

Essay 1 Economic Uncertainties, Macroeconomic Announcements and Sukuk Spreads

Abstract

Given that numerous Sharia'h theorists have argued that Sukuk yields and the yields derived from conventional Bonds are similar, the decision to issue Sukuk or conventional Bonds is a complex one. However, the governance of Sukuk is informed by the tenets of Sharia'h law, the structures and provisions which underlie Sukuk are dissimilar when compared to conventional Bonds. This study's objective is to examine the impact of various factors on conventional Bond and Sukuk markets is investigated, including Financial factors, Economic Policy Uncertainty factor, and US macroeconomic announcement news. The results indicate that in countries such as Malaysia, Indonesia, Turkey, and Singapore, global common shock including US macroeconomic announcements and Economic Policy Uncertainty play a vital role to explain the Sukuk spreads.

JEL classification: C33, F36, G15, E44, E52

Keywords: Corporate Bond Market, Economic Policy Uncertainty, US macroeconomic news, Sharia'h compliance, Sukuk, Yield spreads.

Essay 2 Connectedness of Islamic Equities under Uncertainties

1 Introduction

The rapid and constant improvements in technology, along with the new age financial products, have created deep structural changes in the global financial system. To be more precise, it can be said that financial integration on the global scale came to the forefront primarily in the last 20 years, when a majority of the asset classes joined together to produce a more harmonised structure, and one characterised by broadened connections. Nevertheless, this development has proven a major challenge for policy makers and asset managers as it requires them to identify the best possible way to ensure financial reliability in the context of rapid diversification.

In view of these considerations, the Islamic finance industry has emerged as an alternative, and one that promises qualities such as financial stability and greater diversification opportunities. The Sharia-compliant finance industry, in the last twenty years, has grown tremendously due to the Islamic investors. This sustainable growth is just because of a combined push of (i) oil industry growth in Islamic nations; (ii) Islamic investors' participation; and (iii) regulator's supports towards the Sharia-compliant industries. Currently, Islamic finance assets is estimated between 2.6 and 3.4 trillion USD and this is expected to grow continually in the coming years. (IFSB, 2018)

Several researches have been conducted with a focus on the integration of Islamic equity markets. Majid, Yusof, & Razali, (2007), Majid, Meera, & Omar, (2008), Majid & Kassim, (2010), and Dewandaru, Alaoui, Masih, & Alhabshi (2013) are a few studies of the literature demonstrated that Islamic equity markets are more interlinked. This may indicate that connectedness of Islamic equity market can diminish diversification opportunity in the context of Islamic equity portfolio creation. Connectedness of Islamic equity markets are also observed for both Islamic and Non-Islamic countries (Majid & Kassim, (2010) and Naseri and Masih (2014)). According to Naseri and Masih (2014), Malaysian Islamic equity markets has strong connection with Chinese, Japan (in short term) and US (in long term) markets.

Moreover, after the global financial crisis (2007-2008), the current finance literature emphasize more focus on the determinants of the volatility of financial markets (such as uncertainty in commodity markets and real production). Some strand of the literature also inclined towards studying how the Islamic equities fluctuated and they modelled the volatility of Islamic equity markets (Hussain et al.,2013; Shahzad et al., 2018; Majid, 2016; and Karim

et al., 2017). Because, the importance of Islamic financial system in combination with better business model needs has increased in post crisis period.

The literature is however silent in assessing the impact of uncertainties in output and commodity markets on the connectedness of Islamic equity market. Findings of this study is highly important for Islamic equity portfolio holders who might need to get extra hedging instruments in the case of global shocks. Therefore we first estimate the connectedness of Islamic equity market for Islamic and Non-Islamic countries over the period of January 01, 2010 to August 31, 2018 at different frequency bands. Second we quantify the effect of volatility shocks on the connectedness of Islamic equity markets at different frequency bands. Namely, we consider three major volatility shocks including (i) the US economic policy uncertainty index (EPU), (ii) the US implied volatility risk (VIX), and (iii) necessary commodities (oil and gold) (OVX and GVZ) volatility index.

The current study focuses on the frequency dynamics of connectedness in line with the argument that the financial variables are impacted by the shocks to economic activity at varying frequencies and strengths (Barunik and Krehlik, 2018). This is essential, as the agents function in diverse investment scenarios (i.e., different strategies, trading tools, and investors with diverse trading frequencies) as stated by several scholars (Gencay et al., 2010; Conlon et al., 2016). Specifically, we estimate the long, medium, and short-term frequency dynamics of connectedness of Islamic equity markets following the most current technique described in Barunik and Krehlik (2018) and in the second step, we compute how these connectedness reacts to each volatility shocks (EPU, VIX, OVX, and GVZ) listed commonly in the literature.

We used a wavelet coherency (Aguilar-Conraria and Soares, 2018) analysis to explore the association between connectedness of Islamic equity at a specific band of frequency (long-term, medium-term and short-term) and volatility indices including the US Economic Policy Uncertainty, the US implied volatility risk, crude oil volatility index and gold volatility index. The wavelets analysis in this paper allow to conduct a concurrent strength assessment of the co-movement between two variables over time for both short- and long-term time intervals. This assessment is conducted in the context of the development of such strength over the studied time periods, thereby generating a clear picture of the probable dynamic changes in the relationship between the two variables.

Our results indicate that various volatility indices affect the Islamic and Non-Islamic countries' Islamic equity markets connectedness in different levels. However, different investment horizons of the Islamic equity markets as long-term, medium-term and short-term leads to observe the clear movement with various volatility indices. Volatility of the EPU, OVX and GVZ has significant effect on both Islamic and Non-Islamic country's short-term horizon connectedness of Islamic equity markets. In terms of medium horizon, both Islamic and Non-Islamic countries of Islamic equity are significantly affected by VIX, OVX and GVZ. The volatility of the EPU, OVX, and GVZ indices significantly impact on Non-Islamic countries connectedness for long-term horizon, while Islamic countries connectedness are influenced from EPU, VIX and GVZ. Overall, we record that Non-Islamic countries connectedness of Islamic equity at every frequency band are impacted by EPU more than that of Islamic countries. Also commodity market shocks (OVX & GVZ) significantly influence both Islamic and Non-Islamic countries connectedness of Islamic equity at every frequency band.