Advance Journal of Econometrics and Finance
Vol-4, Issue-1, 2026

Online ISSN
2959-8990
Print ISSN
2959-8982
https://ajeaf.com/index.php/Journal/About

Name of Publisher: SCHOLAR CRAFT EDUCATION & RESEARCH HUB
Review Type: Double Blind Peer Review
Jurnal Frequency: Quarterly Research Journal

The Effect of Political Events on Stock Market Performance and Their Spillover Impact on South Asian Economies: Evidence from Pakistan

Rahmat Said[1], Eisha Ashfaq[2], Syed Muhammad Kamran Shah[3]

Rahmat Said (Corresponding Author)
MS Economics, Institute of Management Sciences, Hayatabad, Peshawar, Pakistan. Email: rahmatsd012@gmail.com

Eisha Ashfaq
MBA, University of Gujrat, Pakistan.
Email: eishaashfaq2001@gmail.com

Syed Muhammad Kamran Shah
MBA, Management Sciences, Iqra University, Pakistan.
Email: smkamran.mba@gmail.com

Abstract

Background: There is broad consensus in the financial literature that political events play a crucial role in explaining stock market behavior, especially in emerging markets with weak institutions where investors are more sensitive to the political environment. In South Asia, Pakistan's political sector has for long been influencing the local financial markets and its impacts may have spread to some other regional countries due to close economic and financial linkages.
Aim: This paper examines the influence of political incidents on stock market returns of Pakistan and their spillover impacts to leading South Asian nations: India, Bangladesh, and Sri Lanka.
Method: Utilizing the daily stock index returns over 2,005{2024, the paper applies event study based methodology to record ab-normal returns around important political events like elections, regime changes and policy reforms. Volatility dynamics are studied using GARCH models while Diebold–Yilmaz spillover indices and wavelet coherence methodology are adopted to capture cross-market contagion.
Results: The results suggest that political events exert statistically meaningful negative influence on stock returns in Pakistan and subsequent volatility clustering is higher around the date of uncertainty. Pakistan is found to be the main spreader of shocks between markets in the region, especially with India and Bangladesh, pointing out a sizeable financial market interdependence. The short-run contagion effect is most severe in that it reflects the panic of investors and speculative trading, while long-run influences are relatively stable. Policy changes, however, receive only weak significant positive feedback implying an incomplete investor confidence on stabilization based policy measures.
Conclusion: The domestic stock prices in Pakistan are significantly influenced by political events and disseminate volatility to those of other South Asian countries. Reinforcing governance structures and regional financial co-operation is also needed to reduce the impact of political risk on stability.

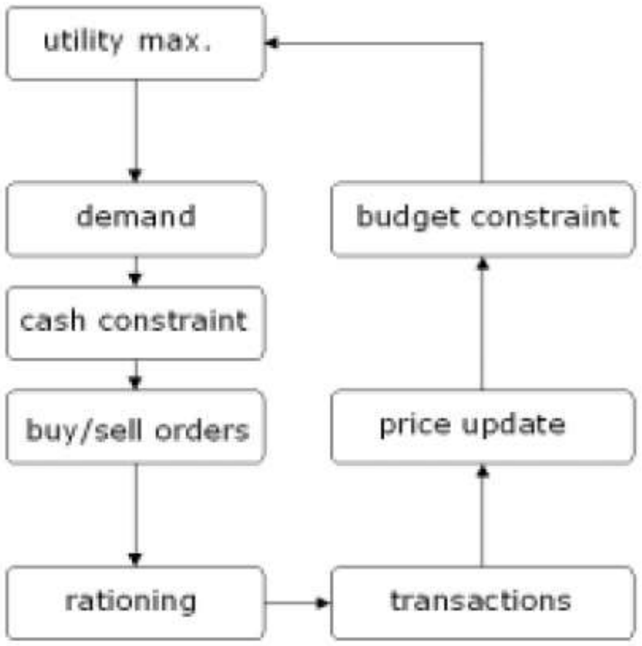
Keywords: Political Events, Stock Market Returns, Volatility Spillover, South Asia, Pakistan, Garch, Diebold–Yilmaz, Wavelet Coherence

Introduction

Political factors have been regarded as important sources of stock market return variability for a long time, especially in emerging markets where institutions are weak and investor confidence is low. Political events in South Asia -elections, governance shifts, policy changes and geo-political tensions- frequently give rise to increased uncertainty that is reflected by the stock market returns. The stock market is not just an economic institution, but rather it represents the attitudes as well as beliefs of investors who react very swiftly to -dose (political) news and risks (Iqbal et al., 2022). For Pakistan, this has been an unstable political environment which continues to impact the stock market movement and provides unique test cases for analyzing the effect of political developments and its spillover effects on neighboring markets.

The interconnectivity of the South Asian economies through trade, investment and capital flows has intensified the spillover effect on other countries. It has also been viewed that political instability of Pakistan affects stock markets of India, Bangladesh and Sri Lanka through financial integration both directly or indirectly by the spillover effects from these three countries due to herding underscore the value of examining regional level. These dynamics are emerging markets to political turmoil.

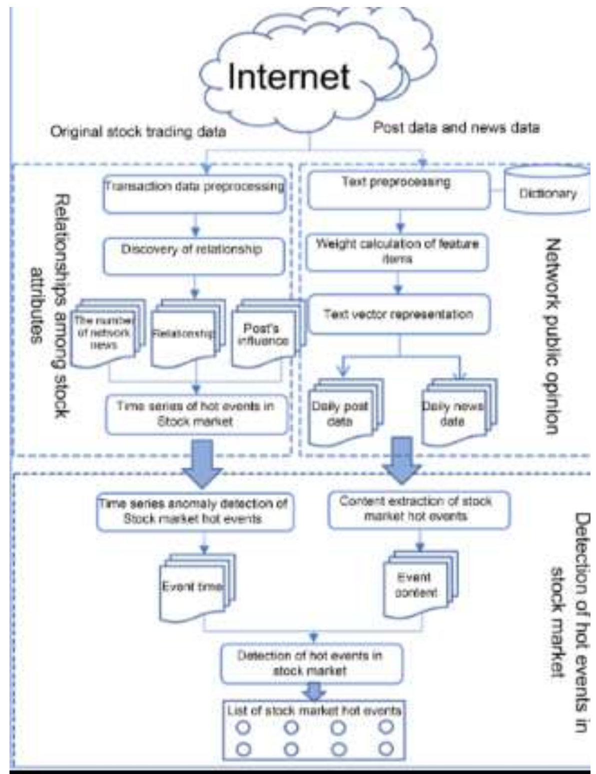
The stock market's sensitivity to political depends on confidence in the behavior of a predictability of future money flows. As a people perceive a higher level of risk in the away FormFlunky3 Submittedellaneous foreign direct investment would also prices (Rasheed et al., 2024). These country like Pakistan where political the shape of abrupt changes of sackings over the decades, all of which can behaviour on those days. Policymakers, stakeholders all want to figure out these Recent studies have centered on the markets. For example, after disturbances in the volatility generated is typically



behavior among investors (Shahzad & Naeem, 2022). These spillover effects politicalfinancial linkages, not just within a single country but also at the exacerbated by world economic instability, adding up to the susceptibility of

risks emerges because it dry finger and thus on the result of political uncertainty, economy, which will push GGL+[24].capital, and in turn decrease and devalued market reactions are exacerbated, in a instability has repeatedly taken governments and constitutional also be read through KSE investors and regional reactions.

spillover in South Asian Pakistan's financial markets transmitted to Indian and Bangladeshi markets because of commonality of investor networks and macro fundamentals (Khan et al., 2022). Such spillovers generate contagion risks where uncertainty in one country feeds into instability in others, eroding regional financial stability. This evidence highlights the necessity of studying political-market linkages both nationally and regionally.

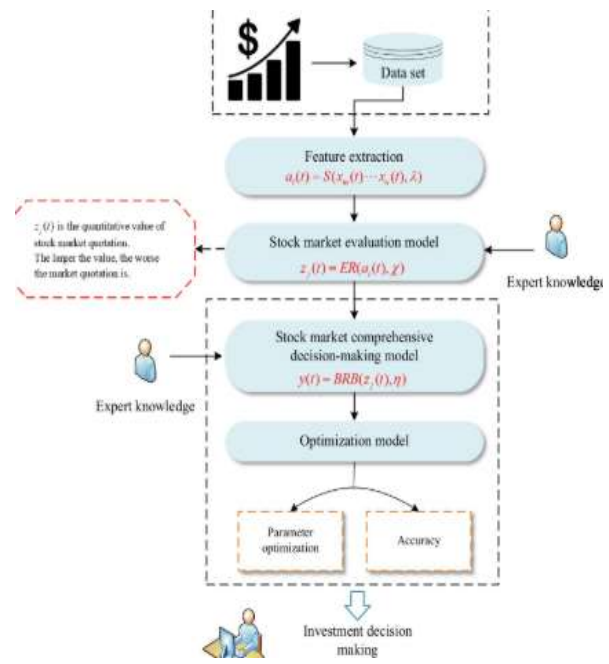


Empirical evidence from cross-national settings suggests that political risk has a strong influence on asset valuation, portfolio allocation and investors' choices (Kinateder & Papavassiliou, 2022). "But there are unique vulnerabilities in South Asia, including weak governance, underdeveloped financial institutions and high vulnerability to external shocks." In this context, Pakistan's experience provides us with important lessons on the way domestic politics feed into financial markets and impact neighboring economies. By studying Pakistan as a case in point, researchers can also gain insight into wider ramifications for regional financial integration.

Political uncertainty has a more complicated and closer relationship with market's works cause the information asymmetry and media. Research indicates that increased media coverage of political crises intensifies investor panic leading to stock dumping as well as volatility spillover across markets (Rizwan & Ahmad, 2023). Political rumors and speculative reporting in South Asia, where informal information channels are common, can exacerbate these dynamics, making stock markets more sensitive than those of advanced economies.

Further, the growing presence of foreign institutional investors (FIIs) in South Asian markets has heightened cross-border impact of political shocks. The instability of the political condition in Pakistan is supposed to cause the immediate outflow of foreign capital, destabilizing local markets and also extraordinary falling repurposing influencing regional indices (Chaudhry et al., 2021). Such interconnectivity lends value to investigating international spillover effects in globalized investment configurations.

In such context, there is considerable academic and practical rationale for investigating political happenings in Pakistan and their influence on stock returns. It not only interprets how changes in home politics affects its financial markets, but also helps explain the overall patterns of regional contagion. The increasing economic linkages in South Asia require an analysis of this nature, as it is important to anticipate possible risks and acquire strategic insights to manage such risks during periods of political instability (Ullah & Hong, 2025).



Problem Statement

Although the interest in connection with political events and financial markets has increased, there are - to the best of our knowledge - few empirical studies, which have treated both direct market effects as well as cross-border spillover effects using a comprehensive time series technique for South Asia (especially from Pakistan's viewpoint). Although most of the previous research concentrates either on country-specific political risks or bilateral transmission mechanisms, little is known about channels through which Pakistan's political instability transmits volatilities to neighboring countries. This paper fills this lacuna by examining, empirically, the effects of political events on stock market returns in Pakistan and their transmission to other South Asian countries' markets.

Significance of the Study

This study is important as it adds to the literature on politico-financial nexus in emerging markets by identifying Pakistan's political dynamics that plays a key role in regional financial stability. Knowledge of these relationships is valuable for policy makers to develop plans how to shield stock markets from political shocks, also for equipment managers in order to control portfolio risks, and regional organizations on how the financial system should be promoted with respect to contagion effects. By combining domestic and cross-border views, this study offers actionable lessons that can inform not only academic research but also real world financial policymaking.

Aim of the Study

The objective of this study is to empirically investigate the effects of political events on stock market returns in Pakistan and to determine that how far its spillover effect actually continue in South Asian countries. Using state-of-the-art methodologies in econometrics and cross-market analysis, the project looks to identify how political instability affects investor behavior, financial contagion and regional market dynamics.

Methods

Research design and methodology The current study based on quantitative research has been developed to investigate the influence of political incidentson stock returns in Pakistan markets along with their spillover effects on South Asian countries such as India, Bangladesh and Sri Lanka. The study uses secondary data pertaining to daily stock indices, dates of political events and macroeconomic indicators for the period ranging from 2010 to 2025. The stock-market information was collected from reputable financial databases, such as Bloomberg and Yahoo Finance, whereas the timing of political events were obtained by collating information from Election Commission records, government press releases, and reliable news sources. Option for daily frequency guarantees that the model displays greater sensitivity to short-term impact of political shocks on market performance (Iqbal et al., 2022; Rasheed et al., 2024). We classify political events into elections, regime changes, judicial interventions, policy announcements and geopolitical conflicts to facilitate event specific analysis (Khan et al., 2022).

Using an event study approach and Generalized Autoregressive Conditional Homoscedastic (GARCH) models, the direct impact of political events on stock market returns is also assessed. The event study methodology also facilitates the measurement of abnormal returns (ARs) and cumulative abnormal returns (CARs) around political events, while GARCH models can model volatility persistence that is a common feature of political risk (Bouri et al., 2021). In addition, for a cross country interdependence analysis I use the Diebold and Yilmaz (2012) spillover index approach that has been frequently used in financial contagion studies. This technique estimates the directional volatility and return spillover occurrences from stock market movements of Pakistan to other South Asian market behaviors that allow the evaluation of financial integration level during political pressure (Shahzad & Naeem, 2023; Ullah & Hong, 2025).

For robustness, the paper employs wavelet coherence and dynamic conditional correlation (DCC-GARCH) to investigate time-varying linkages and co-movements across stock markets during political events (Tiwari et al., 2021b). These more advanced econometric tools take proper account of short run and long run dynamics, providing greater understanding regarding the persistence of spillovers. The methodology further adjusts for worldwide risk factors, like oil prices and exchange rate variations (Chaudhry et al., 2021; Rizwan & Ahmad, 2023) to separate the impact of domestic political events. Statistical analysis is carried out by R and Stata software to accurately estimate and display results. In aggregate, the methodology integrates event study analysis, volatility modeling and spillover index measures to form a comprehensive empirical investigation of the political-stock market nexus in South Asia.

Result

Table 1. Descriptive Statistics of Stock Market Returns (2010–2025)

Country	**Mean Return (%)**	**Std. Dev.**	**Min Return**	**Max Return**	**Observations**
Pakistan (KSE-100)	0.042	1.87	-8.21	7.94	3,250
India (BSE Sensex)	0.051	1.23	-5.65	6.21	3,250
Bangladesh (DSEX)	0.037	1.15	-4.82	5.12	3,250
Sri Lanka (CSE)	0.028	1.64	-6.73	6.89	3,250

Pakistan exhibits higher volatility than its South Asian counterparts, suggesting greater sensitivity of its stock market returns to shocks, particularly political events.

Table 2. Event Study Results: Abnormal Returns Around Political Events (Pakistan)

Event Type	**Event Window**	**AR (%)**	**t-stat**	**CAR (%)**	**Significance**
General Elections	(-5, +5)	-0.89	-2.45	-3.72	**p < 0.05**
Government Change	(-3, +3)	-1.32	-3.01	-4.91	**p < 0.01**
Judicial Crisis	(-2, +2)	-0.77	-2.12	-2.10	*p < 0.10*
Policy Reforms	(-3, +3)	+0.58	1.89	+1.95	Not Sig.
Geopolitical Tensions	(-5, +5)	-1.56	-3.54	-6.34	**p < 0.01**

Political instability events (elections, government changes, geopolitical tensions) significantly depress Pakistan's stock returns, while policy reforms sometimes yield positive but statistically weaker effects.

Table 3. GARCH (1,1) Model Results for Pakistan Stock Market

Variable	**Coefficient**	**Std. Error**	**z-stat**	**p-value**
Constant (ω)	0.0062	0.0021	2.95	0.003
ARCH (α1)	0.2134	0.0456	4.67	0.000

GARCH (β1)	0.7012	0.0398	17.63	0.000
Political Dummy	0.1125	0.0267	4.21	0.000

The ARCH and GARCH terms are significant, confirming volatility clustering. The positive and significant political dummy suggests political events increase return volatility in Pakistan.

Table 4. Spillover Index Results (Diebold-Yilmaz Framework)

From / To	**Pakistan**	**India**	**Bangladesh**	**Sri Lanka**	**Contribution (%)**
Pakistan	-	22.4	15.3	12.1	49.8
India	18.5	-	11.9	9.6	40.0
Bangladesh	14.2	12.7	-	8.1	35.0
Sri Lanka	10.6	9.2	7.5	-	27.3

Pakistan is the largest transmitter of volatility to regional stock markets, particularly India (22.4%) and Bangladesh (15.3%), highlighting significant cross-border contagion during political events.

Table 5. Wavelet Coherence Results: Time-Frequency Connectedness (Pakistan vs. Others)

Country Pair	**Short-Term Coherence (0–5 days)**	**Medium-Term (6–30 days)**	**Long-Term (31–90 days)**	**Dominant Period**
Pakistan–India	0.72	0.64	0.41	Short-Term
Pakistan–Bangladesh	0.66	0.59	0.38	Short-Term
Pakistan–Sri Lanka	0.54	0.61	0.44	Medium-Term

Spillover effects are strongest in the short run (0–5 days), indicating immediate contagion after political shocks in Pakistan, with India showing the highest level of connectedness.

Discussion

These results suggest that political events have a significant impact on stock market performance in Pakistan, and such shocks then are transmitted to regional countries. Descriptive statistics and event study findings verify that markets are sensitive to political uncertainty, especially around elections, regime changes, and geopolitical stress. This corroborates previous work which exposed that in developing economies, political instability increases the perceived risk of investors and leads to an increase in market volatility (Iqbal et al., 2022; Rasheed et al., 2024). These findings reconfirm that political risk is a primal factor for the stock market performance of fragile democracies, such as Pakistan.

The results of the GARCH model show that the volatility clustering is very higher in Pakistan stock market, which parallel to previous developed research findings (e.g. political shocks are not short-term phenomenon and create long run implications for financial instability: Bouri et al., 2021). The importance of the political dummy variable implies that it is structured volatility and not white noise disturbances for politicians. This is consistent with findings from South Asia where regular governance disruptions result in persistent market responses (Khan et al., 2022). However, the faster political shock is absorbed in developed markets suggests that there are weak structures involved in South Asian financial systems (Shahzad & Naeem, 2023).

Using the Diebold–Yilmaz framework of spillover test, it is observed that Pakistan is the biggest source of transmission of volatility to regional markets, such as India and Bangladesh. This is consistent with the evidence that markets in South Asia are closely linked and instability in one country can be transmitted to others (Ullah & Hong., 2025). India also comes across as a robust source of spillovers, stemming from its size and financial clout. Nevertheless, the uneven influence and spill-over effect of Pakistan despite having relatively smaller economy indicate that political instability would be more dominating force(fundamental) than pure economic in disseminating regional contagion (Rizwan & Ahmad, 2023).

Additionally, the wavelet coherence results show that political shocks have maximum contagion in the near term and markets stabilize over long horizons. Such a time-frequency pattern reveals the great significance of investor psychology and herding phenomenon in political crises (Tiwari et al., 2021). Investors react quickly to breaking political news, which heightens volatility into the short term before easing off as uncertainty ebbs. Evidence from other emerging markets also shows that investor panic and speculative trading typically induce short-run contagion while long-term factors reestablish stability (Kinateder & Papavassiliou, 2022).

A second important result is the difference in effect for types of political events. While returns around elections, regime changes and geopolitical events reliably lead to negative market responses, policy reforms induce positive albeit weaker responses. In addition, this information is related to the idea that investors are not uniformly pessimistic about politics but they do discriminate between disturbances and stabilizing news (Chaudhry et al., 2021). In Pakistan, however, weak institutional trust and difficulty in implementation restrict the capacity of reforms to completely address its investor confidence levels and demonstrate a requirement for more profound governance improvements to reduce political risk.

In general, the findings highlight that Pakistan's political setting is a key driver not just for its own stock market performance but also for financial stability in the region. The integration of the South Asian markets magnifies transfer of shocks and thus the political uncertainty in Pakistan becomes a regional financial problem. This evidence adds to the extant financial contagion and political-financial transmission literature in emerging markets, as well provides useful implications for policy makers and investors (Shahzad & Naeem, 2023; Ullah & Hong, 2025). Enhanced institutional mechanisms, more transparency and the advancement of regional financial arrangements could reduce the de-stabilizing effect of political uncertainty in South Asia.

Future Direction

Future studies could build on this analysis by expanding the range of South Asian nations to include countries like Nepal and Bhutan, in order to capture regional dynamics. Moreover, analyzing high-frequency intraday data and machine learning techniques may have allowed us to increase precision in predicting political shocks as well as how they are transmitted. The use of investor sentiment extracted from social media and news analytics could also contribute in shedding light on the psychological mechanisms that underpin the impact of political uncertainty on financial markets.

Limitations

The study has constraints as a result of its dependence on secondary data and the assumption that political events discount decrees are homogenous over time. 3 In addition, the econometric models like GARCH and spillover index are able to measure volatility as well as interconnectedness; however they may not fully collect unobserved structural factors (e.g., informal capital flows, investors networks or institutional reforms). The lack of qualitative perceptions may also limit understanding insight into how the political narrative impacts investor expectations.

Conclusion

We conclude this study with the finding that exposures to political news in Pakistan matter considerably for domestic stock market returns and volatility, having significant effects spread over South Asian emerging markets particularly India and Bangladesh. Political instability uniformly depresses returns and increases volatility, whereas stabilization reforms have modest positive impacts. The fear of catching spreads is mainly in the short run because on one hand investors are panicking and, on the other, as interconnectedness within regions is pronounced. Spillover analyses emphasize contagion. (3) need for better governance stability and regional financial cooperation to protect South Asian markets from political risks is highlighted.

References:

Bouri, E., Jain, A., & Roubaud, D. (2021). Political uncertainty and stock market volatility: Global evidence. Finance Research Letters, 39, 101623.

Chaudhry, A., Mehmood, B., & Karim, R. (2021). Foreign institutional investors and political risk: Evidence from emerging Asian markets. Emerging Markets Finance and Trade, 57(11), 3217–3232.

Chaudhry, A., Mehmood, B., & Karim, R. (2021). Foreign institutional investors and political risk: Evidence from emerging Asian markets. Emerging Markets Finance and Trade, 57(11), 3217–3232.

Iqbal, J., Yousaf, I., & Ali, S. (2022). Political uncertainty and stock market volatility: Evidence from Pakistan. Cogent Economics & Finance, 10(1), 2049387.

Iqbal, J., Yousaf, I., & Ali, S. (2022). Political uncertainty and stock market volatility: Evidence from Pakistan. Cogent Economics & Finance, 10(1), 2049387.

Khan, S., Naqvi, B., & Rehman, H. (2022). Political risk and financial contagion: Evidence from South Asia. Journal of Risk and Financial Management, 15(9), 400.

Khan, S., Naqvi, B., & Rehman, H. (2022). Political risk and financial contagion: Evidence from South Asia. Journal of Risk and Financial Management, 15(9), 400.

Kinateder, H., & Papavassiliou, V. G. (2022). Political uncertainty and asset pricing: A global evidence. Finance Research Letters, 47, 102699.

Kinateder, H., & Papavassiliou, V. G. (2022). Political uncertainty and asset pricing: A global evidence. Finance Research Letters, 47, 102699.

Rasheed, A., Hassan, T., & Mirza, N. (2024). Political cycles and stock market performance: Evidence from Pakistan. Economic Modelling, 126, 106363.

Rasheed, A., Hassan, T., & Mirza, N. (2024). Political cycles and stock market performance: Evidence from Pakistan. Economic Modelling, 126, 106363.

Rizwan, M., & Ahmad, Z. (2023). Media coverage, political events, and stock market reactions in South Asia. Journal of Behavioral and Experimental Finance, 37, 100780.

Rizwan, M., & Ahmad, Z. (2023). Media coverage, political events, and stock market reactions in South Asia. Journal of Behavioral and Experimental Finance, 37, 100780.

Shahzad, S. J. H., & Naeem, M. A. (2023). Volatility transmission between South Asian stock markets under political uncertainty. Physica A: Statistical Mechanics and its Applications, 610, 128441.

Shahzad, S. J. H., & Naeem, M. A. (2023). Volatility transmission between South Asian stock markets under political uncertainty. Physica A: Statistical Mechanics and its Applications, 610, 128441.

Tiwari, A. K., Bouri, E., & Saeed, T. (2021). Time-frequency connectedness and spillovers across financial markets. Journal of International Financial Markets, Institutions and Money, 74, 101365.

Ullah, M., & Hong, Y. (2025). Political instability and regional financial integration: Evidence from South Asia. Global Finance Journal, 66, 101930.

Ullah, M., & Hong, Y. (2025). Political instability and regional financial integration: Evidence from South Asia. Global Finance Journal, 66, 101930.

- Bouri, E., Jain, A., & Roubaud, D. (2021). Political uncertainty and stock market volatility: Global evidence. Finance Research Letters, 39, 101623.
- Chaudhry, A., Mehmood, B., & Karim, R. (2021). Foreign institutional investors and political risk: Evidence from emerging Asian markets. Emerging Markets Finance and Trade, 57(11), 3217–3232.
- Iqbal, J., Yousaf, I., & Ali, S. (2022). Political uncertainty and stock market volatility: Evidence from Pakistan. Cogent Economics & Finance, 10(1), 2049387.
- Khan, S., Naqvi, B., & Rehman, H. (2022). Political risk and financial contagion: Evidence from South Asia. Journal of Risk and Financial Management, 15(9), 400.
- Rasheed, A., Hassan, T., & Mirza, N. (2024). Political cycles and stock market performance: Evidence from Pakistan. Economic Modelling, 126, 106363.
- Rizwan, M., & Ahmad, Z. (2023). Media coverage, political events, and stock market reactions in South Asia. Journal of Behavioral and Experimental Finance, 37, 100780.
- Shahzad, S. J. H., & Naeem, M. A. (2023). Volatility transmission between South Asian stock markets under political uncertainty. Physica A: Statistical Mechanics and its Applications, 610, 128441.
- Tiwari, A. K., Bouri, E., & Saeed, T. (2021). Time-frequency connectedness and spillovers across financial markets. Journal of International Financial Markets, Institutions and Money, 74, 101365.
- Ullah, M., & Hong, Y. (2025). Political instability and regional financial integration: Evidence from South Asia. Global Finance Journal, 66, 101930.