

# Political uncertainty and exchange rate volatility

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## Abstract

This article empirically examines the consequences of political uncertainty on the nominal exchange rate returns and the volatility for over hundred countries around the world. We used the monthly political risk data from the International Country Risk Guide and formed three measure of political uncertainty which is government action, conflicts and quality of governance. Further monthly volatility is constructed from the daily exchange rate returns within each month for the period of January 1984 to December 2013. Our findings suggest that political risk and political risk variables exerts a statistically negative effect on the floating exchange rate. The results also confirm that there is more volatility in exchange rate when political uncertainty is high. Moreover, the model also suggests that the effect on exchange rate returns and volatility are lower if the quality of governance is high.

**Keywords:** Political risk, exchange rate regime, exchange rate volatility.

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