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Effects of Economic Instability on Stock Market Under Different Regimes: Ms-Garch Approach

Koray Kayalidere¹, Tuna Can Güleç¹, Elif Erer²

¹Manisa Celal Bayar University, Turkey

²Ege University, Turkey

ABSTRACT

Purpose of the study is to analyze how the economic instability influences stock market performance on bear and bull markets. We use weekly credit default swaps, exchange rate volatility and stock market returns in Turkey for the period of 01.02.2010-17.03.2017. Markov Switching GARCH(1,1) model is used in the study for its convenience with the structure of the study. Results of the analysis indicate that, both credit default swaps and exchange rate volatility negatively affect the stock market performance in bear and bull markets. However, effects are significantly stronger in bear market than in bull markets. This can be interpreted as that adverse economic conditions, in other words economic instability, lead to diminish stock market returns by increasing investors' risk perception with reference to the country.

KEYWORDS Economic Instability; Financial Markets; Markov Switching

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