



## INTERNATIONAL JOURNAL OF RESEARCH SCIENCE & MANAGEMENT CAPITAL MARKET'S REACTION AND POLITICAL EVENTS IN INDONESIA

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### Abstract

Certainly, the capital market has a high risk, especially in political risk. In investing their money, Investors can do it at their home or abroad. Therefore, political conditions need to be cautioned by investors, because it can affect the stock prices. The purpose of this study is to examine the influence of political events on capital market reaction in Indonesia. The approach in the formulation of this study uses literature studies by collecting and comparing literature derived from journals, articles, and news related to political events. The result of the formulation of this paper indicates that political events (presidential election and reshuffle of presidential cabinet - Kabinet Indonesia Bersatu) can influence the capital market, proven with changes in abnormal return and stock trading activity.

### Introduction

In national economy, the existence of capital market has a very important role. As a country with a burgeoning financial market, the capital market has become an important part of the Indonesian economy, which became the place to raise funds, alternative investment through stock sale and bond issuance, as well as an indicator of the stability of macroeconomic conditions (Beik and Fatmawati, 2014).

The development of the capital market cannot be separated from environmental conditions, which are macro and micro environmental conditions. The examples of macro environmental influences are: inflation, rate hikes, and foreign exchange rates as for the micro environment include: company performance, political announcements, dividend announcements, etc. These factors are very influential on investment decisions in the capital market. The investors will evaluate every announcement issued by the company or government policy, so it will lead to some changes in stock trading transactions, for example with changes in trading volume of stocks, changes in stock prices, bid / ask spread, proportion of ownership, and so on. This indicates that the dissemination of information has an effect which the investors will likely to react.

A study about market's reaction toward event whose information is published as an announcement is called event study. Event Study can be used to test the information content of an announcement and also used to test the market efficiency in the half-robust form (Hartono, 2013: 623). Information content testing only tests the market reaction but does not test how quickly the market reacts. If Information content testing only involves in the speed of reaction from the market to absorb the information announced, then event study is an informed market efficiency test in the half-robust form (Pratama, et al, 2015).

The capital market will react in case of an event affecting the condition of the country. Event Study can be used to test the information content of an event. If the event contains information, then the market will likely react because investors also get the information (Hartono, 2013: 624). One example of market reaction is indicated by the price changes of a security and changes in trading volume. One way of measuring market reaction is to



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measure the abnormal return on the change. If the event contains information, then the investor will get an abnormal return from the market conditions. Instead, if the event does not contain information, then there will be no abnormal return obtained by investors (Hartono, 2013: 624)

Abnormal return is the excess of the actual return generated from an investment to the expected or expected return. Whereas the normal Return is a return that occurs during normal situations, where there is no occurrence of a particular event. Certain events that occur in which containing good information will have a good impact on the increase of abnormal return. On the other hand, the abnormal return will be decreased if the information is considered as bad (Pratama, et al, 2015)

The turmoil of political life, directly or indirectly, has an influence on the economic conditions of a country. Changes within the legislative body as well as within the executive body which are included as part of a political event may affect the state's economic condition. This is because the economic conditions of a country will be influenced by the policies determined by the legislative and executive institutions.

Political turmoil can have a positive or negative impact on the assessment of investors and potential investors, especially for investors and potential foreign investors, given that the Indonesian capital market is still dominated by foreign investors. Political events such as the reshuffle of cabinet and presidential elections are basically easy to be guessed because the signs of political turmoil can be seen through various issues. As well as the cabinet reshuffle due to the performance of some ministers that deemed to be incompetent or more competent in other ministries, as well as the president's own explanation of the reshuffle plan. Indeed, the cabinet reshuffle does not intervene in the stock market directly, but information about these events can be absorbed by capital market actors and influences investors' decision making. It affects stock prices, trading volume and adjusts. Similar to a cabinet reshuffle, the presidential replacement through elections indirectly affects a country's capital market conditions. Therefore, it can be said that political events affect the activity of the capital market indirectly. Political events such as cabinet reshuffle and presidential election can affect both positive and negative stock prices, depending on the perceptions of each investor and potential investor.

Suwaryo (2008) conducted a study on the impact of the presidential election on the abnormal return investors and he concluded that the election event received a response from the capital market in Indonesia as evidenced by the acquisition of abnormal return investors in LQ-45 shares. Although the event created an abnormal return, but the average abnormal return, before and after the election event, there was no significant difference evidenced from the results of statistical tests. It can be concluded that this is an example of event that can be anticipated by the capital market society.

Similarly, a research conducted by Sari (2015) in her research entitled " The Influence of Announcement of Joko Widodo's Presidential Cabinet on Change of Capital Market Reaction at Manufacturing Company in Indonesia Stock Exchange ". Her results concluded that there was an increase in the abnormal return on manufacturing companies in Indonesia Stock Exchange, before and after the announcement of Joko Widodo's presidential cabinet. The increase in abnormal return indicates that the announcement of Joko Widodo's presidential cabinet is a good information for investors, which has an impact on increasing market society' trust toward the government. As for Stock trading volume, the announcement of Joko Widodo's Working Cabinet shows the capital market reaction to the event. This shows that market participants give a positive response to the announcement of Joko Widodo's presidential cabinet indicated by the movement of stock buying activity.

The similar research was conducted by Sopiñana and Gerianta (2016). They conducted research on capital market reaction to Indonesia presidential election event back in 2014. This event shows that in the event of



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quick count announcement by 12 survey institutes in Indonesia, there was a slight differences of market reaction against the events of the announcement of the Indonesian Constitutional Court to companies with high and low DER numbers. There is also a difference in market reaction to the inauguration of the Indonesian President who was elected to a company with high and low DER numbers.

Research on capital market reaction to presidential election was also conducted by Sari, et al, (2017)entitled "Comparative Analysis of Shares LQ45 Before and After The 2016 Presidential Election of the United States". She concludes that there is no significant difference in average abnormal returns on LQ45 index member stocks, before and after the US presidential election 2016. This is because the information contained in the event is not strong enough to make a significant difference in mean abnormal returns. However, there is an average difference in trading activity volume that is significant in the stock of LQ45 index members. This happens because many investors selling their shares which resulting an increase in trading volume of the stock that causes the difference in average trading volume activity.

A research on the effect of Presidential Cabinetreshuffle was also carried out by Muzab (2017) entitled "Capital Market Reaction to Presidential Cabinetreshuffle Volume II - Joko Widodo-Jusuf Kalla". This research concludes that there is no difference of average abnormal return before and after the reshuffle. This is proved by the results of abnormal return in which is not significant with the sig value that greater than the value of  $\alpha$  is  $0.307 > 0.05$ . Then, the results of the analysis show that there is an average difference of Trading Volume Activity before and after the reshuffle event. This is evidenced by the results of a significant Trading Volume Activity with a sig value smaller than the value of  $\alpha$ , which is  $0.000 < 0.05$ .

Based on the backgrounds above, the researchers are interested to examine more about the reaction of capital market of Indonesiatowards the political event,which are presidential election and the reshuffle of the presidential cabinet.

### Methods

In constructing the results of this study, the researchers use the following methods:

#### Formulating Problems

In this case, the researchers chose the topic of problems related to political and economic events. Researchers want to examine the issues of political events such as the presidential election and the reshuffle of the presidential cabinet that may have an impact on the Indonesian economy. the indicators used are the capital market, especially in the abnormal return and the volume of capital market trade in Indonesia, whether it has a reaction due to the event.

#### Searching the Literature Survey

The first step in this process involves the identification of the various publications and non-publications available that correspond to the subject of political and economic events, and then gain access to it. The second step is the collection of relevant information through exploring the material needed in the library or searching for access to online resources. The researchers also accessing the online system and obtaining prints of all publications such as books, scientific journals, scientific articles, academic final assignments, magazines and news related to political events on capital market reaction in Indonesia.



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### Material Selection and Evaluation

At this stage, details on problems, study designs and final findings are systematically recorded in a number of appropriate formats so it can simplify the search of differentiating factors which related to the problem. Then, the researchers can determine what reference sources will be used and which sources are considered relevant and irrelevant to be used as literature material.

### Analysis and Interpretation

The selected literature materials are explored for their similarities and inequalities, whether the relation of each reference. The next step is the researchers made a comparison and then arranged them into a summary of each source of scientific reference. The results of this research are study of the influence of political events on the reaction of capital markets in Indonesia through previous literatures and scientific works.

The researcher also uses the citation method in which the citation refers to the origin or source of a quote, quotes of a statement, or a copy of a person's statement. The original name and quotes cited in the results of this article are still retained.

### Results and discussion

Political events such as presidential election and presidential cabinet reshuffle are events that may affect the capital market activity. This is because the information contained in the announcement of these events can provide a signal for investors in making investment decisions. The information contained in the announcement can be judged as a positive signal if it is considered as good news or vice versa. The capital market reaction to the announcement of these events are indicated by abnormal return and changes in trade volume.

In general, the event of presidential election in Indonesia affect the activity in the capital market as evidenced by previous studies on differences in abnormal returns and trading volume activity under political events. The occurrence of changes in the average value of abnormal return and trading volume activity during the election events in Indonesia indicates that this event has enough information content to make the market react. However, there are some studies related to abnormal returns in before and after a presidential election did not result in significant differences in average abnormal returns. Even though, presidential election event still has a stake to lead to an average difference in trading volume activity.

The emergence of significant differences in trading activity volumes in the event of presidential election indicates that the information contained in these events affect the decision of investors in buying and selling shares. For example, the election of Donald Trump as president of the United States in 2016 raises the uncertainty of the capital market situation that worries investors. These investors have no option than selling their shares, especially investors from Indonesia. The investors are worried about Donald Trump's policies. Then, an increase in stock sales is inevitable. This increase is clearly visible on before and after the presidential election took place. The increase in sales indicates that the information contained in the event of presidential election of the United States in 2016 gives a negative signal (i.e. bad news).

In addition to presidential election information, the information on the presidential cabinet reshuffle in Indonesia has also been alleged from emerging issues in the public, especially among investors. This is because an investor should be sensitive and update to issues and information circulating for the feasibility of their investment shares. The capital market itself has become more sensitive in responding to political events,



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including responding to every political policy under President-led government. Thus, the market will react to the cabinet reshuffle which is shown to have difference in abnormal return and average trading volume activity.

The change of the finance minister also affected the reaction of the Indonesian capital market. This is because the economic policies that will be applied have their own influence. Investors must have their own views and values on the change of the minister at this point, investors are required to be able to assess whether the event contains good news or maybe even bad news. It can be concluded that there are capital market reactions such as changes in abnormal return and difference in average trading volume activity.

### Conclusion

From the discussion, it can be concluded that political events can affect the economic conditions of a country. This is evidenced by the reaction of capital markets toward political events. The reaction of capital market is evidenced by different abnormal return and trading volume activity on political events, for example the presidential election and presidential cabinet reshuffle. In general, the discussion in this scientific article shows that the capital market in Indonesia is sensitive to the emergence of various information, including political information. this requires capital market societies to be more sensitive to events that directly or indirectly affect the stock price.

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