CHAPTER I

INTRODUCTION

1.1 Background of Study

Retrieving the economic crisis that shook the world in 2008, has successfully shown a complete and clear illustration of the impact from the economic uncertainty in the world, both macroeconomic and microeconomic. The uncertainty faced by the world makes significant changes to the economic policy in a country, while the shifting of economic policy follows the changes in the political situation. The effects from the unsteady condition and the domestic economic condition in one country is called spillover impact (Mwase et al., 2016; Samake & Yang, 2014). The contraction caused by all countries, specifically the United States of America, resulted in the global impacts for both the developed and developing countries, including Indonesia. However, the shifting and contraction of external factors that were started in the other country can bring major impacts to the macroeconomic, microeconomic, and businesses for corporations in the global scope.

The environmental changes which are caused by the COVID-19 global pandemic, constructs the economic contractions in every country that is categorized as developed and developing countries, as well as Indonesia. To stimulate the Indonesian financial and economic situation, the government applied several stimuli, as a booster to revitalize the poor economic condition. The given booster is attained by planning and enforcement of economic policy, including monetary and

fiscal, in order to support the financial economy in Indonesia. Despite the maximum result from the implication of the economic policy, which is obtaining economic recovery, the uncertainty and rapid changes of economic policy by the government as well as the unsteady political situation impacted the stock price synchronicity in a country.

Economic policy that is implemented in Indonesia considered as unstable, due to the changing political situation in the country, especially with the COVID-19 pandemic. The constantly changing policies, such as the 7DRR, lower bank reserve requirement, monetary and also the fiscal policy affected the stock price and stock's performance in the related industries in Indonesia. This phenomenon lead to the stock price fluctuation in Indonesia Stock Exchange due to the high uncertainty of economic situation. Some researchers (Baker et al., 2016) opine that the uncertainty caused by the unstable economic policy such as taxation, consumption level, government regulations, and interest rate generate obstacles for consumers and organizations to invest and personal spending. With the high uncertainty rate, resulting in increasing financing cost that decrease investment so that create unsynchronized stock performance in the stock market (Gilchrist et al., 2010; Fernandez-Villaverde et al., 2012).

The asynchrony of stock prices is also triggered by the uncertainty in economic conditions related to the execution of monetary and fiscal policy as adaptation and anticipation to revive the ambiguous economy. Bansal & Yaron (2004) propose that uncertainty and contractions resulted in decreasing value of

assets, including equity such as stocks. This argument is also supported by Bansal, Khatchatrian, and Yaron (2015) who has a similar opinion regarding the relation between uncertainty and stock price. Hypothesis given by Pastor & Veronesi (2010) concluded that the tumbling stock price is affected by the high uncertainty from the economic policy applied by the government.

Previous academics (Gulen & Ion, 2016; Chen et al., 2017) have stated that economic policy uncertainty has a substantial impact on the financial market and the reactions of businesses. Hence, impacted the stock price synchronicity. Julio & Yook (2012) also present empirical evidence for the negative relationship between economic policy uncertainty and investment activities, which results in stock price volatility. Hypothesis regarding the negative relation of the two variables reinforced by Ozoguz (2009). The theory of financing limitations (Shen et al., 2021; Xiong et al., 2020) shows that high uncertainty in economic policy creates difficulty for microeconomics. However, the company decided to do transparency for all information related to the company to increase creditor's trust. As a result, there is less stock price synchronicity in the stock market.

Stock price synchronicity is a reaction between a company's stock return on market and the industry average return, demonstrating the unique occurrence of "raising and falling together." The impact of economic policy uncertainty on stock price synchronicity is influenced by a variety of factors, including the firm's investment decision (Gut et al., 2010), managerial ownership (Kim et al., 2015), trade credit (Liu & Hou, 2019), financial information quality (Neifar & Ajili, 2019), and analyst following (Jiang et al., 2019).

Managerial ownership structure and institutional investors are two more factors that can influence the impact of economic policy uncertainty on stock price synchronicity. Economic policy uncertainty has a negative impact on stock price synchronicity in companies with a high share of institutional investors. More institutional investors can increase the role of supervision and internal control on firm decisions and behaviors (An & Zhang, 2013; Chemmanur et al., 2009; Lin et al., 2014), as well as reduce stock price synchronicity caused by the tendency to expose more unique information to the public (Baik et al., 2010; Hadani et al., 2011; O'Neill & Swisher, 2003; Sakaki et al., 2016).

In the middle of the uncertain economic condition with the COVID-19 pandemic, the global economic downturn leads to implications on several new economic policies to revitalize business and trading activities in Indonesia. The high level of economic policy uncertainty leads to decreasing firm's external financing ability and increasing financing costs. As a result, firms have decided to share more unique and positive information about themselves with the public in order to avoid financial issues and mitigate the negative effects of financing limits. Hence, firms can increase their stock price and lower the stock price synchronicity in the market (Neifar & Ajili, 2019).

1.2 Statement of Problem

The research problems are as follows, based on the background of study that has been stated previously:

1. Does economic policy uncertainty have a significant negative effect on stock price synchronicity?

2. Do institutional investors reinforce the negative impact of economic policy uncertainty to stock price synchronicity?

1.3 Objectives of Research

Regarding the previous stated problem, the objectives of this research are as follow:

1. To examine whether economic policy uncertainty has a significant negative effect on stock price synchronicity.

2. To examine whether institutional investors reinforce the negative impact of economic policy uncertainty to stock price synchronicity.

1.4 Use of The Study

As an author, this research hopefully can be useful for several parties, including:

1. Investors

    If economic policy uncertainty arises, this research will hopefully give investors with references and knowledge to help them make investment decisions in Indonesia's stock market.

2. Firm managerial

   Through this research, it can adequate firm managerial to understand stock price movement along with the shifting of economic policy in Indonesia.

3. Academic and future researchers

   With the best of intentions, this study can be utilized as a foundation and reference for future research on a comparable topic, namely the impact of economic uncertainty policy on stock price synchronicity.

1.5 Research Limitations

The scope of this study is limited to the impact of economic uncertainty policy on stock price synchronicity in the Indonesian stock market. The author employs numerous measurement indexes in this study, including the World Uncertainty Index (WUI), to determine the amount of economic uncertainty in Indonesia, as well as historical stock price data from the Indonesia Stock Exchange from 2009 to 2019.

1.6 Systematic of The Study

This thesis was arranged by chapters and sub-chapters systematically with an APA citation format to ease the readers to understand the flow of the study and correlate references.

CHAPTER I – INTRODUCTION

This section will identify the background of study, statement of problem proposed, objectives of research, use of the study, research limitations, and systematic of the study based on the topic chosen by the author.

CHAPTER II – LITERATURE REVIEW

Chapter II consists of the definition of each literature review and theoretical definition of the topic, such as uncertainty, institutional investors, and stock price synchronicity. Those components become a relevant and valid base theory and author's reasoning that generated and developed to some hypothesis through the research process.

CHAPTER III – METHODOLOGICAL RESEARCH

This chapter shows the data used and the empirical model. It includes variables, both dependent and independent, methods of data collection, and diagnostic tests.

CHAPTER IV – EMPIRICAL RESULT

This chapter shows the empirical result and analysis of this research, including interpretation and implication of the data that use methods mentioned in the previous chapter. The result will be analyzed based on the literature review to provide relevant analysis and answer to the research problem and hypothesis to provide conclusion of the research.

CHAPTER V - CONCLUSION

Chapter V is the last chapter in this thesis which is closed by the conclusion of the research applied and suggestions to support further research.