP	Advanced dynamic two-step system-GMM and quantile regression	Political Instability +ve Economic freedom (+ive)
10	Herrala and Turk-Ariss (2016)	117 countries developing and developed countries (1980-2012)	capital accumulation	MENA countries	Political Instability --- ve
11	Ahmed and Pulok (2013)	Bangladesh (1984-2009)	GDP	Time-series econometric approach	Political Instability --- ve Economic freedom (+ive)
12	Belkhir, Boubakri and Grira (2017)	MENA region/ listed firms from ten countries/ 1997-2012	Stock Return	Univariate and Multivariate Analysis	Political Instability --- ve GDP (+ive)
13	Uddin et al (2017)	OIC /1996–2014	GDP	GMM Estimations	Political stability +ve Political Risk -ve Rule of law (-ive) Economic Freedom (-ve) Corruption (-ve)
14	Hira(2017)	Pakistan (1998 – 2012)	Stock return	ARDL	Political instability is negative (-ve)

Author's computation

In light of the studies above, it can be concluded that there is inconsistency among scholars, and little has been done about investigating the linkage between stock performance and political (in)stability, especially among the OIC member countries. Therefore, this study aims to investigate the potential association between stock performance, political stability, and economic growth.

4.Research Methodology

The previous studies have identified the importance of the stock market on economic growth, particularly in line with the prevailing economic growth theory. Levine (1991) argued that the stock market has a positive impact on economic growth. He used the endogenous growth model to stabilize the direct relationship between stock performance and economic growth where he concluded that the stock market performed the function of risk allocation which is imperative for sustainable development. Also, Aleksynska and Havrylchyk (2013) concluded that natural resources induced foreign investors to invest in the countries endowed with natural resources.
The current fall in oil prices reduced the amount of foreign capital and efforts towards acquiring oil assets and investing in mining. In contrast, Deseatnicov and Akiba (2011) asserted thatpolitical risks in less developed countries negatively affected FDI flows thus affect the stock performance. Political instability is associated with unstable administration and unemployment which is a bane to sustainable economic development. In accordance with Max Weber's political theories, political stability draws upon the legitimate utilization of the physical force by the government. When the country's government is unable to secure basic services and infrastructureslike food, security, shelter, the power of enforcing laws and regulations will be affected, which can result in political instability. Political instability and the failed state concept are synonymous (Mommsen, 1992). In economics, it is a minor issue when the regime is democratic or not because theinvestors have always believed that the host country should maintain political stability, which is key for them to establish their investments in a stable country and how much money they will invest.Economists consider political instability aharmfulcondition to economic growth and performance.

Following these theories and several existing studies on stock market performance, such as that of Belkhir, Boubakri and Grira (2017), Asteriou and Sarantidis (2016), and Herrala and Turk-Ariss (2016); among others, these models have been specified for testing the suggested empirical relationships between the SP, and PI, as well as GDPGR, in addition to REER in the designated countries in this study.

[4.1] $SP = f(PI, REER, GDPGR)$

[4.2] $SP_{it} = \beta_0 + \beta_1 (PI)_{it,} + \beta_2 (REER) + \beta_3 (GDPGR) + \varepsilon_{it}$

where: β_0 measures the intercept coefficient; β_i (i=1,2,3,4,5); and ε_{it} is the white-noise error term; i represents the cross-section (countries); t is the time-series (in years).

Political Stability, as well as the Absence of Violence and/or Terrorism (PI),aim to measure the perceptions of the potential instability in the political environment and/or violence that are politically motivated (such as terrorism). Estimatesprovide the score of the country on percentage (WGI, 2020).

The secondary data source is used in this study. The panel nature of the data is based on data availability; and composed of annual data on stock market performance (SP), political (in)stability – measured by political instability and absence of violence (PI), economic growth, measured by GDP growth rate (GDPGR), and exchange – measured by the real effective exchange rate (REER) in eleven

selected Gulf countries (Qatar, Saudi Arabia, Kuwait, Iraq, Iran, Bahrain, Oman, Jordan, Turkey, Lebanon, UAE), between 2006 and 2019. The data on these variables are obtained from World Governance Indicators (WGI) and World Bank's World Development Indicators (WDI).

To examine the relationship modelled in equations 4.1 and 4.2, the regression with Regression with Driscoll-Kraay standard errors is employed.

5. Empirical Analysis

5.1 Descriptive Statistics

The results of the descriptive statistics for the variables of the model are presented in Table 1.

Table 1
Descriptive Analysis

Variable		Mean	Std. Dev.	Min	Max	Observations	
SP	overall	67.610	41.591	14	142	N =	154
	between		28.246	14	100.143	n =	11
	within		31.619	-10.604	158.610	T =	14
PI	overall	36.146	28.005	0	92.417	N =	154
	between		28.660	2.547	82.277	n =	11
	within		5.719	21.342	53.990	T =	14
GDPGR	overall	4.022	4.885	-7.445	26.170	N =	154
	between		2.109	1.632	9.335	n =	11
	within		4.449	-6.811	20.857	T =	14
REER	overall	89.429	123.736	14	311	N =	154
	between		129.197	14	294.786	n =	11
	within		6.082	66.643	111.857	T =	14

With data on 11 countries spanning 2006 – 2019, it is evident from the summary statistics presented in Table 1 that each of the variables has a positive mean value. The description of the pooled data (overall) also revealed that REER has the highest mean value, while GDPGR has the lowest mean value. Even though GDPGR has an insignificant smallest dispersion from the mean value, each of the other variables does not have a large deviation from their mean values.

5.2 Pairwise Correlation Matrix

The correlation analysis, which defines the extent of the relationship between each of the model variables, is presented in Table 2.

Table 2
Correlation Analysis

	SP	PI	GDPGR	REER
SP	1.000			
PI	0.231	1.000		
GDPGR	0.103	0.127	1.000	
REER	0.108	-0.177	-0.133	1.000

Except for the duo of REER and PI, and REER and GDPGR that exhibit a positive correlation, the signs of the correlation coefficients confirm that a positive relationship exists among the variables. As explained in Shittu et al. (2018), to the extent that the degree of correlation in each case is moderate, the estimates obtained therein are largely free from the multicollinearity problem.

5.3 The Test of Stationarity

To observe the sequence of integration of the model variables, the results of the unit root test are presented in Table 3.

Table 3
Test of Stationarity

Variable	Level	First-Difference
PS	-4.615***	-10.855***
PI	-2.931***	-9.220***
GDPGR	-5.852***	-9.999***
REER	-6.350***	-9.907***

*** denotes significance at 1% level

As presented in the table, the estimates from the Im-Pesaran-Shin technique suggest that each of the coefficients of PS, PI, GDPGR, and REER is significant at 1% level of significance. This is evident from the fact that the W-t-bar statistic is greater than the critical value at 1%, in each case, both at the level and firstdifference. Therefore, our model variables are integrated at I(0).

5.4 Empirical Estimate

The results of the regression estimates from the Random Effect (RE), Fixed Effect (FE), Pooled Ordinary Least Square (POLS) techniques, as well as the Regression with Driscoll-Kraay standard errors are presented in Table 4. The results from our Hausman and Breusch–Pagan LM specification tests suggest that the coefficients be estimated using RE and POLS, respectively. Nonetheless, our post-estimation results further suggest that neither of the techniques is efficient because of autocorrelation and heteroscedasticity problems. Hence, we rely on the Regression with Driscoll-Kraay standard errors, which is robust to the highlighted problems (Haruna & Abu Bakar, 2021).

Table 4
Regression Estimates

DV = SP	POLS	RE	FE	*Driscoll-Kraay*
PI	0.219	0.219	0.150	0.259***
	(0.291)	(0.291)	(0.476)	(0.077)
GDPGR	1.192**	1.192**	1.273**	0.809*
	(0.591)	(0.591)	(0.613)	(0.450)
REER	0.052	0.0512	-0.160	0.059***

	(0.079)	(0.079)	(0.435)	(0.012)
_cons	50.260	50.260***	71.350	49.750***
	(16.905)	(16.905)	(43.872)	(4.078)
Observation	154	154	154	154
F-Stat/Wald chi2	5.540	5.540	1.710	13.46***
Hausman Test (Prob.)		0.944		
Breusch and Pagan LM Test (Prob.)		0.000		
Autocorrelation (Prob.)		0.002		
Heteroscedasticity (Prob.)		0.000		
Pesaran CD Test (Prob.)		0.961		

Note: *** & * denote significance at 1% & 10% respectively; Standard errors are included in the parenthesis

As presented in the table, each of our model control variables shows evidence of a positive relationship with stock market performance. This is evident from the significant and positive coefficient obtained for each interest rate and economic growth, such that stock market performance rises by 0.059% and 0.809% for a percentage increase in the exchange rate and economic growth, respectively. Our main variable, political instability, equally produces a positive estimate in its nexus with stock market performance. Even though this contradicts the *a priori* expectation and several empirical findings (Asteriou & Sarantidis, 2016; Shittu et al., 2020; Belkhir et al., 2017), our empirical finding upholds that political (in)stability promotes stock market performance in OIC by 0.259%. Among the very few studies that support this finding is Uddin et al. (2017). A possible justification for this is the long years of political unrest that characterizes the region and the relative improvement in recent years.

6. Summary and Conclusion

The study analysed the impacts of political instability on stock market performance in eleven Gulf countries (Qatar, Saudi Arabia, Kuwait, Iran, Iraq, Bahrain, Oman, Jordan, Turkey, Lebanon, and UAE). This study is particularly important, given the level of political unrest prevalent in many of the countries for years. In modelling the relationship between these variables, this study employed the Regression with Driscoll-Kraay standard errors, after observing the presence of heteroscedasticity and autocorrelation in the traditional panel techniques; this has been conducted to examine the relationship'sdirection and magnitude between the variables of the model. The empirical findings established the existence of a positive nexus between political instability and stock market performance in the selected OIC countries. Even though this is alien to *a priori* expectation, it can be possibly true because of the long periods of instability in some of these countries. Furthermore, the control variables of the study, including economic growth and exchange rate showed evidence of positive relationships with stock market performance.

An appropriate policy in this regard is for the governments of the OIC to further improve theirpolitical environment and maintain relative peace, which has been experienced in recent years to enhance the performance of the stock market. It is equally evident from one of our control variables, i.e., economic growth, that the governments of these countries improved the general economic performances so that stock markets may be further enhanced. It is recommended that future studies use other measures of political instability and time-series analysis for each of the OIC countries to validate the results of this study.

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