

Stock Return and Volatility Spillover in Sri Lanka from India and China Under Different Presidential Terms

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Abstract

Under different presidential terms, this study investigates the dynamic interrelationship between stock return and volatility spillover from India and China to the Sri Lankan stock market. Utilizing the DCC-GARCH approach, it scrutinizes volatility persistence and cross-market dependencies across these markets, offering a crucial analysis of the political economy's impact on financial market performance. The study's sample period range from January 2006 to December 2022 and is broken down into three sub-periods based on Sri Lanka's presidential terms. The All Share Price Index (ASPI), the National Stock Exchange Index (NSEI), and the Shanghai Stock Exchange Composite Index (SSEC) are used as a proxy for the Sri Lankan, Indian, and Chinese stock markets, respectively. The analysis reveals that the Sri Lankan stock market experiences significant long-term volatility spillover from India and China. Notably, volatility clustering was prevalent during all presidential terms, but only the Mahinda Rajapaksa regime (2006-2015) demonstrated statistically significant volatility clustering from India and China. This implies that the Mahinda Rajapaksa regime exhibited more volatility clustering than the Good Governance and Gotabaya Rajapaksa regimes. However, volatility clustering does not denote higher levels of volatility but signifies the continuity of volatility over time. It implies that investors, policymakers, and regulators must consider political regimes when assessing volatility spillover effects in Sri Lanka's stock market. Further, it reinforces the importance of the political environment in financial decision-making, potentially aiding in mitigating adverse outcomes and refining investment strategies.

Keywords: *DCC-GARCH, political economy, presidential terms, stock return, volatility spillover*